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SMALL BUSINESS CAPITAL FORMATION
ADVISORY COMMITTEE MEETING

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U.S. Securities and Exchange Commission
100 F Street, N.E., Washington, D.C.

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3 Hester Peirce, SEC Commissioner
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P R O C E E D I N G S

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2 MS. DUGNAN: Okay. Good morning and
3 welcome to today's meeting of the SEC's Small Business
4 Capital Formation Advisory Committee. I call the
5 meeting to order. First, I want to extend a warm
6 welcome to everyone, including those members joining
7 us remotely today. It's great to see you all. We
8 also really appreciate members of the public who have
9 tuned in to watch the meeting via webcast on SEC.gov.

10 Courtney, do we have a quorum for today's
11 meeting?

12 MS. HASELEY: We do have a quorum and also,
13 I'll take this opportunity to say for any staff that
14 speaks today, any views we provide are in the
15 speaker's official capacity at the SEC, but do not
16 necessarily reflect the views of the Commission, the
17 Commissioners or other members of the staff. Thank
18 you.

19 MS. DUGNAN: Thank you, Courtney. All right.
20 Well, we want to apologize to everyone for the
21 technical difficulties. We'll hopefully have them
22 worked out quickly, but we will proceed while we work
23 those out. So at our last two meetings, we discussed
24 the accredited investor definition in depth and
25 proposed ways the definition could be improved with a

1 view towards positively impacting the capital raising
2 process for both entrepreneurs and investors.

3 We're pleased to report that the Committee
4 finalized and delivered those recommendations on the
5 accredited investor definition to the Commission.
6 Today, we will continue exploring ways to expand
7 access to and streamline the process of early stage
8 capital raising. This morning, we will discuss
9 regulation crowd funding, also known as Reg CF, a
10 pathway that has gained popularity and attention in
11 recent years, though it still accounts for only a
12 small fraction of total capital raised.

13 Crowd funding offerings have become an
14 important source of funding for underrepresented
15 founders and geographically diverse companies. So we
16 look forward to the Committee's discussion on this
17 topic. Today, we aim to better understand just how
18 Reg CF is being used and with what level of success,
19 what types of founders and investors are using Reg CF
20 and to identify any unnecessary points of friction in
21 an effort to determine how to improve the exemption's
22 effectiveness as a capital raising tool.

23 This afternoon, we will explore the state of
24 angel investing, tapping into the wealth experience
25 from our committee members around this table, both

1 physically and virtually. Angel investing is vital to
2 many small businesses around the country and the data
3 shows that there are many investors who are still very
4 interested in the asset class. We'll discuss current
5 market trends and whether there are ways we can help
6 improve the flow of capital to early stage founders
7 who need it, but before we get started, we are so
8 pleased to have Chair Gensler and the Commissioners
9 join us.

10 We appreciate you all being here and until
11 we are able to get Chair Gensler on Zoom, I'd love to
12 start with remarks from Commissioner Peirce, who is
13 here with us in person. Thank you.

14 COMMISSIONER PEIRCE: Thank you, Erica and
15 thank you all for your continued willingness to serve.

16 I look forward to today's discussions on crowdfunding
17 and angel investing, both of which are invaluable to
18 capital formation at early stage companies. I also
19 look forward to hearing your discussion with Val, who
20 is the head of our strategic hub for innovation and
21 financial technology.

22 A recent conversation, one of many
23 conversations over the past six years, reminded me of
24 just how important an appropriately empowered FIN HUB
25 could be for small businesses. The story always runs

1 something like the following: An entrepreneur who has
2 built a small company with promising commercial
3 prospects would like to introduce a crypto token.
4 This entrepreneur has had numerous conversations with
5 lawyers, but he'd like to get confirmation that his
6 company -- what his company wants to do can be done in
7 a manner that's consistent with the securities laws.
8 With whom should that entrepreneur speak? I'd like to
9 be able to tell him to approach FIN HUB to discuss the
10 possibility of a no action letter or exemptive relief
11 to provide the necessary legal comfort to move
12 forward.

13 For that to be feasible, though, the SEC has
14 to empower FIN HUB to grant such relief after
15 consulting the appropriate people across the SEC. And
16 they have to be able to do that on a timeline that's
17 consistent with commercial urgency, which is always an
18 issue for small companies that are on -- you know,
19 that have limited funding. The SEC as a whole,
20 however, is showing a reluctance to work productively
21 with the public through difficult legal regulatory
22 economic and accounting questions.

23 FIN HUB can't be a one-way door into a
24 building that only views crypto through an enforcement
25 lens. FIN HUB has a knowledgeable, energetic and

1 highly engaged staff, but that staff needs the
2 institutional backing to work with startups to
3 facilitate commercially viable and legally compliant
4 innovation. I, therefore, urge the Committee in your
5 discussion with Val this afternoon to discuss how FIN
6 HUB can be empowered to foster an environment of
7 collaborative experimentation with new technologies.

8 I welcome the Committee's discussion of
9 crowd funding, including how to improve its regulatory
10 framework. As law professor Andrew Schwartz explains,
11 crowdfunding can provide early stage companies with a
12 "simple and inexpensive method of raising capital to
13 help all stripes of entrepreneurs access capital and
14 allow ordinary people to make investments that have
15 traditionally been limited to the wealthy and
16 connected."

17 I have some questions for the Committee on
18 this topic, specifically during the COVID19 pandemic,
19 the Commission temporarily raised the threshold
20 governing reviewed financials from 107,000 to 250,000.

21 That relief lapsed in 2022 and the current threshold
22 is 124,000. Should the Commission raise that
23 threshold to somewhere between 250,000 and 500,000?

24 Second, would the crowdfunding market
25 improve if state blue sky laws were preempted for

1 secondary market transactions in crowdfunded
2 securities? And third, should the Commission make it
3 easier for crowdfunding portals to provide impersonal
4 investment advice so that portals could provide some
5 basic curation?

6 I also am looking forward to this
7 afternoon's discussion on angel investing, including
8 how to encourage it. Angel investors provide early
9 stage companies not only with capital but also with
10 mentorship grounded in years of accumulated business
11 wisdom. This mentorship works best in communities
12 that are crowded with angel investors so early stage
13 companies can learn from a wide range of successful
14 business leaders. Angel investing is often a team
15 sport. Angel investors not only invest together, but
16 they learn together. More seasoned angels educate the
17 newer angels.

18 Because the angel investors must be
19 accredited, the Committee's recent recommendations on
20 the definition of accredited investor are particularly
21 relevant to today's discussion. Our restrictive
22 accredited investor standard disqualifies 82 percent
23 of Americans from accessing private investments,
24 including through angel investing. Given cost of
25 living-based income disparities, it's harder for angel

1 investing to flourish in small inexpensive cities than
2 in larger expensive ones. By one estimate, for
3 example, a woman making \$250,000 in New York City
4 needs only \$96,000 annually in Cleveland to main the
5 same standard of living.

6 The lower cost of living in Cleveland means
7 that her dollars go much further, but existing
8 accredited investor thresholds do not recognize that
9 fact. The Committee made two recommendations that
10 could mitigate the arbitrariness of the definition.
11 First, the Committee recommended that the Commission
12 not adjust the financial thresholds, even
13 prospectively for inflation. As Committee members
14 know, inflation adjustments would empty the angel
15 ranks in cities that need them most. Not raising them
16 will keep angel groups intact and allow them to invite
17 more members of committees to participate over time.

18 Second, the Committee recommended allowing
19 individuals who successfully complete an educational
20 program to invest up to 5 percent in total of the
21 greater of the income or net worth over a 12 month
22 rolling period. If this recommendation were adopted,
23 our New York transplant, now relishing life in
24 Cleveland, although only making \$100,000 could invest
25 almost \$5,000 as an accredited investor. She would no

1 longer be prohibited from being an angel simply
2 because she prefers to live in Cleveland.

3 I would love seeing a fuller unlock by
4 allowing education to unlock full accountability --
5 eligibility without that cap. In your angel investing
6 discussion today, you might want to consider whether
7 the low percentage cap will still exclude most
8 investors below the current income and wealth
9 thresholds from participating in many private
10 investment opportunities. Mandatory investment
11 minimums might be higher than the permitted investment
12 amounts.

13 The Committee's third recommendation, which
14 calls for new Reg D disclosures about key investment
15 risks could be useful if it's a simple where new small
16 companies equal big risks type of disclosure, but we
17 have to be careful. Last year alone, issuers relied
18 on Reg D to raise around \$3 trillion, including from
19 many angel investors. Beyond a basic buyer beware
20 type disclosure requirement, mandatory disclosures
21 could undermine the freedom to craft disclosure in
22 response to demand by investors, as opposed to
23 regulatory demands.

24 Thank you for your consideration and I look
25 forward to your discussions.

1 MS. DUGNAN: Thank you so much,
2 Commissioner, really appreciate that. Wonderful.

3 Chair Gensler, are you able to hear us now?

4 CHAIR GENSLER: Yes, very well. I was able
5 to hear Commissioner Peirce's discussion of angels in
6 Ohio.

7 MS. DUGNAN: Wonderful. Thank you so much.

8 And now that our technical difficulties have been
9 resolved, it's my honor to invite you for remarks.

10 CHAIR GENSLER: Thanks so much. And I'm
11 pleased to speak to the Small Business Capital
12 Formation Advisory Committee, as is customary, and I'm
13 sure my colleague said, I'd like to note that my views
14 are my own, in my case, as chair of the Sec, and I'm
15 not speaking on behalf of my fellow commissioners or
16 this staff. For I assure you, Commissioner Peirce,
17 there are many people and others that could be angels
18 in any state of this country.

19 I understand the Committee will discuss
20 alternative methods of capital raising in our markets,
21 particularly crowdfunding and angel investing and the
22 Committee will hear about crowdfunding from Dr. Melody
23 Chang, Assistant Professor of USC, Marshall School of
24 Business. Small and early stage businesses often
25 start out raising money from friends and family, but

1 that, of course, if you have success, that gets tapped
2 out pretty quickly and that often means eventually out
3 striping the friends and family's available capital,
4 sometimes very quickly. And that's why alternative
5 methods of capital raising play such an important
6 critical role to business formation.

7 Angel investing, crowdfunding have helped
8 develop our vibrant private markets, alongside robust
9 public markets. And I believe our US economy, as well
10 as individual companies and entrepreneurs with ideas
11 have and will continue to benefit from capital
12 formation in both the private markets, such as
13 crowdfunding and angel investing and the public
14 markets.

15 When it comes to the public markets,
16 congress has required companies to register public
17 offerings of securities with the SEC and include
18 specified disclosures to investors. At the heart of
19 those disclosures lies a basic bargain embedded in our
20 securities laws, and this has been true for 90 years.

21 It's that investors get to decide on their
22 investments, but it's based upon full, fair and
23 truthful information material to their investment
24 decisions. Meanwhile, congress, all the way from the
25 beginning and the Commission have also created certain

1 exemptions from those requirements, including smaller
2 businesses with smaller pools of investors. And these
3 exemptions have formed part of the private markets as
4 we know them today. So they coexist, private, public,
5 congressional exemptions, Commission exemptions live
6 in that balancing.

7 Congress and the SEC have repeatedly
8 revisited these various exemptions over time, with a
9 careful eye towards protecting investors on the one
10 hand; facilitating capital formation on the other.
11 For example, in something known as the Jobs Act, Title
12 III of this 2012 law, Congress expanded the exemptions
13 to include crowdfunding and then the SEC then adopted
14 regulation crowdfunding. I think you'll hear from
15 Commissioner Uyeda, who subsequently was in the
16 Chair's office working on that rule. And you'll hear
17 more about it today.

18 When regulation crowdfunding first went into
19 effect, I think adopted in '15, but when into effect
20 in '16, we saw 22 new crowdfunding offerings per month
21 on average. Firms were allowed to raise, at the time,
22 a maximum of \$1 million under that exception. By '22,
23 six years later, we saw the average go up about
24 sixfold to 135 offerings per month. The funding cap
25 had also been risen to about \$5 million annually. The

1 number of US counties with crowdfunding companies more
2 than doubled between 2019 and 2022.

3 The trends are part of the SEC's ongoing
4 work on behalf of the businesses that seek to
5 capitalize on opportunities and investors to
6 participate in them. Separately, I understand that Val
7 Szczepanik who leads our -- the SEC's strategic hub
8 for innovation and financial technology, more commonly
9 called FIN HUB, will share some thoughts on the
10 landscape concerning crypto assets and crypto token
11 offerings. As I've said in the past, the Commission
12 acts within the law and how the courts interpret the
13 law without prejudging any specific crypto asset, I
14 believe, that the vast majority of crypto assets are
15 investment contracts and, thus, subject to the federal
16 securities laws.

17 Full, fair and truthful disclosure are at
18 the heart of those laws. It underlies that basic
19 bargain that I discussed earlier and there's nothing
20 about the crypto securities markets that suggests that
21 investors are less deserving or in need of those
22 disclosures or the protections of our securities law.

23 To investors who may be listening to this webcast,
24 without prejudging any specific crypto asset, absent
25 such mandated disclosures, these are mandated in our

1 laws to help investors make their investment
2 decisions. Absent that, I encourage investors to
3 exercise caution about the myriad of risks associated
4 with products whose value is tied to crypto
5 securities. I look forward to the Committee's
6 thoughts on all of these matters. I thank you and
7 back over to you.

8 MS. DUIGNAN: Thank you, Chair Gensler. We
9 appreciate your remarks. And with that, I'd like to
10 invite Commissioner Uyeda.

11 COMMISSIONER UYEDA: Well, thank you very
12 much, Erica. Good morning. It's a pleasure to be
13 with all of you virtually, at least, at the
14 Committee's May meeting. In 1992, Congress enacted a
15 law designating the month of May as Asian Pacific
16 American Heritage Month. Thus, today's agenda for the
17 Committee is particularly appropriate, given the deep
18 connection between the Asian-American and Pacific
19 Islander community and small businesses.

20 According to the US Small Business
21 Administration, there were nearly 3 million AAPI-owned
22 businesses in 2019. These businesses employed around
23 5 million people and generated nearly \$990 billion in
24 sales. First generation immigrants, like those in the
25 Asian-American Pacific Islander community, often find

1 limited opportunities for meaningful employment; yet,
2 they may have significant entrepreneurial spirit. And
3 I have personal experience working in such a business.

4 My first job as a teenager was working for my
5 grandfather's family business in Southern California.

6 Driving a small truck, he would deliver produce to
7 restaurants and retailers from the wholesale market.
8 Through persistence and hard work, he accomplished the
9 American dream.

10 The story of the immigrant family business
11 has been repeated countless times and become an
12 important cornerstone in the Asian-American and
13 Pacific Islander community. The struggle of such
14 entrepreneurs has played a role in shaping my views on
15 the regulatory environment for startup capital.
16 Today, the Committee will discuss two topics within
17 startup capital: regulation crowdfunding and angel
18 investors. As directed by the Jobs Act, the
19 Commission adopted Regulation CF in October of 2015.

20 As a member of the Commission staff, I
21 worked on both the proposal and final adoption of
22 Regulation CF, Jenny Regal, Amy Reischauer and Julie
23 Davis, all of whom work very closely today with this
24 Committee, also worked on the adoption of that
25 regulation.

1 Nearly nine years later, we can evaluate
2 whether crowdfunding has achieved its intended goal of
3 providing startups and small businesses with capital
4 by making relatively low dollar offerings of
5 securities less costly. According to the latest
6 annual report from the Office of the Advocate for
7 Small Business Capital Formation, regulation
8 crowdfunding has been particularly attractive to small
9 businesses located outside of traditional capital
10 hubs.

11 Professor Melody Chang, who will be the
12 speaker for the Regulation CF session, suggest that
13 there may be, "A potential lack of awareness among
14 women and minority led startups about the
15 opportunities presented by regulation crowdfunding. I
16 look forward to hearing a readout of the Committee's
17 discussion of regulation crowdfunding's opportunities
18 and challenges as a method of early stage capital
19 raising.

20 The second topic will be angel investing. I
21 recently had the pleasure of visiting a startup
22 company in Miami and met with the founder and her
23 angel investors. They emphasized the gap in available
24 capital for small companies that have outgrown what
25 can be raised from friends and family but are below

1 the investment size of a venture capital fund. The
2 startup nature of the business often means that bank
3 financing is also not an option. While angel
4 investing is not for everyone, I'm interested in
5 further learning the extent to which angel investing
6 can play a role in facilitating capital formation.

7 Finally, I would like to congratulate this
8 Committee for issuing its recommendation on the
9 accredited investor definition last week. These were
10 the first official recommendations since the
11 Commission was largely reconstituted last June. I
12 look forward to further recommendations from this
13 Committee. So thank you very much for your time and
14 participation today. I hope you have a very
15 productive meeting.

16 MS. DUIGNAN: Thank you so much,
17 Commissioner. We appreciate those thoughtful remarks.
18 And thank you to the Chair and both Commissioners for
19 making some time for us this morning. All right.
20 With that, we are pleased to jump into our first topic
21 of the day, regulation crowdfunding. Reg CF enables
22 companies to raise capital from their local community,
23 product loyalists and other nonaccredited investors.
24 Reg CF offerings allow eligible companies to raise up
25 to \$5 million in capital in a 12-month period from

1 investors online using a registered funding portal or
2 a broker-dealer.

3 An interesting statistic in the SEC's
4 amazing Small Business Advocacy Team's annual report
5 is that 70 percent of capital raised through Reg CF is
6 distributed outside of the top ten capital hubs and
7 approximately 25 percent of crowdfunding offerings in
8 Q3 2022 had at least one founder of color. So this
9 really is a pathway that is increasing access to
10 capital for many small businesses and underrepresented
11 founders across the US.

12 We thought we might begin by having SEC
13 staff provide some background information on Reg CF to
14 the Committee and audience, recognizing that whilst
15 most of us are familiar with crowdfunding, we don't
16 all have specific understanding of the regulatory
17 framework and for that, I'm going to turn it over to
18 our fellow Committee member and the SEC's Small
19 Business Advocate, Stacy Bowers.

20 Stacy?

21 MS. BOWERS: Thank you, Erica, and good
22 morning, everyone. So I'm just going to provide a
23 little bit of a high level background of some of the
24 regulations that govern crowdfunding to sort of set
25 the stage before Dr. Chang provides her presentation

1 and all of you head into the discussion. So just as a
2 reminder, I think everyone in the room recognizes
3 whenever you offer and sell securities, they either
4 need to be registered or there has to be an exemption
5 from the registration requirement and regulation
6 crowdfunding is one of those exemptions.

7 So it was created by Congress under the Jobs
8 Act of 2012 and with a fair amount of specificity
9 about the rules that went into effect in 2016. So
10 just to highlight, I'm only going to highlight a
11 handful, I couldn't cover them all, but to think about
12 the aggregate offering amount. So while Reg CF
13 initially allowed \$1 million, it has since been
14 adjusted twice: once for inflation and most recently
15 as part of the SEC's Harmonization Initiative. And so
16 now, during a 12-month period, as Erica mentioned, an
17 issuer can raise \$5 million under a regulation
18 crowdfunding offering.

19 One thing to note about crowdfunding, which
20 makes it a little bit different than some of the other
21 exemptions is every crowdfund has to happen through a
22 registered intermediary, and that can be either a
23 broker-dealer or a funding portal and the crowdfund
24 has to occur online as well. So sort of the idea
25 being the crowd will fund the offering and that will

1 happen through this online portal. And then I do just
2 want to highlight that an issuer can only use one
3 portal at a time, so they can't list their crowdfund
4 on multiple -- with multiple intermediaries or
5 multiple portals at the same time.

6 So both accredited and nonaccredited
7 investors can invest in a reg crowdfund offering and
8 while originally, there were limits across all
9 investors and the amount of money that they could
10 invest, those also shifted in 2020 as part of
11 harmonization. So now, accredited investors can
12 invest an unlimited amount of money into a regulation
13 crowdfund. And we rely on that same definition that
14 shows up in Reg D to define what is an accredited
15 investor.

16 And then nonaccredited investors, their
17 dollar thresholds have also been adjusted, but there
18 are limits on the amount of money that a nonaccredited
19 investor can invest. Again, I'm going to try to do
20 this and make it make sense because I always feel like
21 it's a little bit of a tongue twister. So if a
22 nonaccredited investor has annual income or net worth
23 of less than \$124,000, they can invest the greater of
24 \$2,500 or 5 percent of the greater of their annual
25 income or net worth.

1 If an investor has annual income or net
2 worth that exceeds \$124,000, then they can invest 10
3 percent of the greater of their annual income or net
4 worth. So hopefully I got to just give you a sense of
5 how that plays out. And I'm sure George will be able
6 to weigh in a little bit more clearly as somebody who
7 runs one of the portals and has to make those
8 assessments. So one of the things that happens with a
9 Reg CF offering is the issuer has to file a Form C.
10 And this is a disclosure document that puts
11 information out there to potential investors about the
12 Reg CF offering. And so I'm just going to highlight a
13 couple of the disclosure items that show up in the
14 Form C.

15 So offering amounts, so with every Reg CF,
16 there has to be a targeted amount and the issuer has
17 to meet that target by the target deadline in order to
18 close the regulation crowdfunding. So that target
19 amount and that target deadline will be included in
20 the Form C. And then the issuer might also be willing
21 to take more than the target and if they're going to
22 take a maximum, that has to be indicated as well, in
23 addition to that, how they will accept that sort of
24 oversubscription of funds.

25 You're going to get some information about

1 the company itself, about its business, its employees,
2 its holdings, those type of things. There'll be some
3 risk factors. There'll be disclosures about the
4 directors and the officers of the company, about the
5 beneficial owners. So those investors who already own
6 greater than 20 percent. The company will have to
7 explain how it's going to use the proceeds from the
8 Reg CF offering. They have to describe their
9 capitalization structure. So they have to talk about
10 the various classes of securities that they have
11 created that are also outstanding and the terms around
12 those, and they also have to provide disclosures if
13 they've already -- maybe they've issued promissory
14 notes previously so they're going to provide that
15 information as well.

16 Another thing that the Form C has to cover
17 is the cancellation process. So one of the things
18 that happens in a Reg CF is that an investor has up to
19 48 hours prior to when the offering is set to close to
20 change their mind and cancel their subscription. So
21 that cancellation process has to be set out in the
22 Form C. And then the other thing that happens with a
23 crowdfund is if there's been a material change in the
24 terms, investors have to reconfirm their commitment to
25 participate in that crowdfunding and remain in it as

1 an investor, so that information will be set out. So
2 that's just a little bit of a highlight of what's
3 required in the Form C. By no means does it cover
4 every piece of disclosure that's required.

5 I do want to touch a little bit just on the
6 financial statement requirements because I think it
7 could play a role in your discussion today. So if an
8 issuer is raising \$124,000 or less, in that
9 circumstance, they need to include the same kind of
10 financial information that would be in their federal
11 tax return. And that has to be certified by a
12 principle executive officer of the issuer. If the
13 issuer wants to raise more than \$124,000 but not more
14 than \$618,000, then the financial statements have to
15 be reviewed by an independent public accountant.
16 Though, I will say if that issuer has audited
17 financial statements, then they do have to provide the
18 audited financial statements.

19 And then if an issuer is raising greater
20 than \$618,000, they have to provide audited financial
21 statements. There is an exception if it's the first
22 time that they're doing a crowdfund and they're not
23 raising more than \$1.235 million, then they can
24 provide audited or not audited but reviewed financial
25 statements. So there is a little bit of an exception

1 for that first time issuer doing a crowdfund in that
2 circumstance. But again, just like with the prior
3 discussion, if they happen to have audited financial
4 statements, then they do have to provide those.

5 The other thing to just highlight a little
6 bit is that issuers, they do have some ongoing
7 reporting requirements, as a company that's done a
8 crowdfund. So they have to file an annual report and
9 they have to file that within 120 days of their fiscal
10 year end. And similar to the Form C, they're going to
11 provide certified financial statements, unless they
12 have reviewed or audited financial statements to
13 provide.

14 And then the annual report requirement, it
15 goes on for a certain amount of time, but there are
16 different ways that that can come to an end, so if the
17 issuer has filed at least one annual report and now
18 has less than 300 holders of record, they don't have
19 to continue to file an annual report. Also, if they
20 file three annual reports and they now have less than
21 \$10 million in assets, that obligation to file the
22 annual report. And then also, if the issuer becomes a
23 34 Act reporting company, so they're filing their 10-K
24 and 10-Q, then they don't have to do the annual report
25 for Form C. And there are some other ways that that

1 obligation goes away, but just to highlight, that
2 requirement can change depending on the issuer and its
3 situation.

4 There are some other filings that happen for
5 issuers if you're doing a Reg C, so as I mentioned,
6 they have to file the Form C before they start their
7 offering. If they amend that Form C, they have to
8 file a Form C/A, just indicating there's an amendment.

9 They also have to provide Form CU, which is a
10 progress update. So that's letting the investors know
11 where they are as far as hitting 50 percent of their
12 target and then also at the point that they hit 100
13 percent of their target.

14 We talked a little bit about they file an
15 annual report, which is the Form CR, and then when
16 they no longer have to do the annual report, they file
17 a Form -- I'm going to look down at my notes -- TR,
18 the terminating report, indicating they're no longer
19 required to file that annual report.

20 So advertising, so there are requirements
21 about advertising a Reg CF offering and issuers cannot
22 directly or indirectly advertise the terms of the
23 offering. With that said, they can have a small
24 statement that they put on their website that
25 indicates that they're doing a CF offering. They can

1 highlight a few of the factual terms and then provide
2 a link to the intermediary, generally the portal
3 that's hosting that Reg CF offering for them.

4 On the other hand, they can communicate
5 through the portal. So one of the things that
6 intermediaries are required to do is to provide
7 communication channels. So within those communication
8 channels, investors can communicate with each other.
9 So again, back to the idea of the underlying idea for
10 crowdfunding, for investors to be able to communicate
11 with each other, but also within that communication
12 portal, the issuer can communicate and answer
13 questions that are posted, provided that they make it
14 clear that they are the issuer or they're a person
15 acting on behalf of the issuer.

16 Also, in a crowdfund, the issuer can pay a
17 promoter to help promote and if the promoter is in
18 there on that communication channel, they also have to
19 make it clear that they're acting as a promoter and
20 they're being paid promoter compensation. One of the
21 things that also changed in 2020 is the ability for
22 the issuer to test the water, so to speak, so to take
23 that opportunity to see is it worth undertaking a
24 crowdfund, knowing that any of those communications
25 that they put out to test the waters are considered to

1 be an offer of securities and so would be subject to
2 the antifraud provisions.

3 Intermediaries have their own set of
4 regulations that govern them and that they have to
5 fill in being an intermediary. So they have to be
6 registered. They have to believe that the issuer
7 complies with the crowdfunding requirements before
8 listing them on their portal. They have an obligation
9 to provide educational material to potential
10 investors. As I mentioned, they have to create these
11 communication channels. They have to have processes
12 in place for investors to be able to open up accounts
13 and to fill out the paperwork that will indicate
14 whether they're an accredited or a nonaccredited
15 investor so that there's an understanding about those
16 investment limits.

17 And that barely touches the surface, I think
18 that's fair to say, George, of all of the things that
19 intermediaries have to do. And then I just want to
20 highlight a couple of miscellaneous points when it
21 comes to Reg CF. So the securities are restricted, so
22 that means the securities can't be readily resold for
23 the first year. With that said, they can be sold or
24 transferred back to the issuer, to another accredited
25 investor or to a family member or they can if it's

1 part of a registered offering. The securities are
2 exempt from the state blue sky laws, obviously not the
3 antifraud provisions, but the state blue sky laws
4 themselves.

5 And then there are no limits on the number
6 of investors in a regulation crowdfund and there no
7 limits, sort of as we see with Reg D, there's not a
8 limit to how many can be nonaccredited versus
9 accredited. That's just a little bit of a high level
10 of some of the regulations, so as you start your
11 discussion after Dr. Chang's presentation to just give
12 you some background. Thanks.

13 MS. DUIGNAN: Thank you so much. We really
14 appreciate that overview. It's incredibly helpful.
15 So with that content and background, I'm very happy to
16 introduce our invited speaker, Dr. Melody Chang. Dr.
17 Chang is the assistant professor of management and
18 organization at USC's Marshall School of Business.
19 Her research is in the areas of entrepreneurship,
20 labor markets and innovation, with a focus on how
21 entrepreneurs and innovators from diverse backgrounds
22 and experiences can successfully navigate the labor
23 market and capital markets. Melody or, sorry, Dr.
24 Chang holds a PhD, master of philosophy and a master's
25 in management from Yale University, as well as a BA in

1 Economics from the University of Pennsylvania. Prior
2 to her doctoral studies, she was an investment banking
3 associate at Goldman Sachs.

4 We invited Dr. Chang to be here today
5 because she is the author of a just released
6 independent academic report, "Women and Minority Owned
7 Businesses in Regulation Crowdfunding," on the
8 experiences and outcomes of women and racial minority
9 business owners who participated in Reg CF.

10 Dr. Chang, welcome.

11 DR. CHANG: Hi and thank you so much for the
12 introduction. Let me share my screen. Can everyone
13 see my screen?

14 MS. DUGNAN: Yes.

15 DR. CHANG: So thank you so much, again, for
16 inviting me to this meeting. I'm really excited to be
17 part of the discussion. So Stacy provided a wonderful
18 overview of Reg CF and the legal requirement, and I'll
19 extend the discussion by focusing on women and
20 minority entrepreneurs in Reg CF, specifically, I'll
21 be examining their participation and outcomes in Reg
22 CF, as well as their business performance before and
23 after the participation.

24 So this is -- as Commissioner said, this is
25 a timely investigation, as Reg CF will have its eight

1 anniversary soon. And a key feature of regulation
2 crowdfunding compared to other traditional funding
3 sources is that it allows startups and small
4 businesses to raise capital from the general public,
5 including nonaccredited investors. And historically,
6 startup investing was only open to accredited
7 investors like venture capitalists and angel investors
8 who are predominantly white male. And because
9 investment decisions are driven by social networks and
10 people prefer to make investments to those who share
11 similar social characteristics, there have been
12 funding disparities based on gender and race.

13 So we know that only less than 1 percent of
14 the businesses in the US receive investment from VCs,
15 and just 2 percent of this capital went to all female
16 founders and only 1 percent to black founders. And
17 this is a huge problem because often women and
18 minority entrepreneurs lack resources kind of sustain
19 and build their businesses.

20 And while solving financial disparities was
21 not the primary goal of this funding source, many
22 people believe it could reduce barriers to capital
23 access, especially for women and racial minority
24 entrepreneurs. And this is because startup investing
25 became available to a broader, more diverse investor

1 base with the introduction of crowd. So the goal of
2 my research is to address whether women and minority
3 business owners can benefit from Reg CF, what are
4 their experiences and challenges so far.

5 So today, I'll start off with a brief overview of
6 Reg CF landscape. Then I'll discuss participation of
7 women and minority owned business, as participation is
8 the first step in assessing the effectiveness of the
9 funding program. Third, I'll observe the Reg CF
10 outcomes of women and minority-owned businesses and
11 then I assess what happens after Reg CF funding
12 rounds, such as future funding and exits. And I'll
13 consider how these outcomes vary based on gender and
14 racial ethnic groups. And finally, I will end with
15 some policy recommendations and open up the discussion
16 to the public.

17 So starting with a brief overview of Reg CF,
18 during this study period, which is from its inception
19 in May 2016 to the end of 2022, there were nearly
20 6,000 offerings by 5,200 businesses that collectively
21 raised \$1.4 billion in total. And you'll notice that
22 the landscape of Reg CF has experienced a remarkable
23 transformation, the number of offerings and amount
24 raised are on upward trajectories, especially can see
25 that during the COVID era, there has been a huge

1 uptick in the participation.

2 And Reg CF has attracted entrepreneurs
3 across industries, from local businesses to high tech
4 startups, so they are Main Street business, like food,
5 beverage and restaurants that contribute to local
6 communities and economies. We also see a lot of
7 innovation driven companies, like software
8 applications, consumer products and goods, which
9 include hardware and innovative consumer products,
10 which are also popular. So there's a diverse set of
11 businesses and products that are participating.

12 And most firms that seek funding through Reg
13 CF are relatively young with nearly half being two to
14 three years old, around 70 percent are less than three
15 years old. And in terms of business size, small firms
16 with two to three employees constitute the largest
17 group. Around 90 percent of companies have less than
18 10 employees. So you can see that the Reg CF is
19 targeting very young and small companies.

20 So my report contains more details about
21 business and financial information about these firms.

22 So if you're interested, please check it out if you
23 want to learn more about these firms. So who
24 participates in Reg CF and are we seeing a lot of
25 women and minority-owned businesses?

1 And I classified each business into three
2 gender composition groups, so first, all male, all
3 female and mixed gender teams. And you can see that
4 the majority of all founding teams consist of all male
5 founding teams. But on a brighter note, the
6 proportion of all female teams has increased from 10
7 percent in 2016 to 14 percent in 2022. So although
8 there is still underrepresentation in terms of gender,
9 there has been some improvement being made in terms of
10 competition.

11 In terms of race and ethnicity, I first
12 categorized each firm into three categories, so all
13 white teams, all non-white, which includes black,
14 Hispanic, Latino and Asian entrepreneurs and also
15 mixed nonwhite and white. And 71 percent of
16 businesses are led by all white founding teams; 21
17 percent are led by minority only. And I tried another
18 grouping method by distinguishing black and Hispanic
19 Latino founders who are particularly underrepresented
20 in the startup research landscape, the proportion of
21 all white teams remained the same, but here, I
22 separated out the all black or all Hispanic Latino,
23 which represent 11 percent of the businesses. Also,
24 black or Hispanic on team represent 4 percent of the
25 businesses. Other racial ethnic mixes represent 13

1 percent, and this includes Asian-led or a mix of Asian
2 and white entrepreneurs.

3 So similar to gender composition, there has
4 been some improvement being made. The proportion of
5 all white teams decreased and while the proportion of
6 all non-white teams have increased two fold from 11
7 percent in 2016 to 23 percent in 2022. And if you
8 distinguish black and Hispanic Latino founders, we see
9 more and more black and Hispanic founders over time,
10 as shown in the navy and grey bars.

11 So overall, there is still
12 underrepresentation in terms of gender and race, but
13 there has been some improvement over time. And I
14 scored pre-offering performance differences, which are
15 indicative of the quality of the business. And I
16 looked at the proportion of businesses that generated
17 revenue and profit prior to participating in Reg CF.
18 And I find that all female teams have a higher
19 proportion of businesses that generate revenue and
20 profit, followed by mixed gender teams. And it is
21 noteworthy that the female-led teams actually tend to
22 have better financial performance than all-male teams
23 going into Reg CF.

24 And in terms of racial ethnic composition,
25 all white teams have the highest proportion of

1 businesses generating revenue, although the difference
2 between the groups are pretty small, but I find that
3 minority led teams, in particular, all black or all
4 Hispanic Latino teams have the highest proportion of
5 businesses generating profit of -- and while prior
6 research suggested that investors often under value
7 the competence of female entrepreneurs and racial
8 minority entrepreneurs, the objective performance data
9 of these early stage businesses show that these
10 assumptions are unfounded and, in fact, women and
11 minorities often have better track records than those
12 of male-led or white-led teams.

13 So just to summarize what we saw in terms of
14 participation, the proportion of women and racial
15 minorities are still underrepresented but increasing
16 over time. Participative firms led by women and
17 minorities have track records that often surge past
18 those of male-led and white-lead teams. And the
19 participation analysis highlights that entrepreneurs
20 from historically marginalized groups need to be more
21 aware of this relatively new funding source. Also, it
22 is imperative to make sure that this funding source is
23 accessible to women and minority founders because
24 these business owners often resource constrained, so
25 there needs to be minimized cost associated with

1 fundraising.

2 So now, let's look at Reg CF outcomes of
3 women and minority-led businesses. How do they
4 perform compared to white and male-led business
5 owners? So this figure shows per proportion of
6 businesses that get funded by successfully meeting
7 their target offering amounts. Over the years, all
8 groups have seen improved chances of securing any
9 funding. The percentage of all-female founders that
10 were funded increased from 59 percent in 2016 to 77
11 percent in 2022. All-male teams, their rate climbed
12 from 45 percent to 81 percent.

13 So except for the inaugural year, all-female
14 founding teams had lower average success rates
15 compared to all male or mixed gender teams. And here,
16 I show the average funding amount by gender
17 composition groups, all-female founding teams in navy
18 bars had the lowest average funding amount across all
19 years. And the average funding amount is around 1.5
20 to 2 times greater for all-male founding teams across
21 all the years.

22 So overall, there is no discernable evidence
23 of narrowing the gender gap and while earlier, we saw
24 that all-female teams have the better -- had better
25 proffering financial performance, all-female teams

1 have consistently experienced lower success rates in
2 receiving funding and tend to receive smaller amounts
3 compared to all-male or mixed gender counterparts.

4 In terms of race and ethnicity, you can see
5 that there is a stark funding gap between all-white
6 founders in the turquoise color and all-black and all-
7 Hispanic founders in the navy line. Especially in the
8 early years of Reg CF, black and Hispanic founders had
9 funding rates lower than 50 percent until 2019. And
10 for all-black and all-Hispanic Latino founding teams,
11 the funding amount difference compared to all-white
12 founding teams has narrowed between 2017 to '19 -- to
13 2020, but this gap has widened since 2021. And in
14 2022, all-black or all-Hispanic Latino teams received
15 check sizes less than half of all-white teams.

16 And while all-black or all-Hispanic Latino
17 had comparable performance in terms of revenue and
18 superior performance in terms of profitability, they
19 consistently had lower average funding rates and
20 received lower funding amounts. So overall, women and
21 minority appear to have a higher chance of securing
22 funding by participating with Reg CF compared to
23 traditional funding sources. More than half of all-
24 female, all-black and all-Hispanic Latino founding
25 teams successfully raised money in Reg CF, whereas

1 these groups received 2 percent and 3 percent of all
2 VC funding respectively.

3 The funding success rates for all-female and
4 all-non-white teams are still lower but are becoming
5 more comparable to those at all-male or all-white
6 teams over time, but among businesses that raise
7 capital, there are still substantial gaps in funding
8 amounts between all-female versus all-male teams, as
9 well as between all-non-white versus all white teams.

10 The average funding amount for an all-male
11 team is 1.5 to 2 times greater than that of all-female
12 teams. Similarly, all-black and all-Hispanic Latino
13 teams receive disproportionately less funding compared
14 to their all-white counterparts.

15 And next, I examined what happens after
16 Regulation Crowdfunding and how the future outcomes
17 vary by different gender and racial composition
18 groups. And I'll present findings related to future
19 funding and exit outcomes, given the time constraint,
20 but in the report, you can see more analysis related
21 to various outcomes, including repeat participation,
22 business and financial performance and survival rates.

23 And here, I look at Regulation D funding
24 outcomes. Regulation D funding is usually a private
25 placements, which involve funding by accredited

1 investors like VCs and angels. So here, I share how
2 the proportion of Reg CF participants that
3 subsequently raised Reg D funding. So I find that Reg
4 CF outcome is positively correlated with future Reg D
5 funding rates and amount received. On average, around
6 10 percent of Reg CF participants subsequently raise
7 Reg D funding. If you fail to receive funding from
8 Reg CF by not meeting your target amount, then the
9 subsequent funding rate drops down to 3 percent, but
10 if you succeed and successfully raise capital, the Reg
11 D funding may increase it to 12 percent.

12 And considering gender and race, I find that
13 women and minority led teams, especially black and
14 Hispanic founding teams had lower Reg D funding rates
15 compared to all-male and all-white teams. And the
16 gender and racial/ethnic funding gaps really stand out
17 when we consider amount of funding, the Reg D amount
18 funding, while Reg CF has helped some women and racial
19 minority leaders get started with their initial
20 funding, moving on to more common types of venture
21 financing like Reg D still show how uneven the
22 opportunities are, right? So this really underscores
23 the need for more policies to support women and
24 minority entrepreneurs beyond just the Reg CF stage.

25 When considering exit outcomes of Reg CF

1 participants, since the establishment of Reg CF around
2 eight years ago there have been 14 IPOs and 71
3 acquisitions as of March 2024. Since most startup
4 exit takes about five to ten years, it is still early
5 to make assessment, but these instances highlight that
6 Reg CF has potential as an investment avenue. So this
7 table lists all IPO offerings known to date. Among 40
8 firms that went public, all businesses, except for one
9 mixed gender team, are led by all-male founding teams.

10 Also, only two are all-Asian founding teams, while
11 the remaining are all-white -- the remaining are all-
12 white.

13 So we haven't encountered any black or
14 Latino led firms that went public. There were 71
15 acquisitions. The precise terms of these acquisitions
16 and the exact proceeds distributed to the investors
17 are often not disclosed. The gender composition of
18 acquired companies mirror the gender composition of
19 Reg CF participants. There are some successful
20 acquisitions of women led Reg CF participants, about
21 17 percent are all-female teams. In terms of race and
22 ethnicity, 8.5 percent of all acquisitions, a modest
23 proportion, involves all nonwhite teams.

24 Though no acquisition occurred for all-black
25 or all Hispanic founders. So acquisitions of

1 minority-led teams mostly involved Asian founders.
2 Again, it is premature to fully assess the exit and
3 return outcomes of Reg CF offerings, but the data thus
4 far indicates that the majority of IPOs and
5 acquisitions are associated with teams founded by all-
6 male or all-white individuals, which highlight the
7 need for ongoing support.

8 So in conclusion, this report highlights the
9 ways in which women and racial ethnic minority groups
10 engage with Reg CF to secure investment and examine
11 challenges they encounter both during and after
12 participation. Although there has been a bump in the
13 number of women and minorities jumping into Reg CF,
14 they still don't reflect the full diversity of US
15 business owners. And this means that not enough
16 minority entrepreneurs know about this newer way to
17 fund their businesses.

18 Also, even though women and minority led
19 businesses were doing just as well compared to those
20 led by men and white teams before they started using
21 Reg CF, there are still persistent differences in
22 funding base and funding amount based on gender and
23 race. And this is problematic because in the report,
24 I show that Reg CF outcomes correlated with future
25 businesses and financial performance, including Reg D

1 funding and survival rates.

2 And this report points out how crucial it is
3 to support businesses after Reg CF. Those companies
4 that pay off for investors at the end so far are
5 usually led by all-male or all-white teams. So and it
6 is key to recognize that not paying enough attention
7 to women and minority entrepreneurs who often do
8 really well before Reg CF is not just overlooking a
9 social issue, it also means missing out on solid
10 business opportunities because of biases. And it is
11 crucial that capital is allocated to businesses based
12 on how they perform, not based on the background of
13 entrepreneurs.

14 In terms of policy implications, it's key
15 that we encourage more people to take part so
16 platforms and programs like accelerators can think
17 about pushing outreach to underrepresented
18 entrepreneurs through awareness campaigns. Also,
19 there should be fewer barriers to getting involved in
20 Reg CF. For example, the government can look at
21 helping out with the costs associated with
22 fundraising, like marketing, legal and accounting
23 fees.

24 Also, it is imperative to tackle any biases
25 in funding. One way to do this is by sharing the

1 success stories of businesses led by women and
2 minorities, platforms might want to set up antibias
3 training, offer perks to encourage taking base
4 trainings. There could also be incentives like
5 investment credits to a subsidized offering led by
6 women or minorities. And we learned that ongoing post
7 Reg CF support is crucial, which means networking and
8 mentorship are super important.

9 So platforms and entrepreneur programs
10 should offer opportunities to a network, especially
11 for women and minority founders and to help with
12 successful exit, it is also beneficial to encourage a
13 partnership that can lead to strategic alliances or
14 acquisitions. So mentorship networking events that
15 involve not only financial investments but also
16 strategic investors would also be important.

17 So this marks the end of the presentation.
18 Thank you so much for your interest and for listening
19 to my research insights. Please let me know if you
20 have any thoughts. I just want to highlight that
21 creating a more inclusive and equitable
22 entrepreneurial ecosystem requires concentrated
23 efforts from policymakers, platforms and all
24 stakeholders and entrepreneurial ecosystems, so please
25 keep your continued interest in this area. Thank you

1 so much.

2 MS. DUIGNAN: Thank you, Dr. Chang. We
3 really appreciate the important work that you've done
4 here and you taking the time to share it with us today
5 as well, so thank you so much and we look forward to
6 digging in deeper to this amazing data. All right.

7 Well, Jasmine?

8 JASMINE: Do we have time for questions?

9 MS. DUIGNAN: Oh, yes, yes. Sorry. Thank
10 you for the reminder, Jasmine. Wonderful. Does
11 anyone on the committee have questions for Dr. Chang?

12 JASMINE: I have a question for Dr. Chang.
13 It was a wonderful presentation, very interesting
14 paper. Thank you. I was wondering if you either have
15 done or have any incite through maybe interviews or
16 cases studies into the reasons -- I'm sort of curious
17 about kind of the differences between crowdfunding
18 versus angels in maybe getting funding to more diverse
19 founders. And I'm just wondering kind of why. I mean
20 I can speculate as to why, but I wonder if you have
21 any incites on that front.

22 DR. CHANG: Yeah. So based on like my
23 conversations with like the entrepreneurs who have
24 participated in Reg CF, I think the reasons why people
25 choose Reg CF is because -- not just because it's like

1 easier to be exposed to the broader group of
2 investors, but it also provides like good marketing
3 initiatives. It provides like a fan base kind of
4 support system for the businesses. Also, another
5 benefit of Reg CF compared to angel or VC is that
6 compared to those traditional financing sources, you
7 can create your own deal terms; you can set your
8 valuation amount, right, so the decision making
9 regarding the deal term valuations are kind of driven
10 by entrepreneurs, not based on kind of negotiations,
11 so that's another benefit.

12 MS. DUIGNAN: Diego?

13 MR. MARISCAL: Yes. So similar to Jasmine,
14 great presentation. Thank you so much. So just as a
15 way of context, so my name is Diego, Diego Mariscal.
16 I lead an accelerator for founders with disabilities.
17 So I really appreciated the recommendation
18 specifically around accelerators and encouraging more
19 support to underrepresented founders. But in that
20 same vein, I'm curious if you looked at -- I mean your
21 paper primarily focuses on women and minority, but I'm
22 curious if you've looked at the intersection between
23 gender and other minority groups and specifically from
24 where I sit, curious if you looked at any disability
25 specific data and, you know, how might that impact

1 your research.

2 And then the second question I had was
3 around you mentioned a number of recommendations and
4 I'm wondering if those -- which I appreciated and
5 agreed with a number of them, but I'm wondering are
6 those recommendations evidence-based and can we point
7 to those recommendations sort of having substantive
8 gains in the space, wondering if you could talk a
9 little bit more about that. Thank you.

10 DR. CHANG: Yeah. Thank you for these
11 excellent questions. So in terms of your first
12 question, though, related to whether you look at other
13 dimensions beyond gender and race. So in my other
14 studies, I've considered how Reg CF is helping to
15 diversify in terms of people who lack social status
16 like elite education, industry and location. But I
17 haven't looked into disability, but it's of my
18 interest. I'm also interested in like SES and
19 disability, so since you are the expert in this area,
20 I would love to kind of keep the conversation going
21 about how we can examine kind of the disability
22 business owners in the Reg CF funding space.

23 I think the primary reason that there is not
24 enough research is because of the lack of data around
25 the disability -- the entrepreneurs with disability,

1 so I would love to kind of keep my interest going in
2 this space, especially if the data becomes more
3 available and accessible. So definitely, let's stay
4 in touch and I would love to hear about your
5 perspectives. In terms of recommendations, I pointed
6 out some recommendations related to awareness
7 campaigns like anti kind of bias training.

8 There hasn't been much research around these
9 interventions and this is kind of where my future
10 research is headed. It'll be great to conduct some
11 kind of field experiments or like interviews to kind
12 of see if these interventions are successful,
13 particularly if after like cooperating with funding
14 platforms or accelerator programs, so there hasn't
15 been much research around the effectiveness of
16 interventions and I would love to see more research
17 and conduct research in this area to see whether these
18 policy recommendations and interventions are
19 effective.

20 MR. MARISCAL: Thank you.

21 MS. DUIGNAN: Sue?

22 MS. WASHER: Yeah. So my question is around
23 you mentioned that despite the women and minority-led
24 companies having somewhat better financials, many of
25 them having better financial performance going in,

1 they either are not successful at raising financing
2 under Reg CF or they get smaller checks. Do you have
3 any data that says what happens to those companies?
4 So they -- either the ones that weren't successful in
5 their Reg CF, even though they had good financials,
6 what happened to those companies over time, and then
7 the ones that did actually close but had less of a
8 check, how did they do over time? Because I think
9 that really goes into something that we're missing
10 from our financial environment if good companies
11 aren't able to raise that money. So what does your
12 data say about that?

13 DR. CHANG: Right. And it's definitely like
14 a missed market opportunity because there are so many
15 successful women and minority led founding teams out
16 there. So my report kind of has more details about
17 what happens to these businesses, whether they meet --
18 whether they get funded through Reg CF and whether
19 they don't get Reg CF and I find that the Reg CF
20 success and amount raised are correlated with their
21 future performance, so I briefly showed the Reg D
22 funding outcomes, so confirmed that -- successfully
23 has successful fundraising are more get funded through
24 Reg D later on from accredited investors, but those
25 that get -- that do not get funded through Reg CF,

1 they actually have like smaller chances at receiving
2 subsequent funding.

3 Also, it's correlated with other business
4 survival, revenue and net income. So having -- so
5 this is a -- so getting setbacks in the early stage
6 funding has like a large implication in terms of their
7 future funding, so it is imperative that there is less
8 biases in the Reg CF funding stage.

9 MS. WASHER: Thank you.

10 MS. DUGNAN: Bailey?

11 MS. DEBRIES: Yes. Thank you, Dr. Chang. I
12 had two questions for you and thank you for the
13 presentation. The first is a little bit of a gap for
14 me, I was curious if you could illuminate some
15 information about the number of Reg CF internet
16 platforms that exist today and of those, I'm curious
17 if your research went into of those internet platforms
18 which ones were owned or led by women or black or
19 brown individuals versus white males. So just seeking
20 to understand, you know, the availability of the
21 intermediary channel and the connections there and
22 affinity for use of those. So I'll start there and
23 then I have one other separate question.

24 DR. CHANG: Yeah, sure. Thanks for that
25 question. So in my -- based on my data, there have

1 been about 101 active Reg CF platforms during the
2 study period and around 40 platforms had at least 10
3 Reg CF offerings, 20 platforms had at least 20
4 offerings and it's a pretty -- and the top three Reg
5 CF platforms account for about 75 percent of the
6 market share, so there are some clear kind of leaders
7 in this funding space. I haven't looked into the
8 backgrounds of the founders of these platforms, but
9 based on the top leading platforms, -- based on my
10 quick search, I think the majority are led by all-
11 white male founders. But I would love to kind of dig
12 deeper into this issue about like what are the
13 backgrounds of the founders of the platforms, how does
14 that affect the funding outcomes of women and minority
15 led businesses.

16 MS. DEVRIES: Thank you.

17 DR. CHANG: And was there a second question?

18 MS. DEVRIES: Yeah. So my second question,
19 when -- you know, looking at some of the outcomes data
20 that you shared around IPOs and M&A outcomes, it led
21 me to think about whether more broadly you may have
22 examined the break of what you might call Main Street
23 businesses from innovation economy businesses matrixed
24 with whether they were female owned businesses or
25 black and brown or all-white businesses, if you had

1 done any examination of that, so just would love to
2 understand kind of, you know, one with the broader
3 pie, the breakdown you see between Main Street and
4 innovation economy based on gender and race and then
5 for the successful exit outcomes if there were any
6 trends as well?

7 DR. CHANG: Yeah, good question. So in
8 terms of IPOs, I think the majority are more high-tech
9 startups because we need to get kind of support from
10 retail investors, I feel like more high-tech startups
11 are getting more traction in terms of IPOs. It's
12 mostly software, healthcare startups based on my --
13 based on my understanding. In terms of acquisitions,
14 there have been 70 acquisitions. I haven't looked
15 into the kind of specific breakdown of the businesses,
16 but I think here, there is a mix of Main Street
17 businesses and more high-tech startups. I've seen a
18 lot of like food and beverage companies and also some
19 consumer product -- innovative consumer products, so
20 there is a good mix of Main Street and high-tech
21 startups in the acquisition.

22 MS. DEVRIES: Thank you and any trends based
23 on race or gender that you noticed in terms of the
24 industries?

25 DR. CHANG: I haven't broken down into

1 gender and race, but since like all except for one are
2 all-male founding teams in the IPOs --

3 MS. DEVRIES: Oh, I just meant the overall
4 pipeline.

5 DR. CHANG: Yeah.

6 MS. DEVRIES: Okay, yeah.

7 DR. CHANG: Overall, yeah, yeah. It's in
8 the report, but you can see that in terms of IPO -- I
9 think not -- like except for one, it's all-male,
10 except for two, it's all-white. In terms of M&A, I
11 think about 70 percent are all-male; 80 percent are
12 all-white for acquisitions.

13 MS. DUGNAN: George?

14 MR. COOK: Hi, Dr. Chang. Thank you for
15 your important work. This is George from Honeycomb
16 Credit. I'm curious kind of building on that last
17 point there, in your study, you showed that nearly 25
18 percent of these offerings are for debt or revenue
19 share. And that seems to be a growing percentage as
20 well. So a successful outcome for a debt or revenue
21 share is not an acquisition or liquidity of event, but
22 rather successful repayment. So I'm curious of you
23 have any data on successful repayment rates and return
24 profiles to investors through kind of that lens, from
25 the ones that are not equity offerings and if so, any

1 data around gender or racial lines there?

2 DR. CHANG: Yeah -- about like the exact
3 proceeds to investors. Unfortunately, the information
4 about returns to investors are not publicly accessible
5 and I really hope to gain more information about these
6 proceeds to investors, even for IPOs and M&As, it's
7 like hard to get information about the exact proceeds
8 to investors. So unfortunately, I don't have enough
9 data to answer that question, but I think -- maybe
10 I'll future conduct surveys involving entrepreneurs to
11 kind of get insights about whether you provided
12 returns to investors, but as of yet, it is hard to get
13 data on that information. And if you have any
14 insights into the incidents around the platform,
15 please share it with me and I'd love to discuss about
16 this.

17 MS. DUIGNAN: Vincent?

18 MR. CORDERO: Hi, Dr. Chang, Vincent
19 Cordero. Question, you elude to in the
20 recommendations section, incentives, what are your
21 thoughts on that in terms of facilitating more
22 investment into diverse loan fund companies?

23 DR. CHANG: Yeah. So I think there have
24 been some discussions around the entrepreneurship
25 funding programs about like creating investment

1 credits to subsidized offerings led by women and
2 minorities, also supporting R&D efforts led by women-
3 led and minority led business owners. So maybe there
4 could be some incentive, like investment credits or
5 potentially tax credits for a business making
6 investment into those companies.

7 MS. DUIGNAN: Herbert?

8 MR. DRAYTON: Good morning, Dr. Chang,
9 Herbert Drayton. Two question. One is in your
10 research, were you aware of any sort of platform
11 thesis for any of these crowdfunding platforms that
12 prevented them from allowing folks to put offerings on
13 the platform to cover the gamete from the mainstream
14 business up to the software? And then the second
15 question, were there any noticeable barriers with the
16 application process that prevented minorities and
17 women from applying?

18 DR. CHANG: Yeah. So in terms of like
19 platform investment basis, I feel like the leading
20 platforms are mostly open to all, but they have these
21 like sections highlighting like women founders, Latinx
22 founders, black founders, so I think there are some
23 sections that are -- in the platform that are kind of
24 showcasing these minority women led firms. I feel
25 like platforms like Green Vest are kind of targeting

1 more kind of Main Street businesses so they are from a
2 platform that has focus areas. And to your second
3 question about the application process, I feel like
4 the key challenges related to the application process
5 is requirements like legal fees, accounting fees,
6 marketing efforts. It lowered the barriers to capital
7 access, but there are some of these procedures
8 involved, which can be costly to under-resourced
9 women, right, and minority entrepreneurs, right?

10 So I feel like there should be kind of
11 minimized costs related to these requirements. Also,
12 there could be some subsidies or grants that can help
13 out women and minority led founders to come up with
14 the preparation costs.

15 MR. DRAYTON: And just one quick follow-up,
16 I noticed in your report that, if I recall,
17 crowdfunding peaked in 2021, the year following George
18 Floyd's death, and now it seems like it's starting to
19 dip back down. Do you think that we'll get back down
20 to with the 2018 levels and not peak again?

21 DR. CHANG: It's hard to tell, to be honest.
22 It was good to see some uptick in the numbers. It
23 has been increasing, but I think in 2020 -- so
24 after -- in 2022, I think the rate has been -- the
25 participant of black and Hispanic founders has went

1 down a little bit, has slowed down. Yeah, it's hard
2 to answer that question. And also in 2022, there has
3 been also a lot of like -- environmental factors.
4 There has been challenging economic conditions, which
5 could make them more difficult to participate in this
6 funding program because there are some resources that
7 cost involved in participating. So I mean it's hard
8 to tell like what the rates will be in the future, but
9 I feel like there will be some ongoing interest and
10 effort in this.

11 MS. DUIGNAN: Bart?

12 MR. DILLASHAW: Dr. Chang, thank you very
13 much for your presentation. I just had a question, do
14 you have any data demographics or amount investment or
15 otherwise on the investor side for Reg CF? I know the
16 report focused on a lot of the issuer side, but I'm
17 curious if there are any insights to be learned based
18 on the investor side of things?

19 DR. CHANG: Yeah. It's hard to get
20 information about who these investors are and I've
21 been always curious about these investors. I did
22 speak with some platform founders to get advice about
23 what the profile of investors looked like. It varies
24 by platform, but based on my conversation with three
25 platforms around like 85 to 90 percent have been non-

1 accredited investors, so it's opening up investment
2 opportunities to kind of regular everyday investors,
3 not just accredited investors.

4 The gender and their -- all of them were not
5 willing to share their race, ethnicity information
6 because they are not being collected. Also, gender
7 information, it's like not required information to be
8 collected -- to kind of sign up for the platform, so
9 the exact numbers are hard to get, but roughly, it was
10 around like 70 percent male and about 30 percent
11 female.

12 MS. DUIGNAN: Wonderful. And I just have
13 one question, the one section of your report that
14 piqued my interest was on offering structure. And
15 just noticing that, you know, though the report states
16 that this is similar to the practice of VCs, we see
17 here that, you know, 32 percent of the equity-based
18 securities of the securities issued were either common
19 or limited nonvoting common and another 28 percent
20 were SAFE, simple agreement for future equity. So
21 about 60 percent of the total securities issued are
22 really in formats which, you know, VCs and I would say
23 most savvy angel investors would almost never invest
24 in and a SAFE is one that we really desperately prefer
25 not to invest in.

1 Yet, you know, people who go onto these
2 platforms believe that they are investing on the same
3 footing or in similar securities to VCs and this, you
4 know, really does present a lot of risk through lack
5 of structure. So what are your thoughts there on how
6 that could be improved or at least people could be
7 better informed that the securities the VCs get and
8 what they're getting are not the same?

9 DR. CHANG: Right. So I think there needs
10 to be more education materials by platforms and policy
11 makers about what the structure looks like, what does
12 it mean to investors, so more kind of disclosure
13 education I think is required to make sure that the
14 people are making informed decisions. In terms of
15 offering structures, like it is difficult to control
16 how business owners -- what type of business offering
17 structure that they would prefer they should select,
18 right? But I think it's good to have a lot of options
19 available for different types of entrepreneurs,
20 definitely more -- I think there needs to be more
21 information, training to these every day nonaccredited
22 investors to make sure Reg CF is sustainable funding
23 source. But if anyone else in the audience has a
24 better solution or advice, please let me know. I
25 would also like to learn more about it.

1 MS. DUGNAN: Okay, great. Do we have any
2 more questions from the Committee? All right,
3 wonderful. Dr. Chang, thank you so much for your time
4 today. This was so informative and I want to thank
5 the Committee for all of the incredibly inciteful
6 questions.

7 DR. CHANG: Thank you, everyone.

8 MS. DUGNAN: Apologies. I'm having a
9 little bit of an issue with -- a technical issue with
10 my computer now. I'm bringing up a document and
11 somehow it got -- it has been hidden, but it will come
12 up shortly. And I believe our next step is that we
13 can get into the discussion on Reg CF, talk a little
14 bit about what we've learned from this amazing
15 presentation and I think it would be a great idea for
16 George to kick us off with some of his thoughts on the
17 topic.

18 MR. COOK: Yeah, happy to. I have been
19 eating, sleeping and breathing regulation crowdfunding
20 since 2017, so happy to share some thoughts. And I
21 think Herb, you asked a really salient question about
22 is there something in particular holding entrepreneurs
23 back from using regulation crowdfunding and I can say
24 with a lot of confidence that the number one thing
25 that we see holding people back from using regulation

1 crowdfunding is the requirement for review and audited
2 financials at \$124,000 threshold.

3 As you can imagine, a lot of these companies
4 with -- as Dr. Chang pointed out, many of them -- the
5 majority have less than three years of operating
6 history. Most of them do have a good bookkeeping
7 relationship. Most of them do have a CPA, but to get
8 reviewed financials for a small business can cost
9 anywhere from \$5,000 to \$10,000 per year. So for two
10 years of historical financials, you're talking \$10,000
11 to \$20,000 to raise \$125,000. That makes the cost of
12 capital through regulation crowdfunding extremely high
13 and if you look at the data on regulation
14 crowdfunding, you'll see a tremendous number of
15 offerings that cap out magically at \$124,000 and then
16 they go home.

17 We saw through the pandemic relief, the SEC
18 temporarily raised that limit to \$250,000 and we saw
19 the number of businesses able to raise between
20 \$124,000 and \$250,000 really surged and at least from
21 our limited view, we actually saw businesses that
22 raised over, at the time, \$107,000 was the threshold,
23 we saw the businesses that raised over \$107,000
24 actually have higher outcomes, better outcomes. And
25 there's two reasons for that. One is more fully

1 capitalized businesses, businesses that are
2 artificially compressed on how capitalized they are by
3 the \$107 or \$124K cap are less likely to be successful
4 because they don't have as much money in the bank to
5 go out and buy the equipment they need, buy the --
6 open the new location, whatever it might be.

7 And secondly, our data internally at
8 Honeycomb is showing that the number of people
9 participating in an offering is directly correlated to
10 successful repayment of a loan, more than credit
11 score, more than years in business, more than
12 profitability, the number one correlated factor to
13 successful repayment to date on Honeycomb, our very
14 limited dataset, has been the number of people
15 participating in an offering. So it really goes to
16 show that there is knowledge in the crowd, that people
17 voting with their wallets on a product they believe in
18 is actually helping to derisk that company. And I
19 think there's some pretty compelling evidence that we
20 should consider raising that reviewed financial cap
21 back up to \$250,000. I've also seen proposals of
22 \$500,000, which I think would be worth discussing as
23 well.

24 MS. DUGNAN: Herbert?

25 MR. DRAYTON: Are we allowed to ask our

1 colleagues questions?

2 MS. DUGNAN: Ask away. You're allowed to
3 absolutely grill him.

4 MR. DRAYTON: George, I have a question for
5 you. On the reviewed and audited financials piece,
6 clearly that's a barrier, are they allowed to accept
7 that \$5,000 to \$10,000 cost for the reviews as a part
8 of the investment?

9 MR. COOK: Yes, but keep in mind you have to
10 spend that money before you can post your offering.
11 So you're making this \$10,000 investment into your
12 financials, but then you don't know if you're
13 necessarily going to hit your funding goal. So
14 there's -- you're kind of taking a gamble that you
15 would be able to fund that.

16 And keep in mind that one of the things
17 that's disclosed and rightfully so is a detailed
18 accounting of where you're going to spend your money
19 and investors tend to be less excited about paying
20 your accountant than they do buying your equipment or
21 helping you develop a new product or whatever it might
22 be.

23 MR. DRAYTON: So I was asking for me
24 personally, could I do that as a part of the
25 investment? If I -- if I know a small business and

1 their financials are strong but they're lacking the
2 resources to get -- well, relatively strong, they're
3 lacking the resources to pay for that review, could I
4 pay for that review, knowing that I am then also going
5 to invest in them through that crowdfunding platform?

6 MR. COOK: It would probably have to be a
7 private transaction happening outside of the Reg CF
8 framework.

9 MR. DRAYTON: And my second question,
10 something you said, you said most are successful
11 because of repayment of a loan, is that a repayment of
12 the loan on the platform or to a CFI or bank or --

13 MR. COOK: To the platform. So Honeycomb
14 operates -- we're primarily a debt and revenue share
15 platform, so 95 percent of our offerings are -- have
16 monthly recurring payments. So that's the framework
17 that I have data on.

18 MR. DRAYTON: And I'm sorry, one quick
19 follow up to that. If I as a business owner comes
20 onto the platform to get a loan, do I still have to
21 have the reviewed financials?

22 MR. COOK: Yes.

23 MR. DRAYTON: Okay, got it. Thank you.

24 MALE SPEAKER: While we're grilling you,
25 George, I have curiosity. Do you have any information

1 or insights you can share again on the investor side
2 in terms of are you seeing them capped out on the
3 amount that they can invest? I know -- I think you've
4 made comments before about that you have seen some
5 patterns in the investments that they kind of invest
6 in one and then will, you know, invest in others from
7 there, but are you seeing any limitations on the
8 investor side based on the total amounts they can
9 invest or anything on the caps on that side?

10 MR. COOK: Yeah, good question.
11 Historically, we saw a lot of issues. But the changes
12 in 2020, there was pretty sweeping changes. The two
13 biggest ones, as far as I'm concerned, one, the
14 increase from \$1.7 million cap on how much you could
15 raise to \$5 million really helped and the other was
16 historically, they were looking at the lesser of your
17 income or net worth and we ran into a tremendous
18 number of issues where young people coming out of
19 medical school, very high income, very low net worth
20 were capped out and vice versa, retirees, relatively
21 low income, relatively high net worth were capped out.

22 They changed that to the greater of your
23 income or net worth and since that change, we've seen
24 very few limitations.

25 MS. DUGNAN: Sorry, go ahead.

1 FEMALE SPEAKER: Sorry to keep you on the
2 spot, George. So I'm a little bit curious, Andrew
3 Schwartz in his book indicates that platforms actually
4 play a role in sort of screening the companies that
5 they allow to come on and do a crowdfund on their
6 platform and I wonder, I don't mean to keep putting
7 you on the spot, but can you speak to that a little
8 bit, maybe about what your process is or if you want
9 to speak more broadly, that would be fine as well.
10 Thanks.

11 MR. COOK: Yeah. I think every platform has
12 a little different philosophy on this, you know, some
13 platforms take more of an all comers are welcome, if
14 you can meet the SEC requirements, then you're welcome
15 to use their platforms. We do have certain criteria
16 at Honeycomb.

17 Some of those are financial criteria. We're
18 looking at debt service coverage ratios. We're
19 actually looking at credit on business owners because
20 it is, most of the time, a traditional debt product.
21 So we're following a process that's a little bit more
22 akin to a CGFI or a community bank. Trying to make
23 sure that there's some level of confidence that we
24 have as a portal that an issuer can service the debt
25 they're about to take on.

1 There is also many portals, including ours,
2 will look at some level of ability for an offering to
3 be successful. So one thing we look it is we have
4 some metrics we look at around social media
5 engagement. Is there activity around the business
6 that demonstrates that they -- if they post on social
7 media, people are going to respond positively, both
8 because we want them to be successful, but it's also,
9 you know, we want to -- we want to bring businesses
10 that people are going to be excited about onto the
11 platform.

12 FEMALE SPEAKER: So we've commented about
13 the cost of the reviewed and/or audited -- probably
14 reviewed at this level and that's for just \$124K being
15 raised, but what are the other costs? What are the
16 all-in costs? If you're paying for a review, there
17 have to be other associated costs. So what is the
18 all-in like percentage cost of raising \$124,000?

19 MR. COOK: It varies widely by the platform.
20 Obviously, all platforms will have some cost to host
21 an offering. You know, that will range based on their
22 revenue model, usually somewhere between seven to ten
23 percent of what's raised across the platform. Some of
24 that's paid by investors. Some of that's paid by
25 issuers.

1 Some platforms have a required marketing
2 budget that they will say hey, you're only allowed
3 onto our platform -- if you certify, you're going to
4 spend so much money marketing your offering. We don't
5 have any requirements like that, but we do see that at
6 other platforms. And that will be another, you know,
7 significant percentage of what you're raising.

8 FEMALE SPEAKER: So if I'm hearing that
9 correctly, you're paying even to ten percent to the
10 platform, you're maybe having some advertising cost
11 and you're paying \$5,000 or \$10,000, which of \$124,000
12 is another seven-ish to ten percent. It could be --
13 it could be easily 20 percent of what you're raising
14 just goes into raising the money. That's like credit
15 card debt. That's a lot.

16 MR. COOK: Well, it is, yeah. And it's
17 important to understand the alternative, though, for
18 most Main Street small businesses. You know, banks --
19 bank lending through SBA 7A loans from the peak in
20 2007 is down almost half.

21 The average size of an SBA loan went from
22 about \$140,000 to \$550,000. So the thing about
23 traditional Main Street small businesses, the ability
24 to access capital through traditional providers is
25 essentially gone and the online lenders that have

1 replaced them are extraordinarily expensive.

2 MS. DUGNAN: Davyeon?

3 MR. ROSS: George, I'm going to keep you on
4 the spot because you're doing such an amazing job.
5 Thank you for the insight. Just a couple quick
6 questions. I know, for the most part, a lot of these
7 businesses are small businesses versus high-tech
8 startup companies. I'm curious what percentage, if
9 any, you've seen of the high-tech coming into the
10 platform. Additionally, I'm curious to understand if
11 companies that are going to raise follow-on capital,
12 if that is perceived as a negative impact in regards
13 to going down the path of utilizing some of these
14 different platforms?

15 MR. COOK: Yeah, it's a good question. So
16 on the first part, with Honeycomb, we do some high-
17 tech, not a lot.

18 It's less than 5 percent of what we do. To
19 Erica's earlier question about how we think about the
20 asset class within equity, we require that they have a
21 term sheet from an outside investor and we just follow
22 that term sheet exactly, so we try to make sure that
23 they're investing at the same exact terms as other
24 outside investors.

25 But again, that's a pretty small percentage

1 of what we do and it typically is -- I think about it
2 as kind of a doughnut hole between standard high-tech,
3 high growth venture backable companies and kind of
4 Main Street Companies. There's businesses in between
5 that are sort of tech enabled, might not have venture
6 like returns but also might have a longer growth
7 timeline to get to profitability and, therefore, be
8 able to take on traditional debt. And so that
9 doughnut hole, we're seeing a lot of companies come to
10 Reg CF and it's a good fit for them.

11 In terms of does Reg CF prohibit you from
12 raising in the future, one issue in the past was it
13 was very, very difficult to use SPVs to invest on
14 regulation crowdfunding. As you can imagine, most
15 people don't want 400 people in their cap table.
16 Again, in the 2020 changes, they made it easier to
17 structure an STV to handle an equity offering, which,
18 in turn, does at least from a cap table perspective,
19 make things much more manageable.

20 MR. ROSS: That was kind of where my
21 question was going.

22 MS. DUIGNAN: Diego?

23 MR. MARISCAL: Yeah. So I'm going to keep
24 it going. Question around sort of the success rate, I
25 guess you can speak on Honeycomb but also industry-

1 wide, if you can share a bit about the success rate of
2 percentage wise of people that or businesses that go
3 into the platform versus the ones that actually get
4 funded.

5 And then also, if you can share a bit about
6 how many are unsuccessful to the point that they
7 default on their loan or, you know, what does that
8 look like -- what does that look like percentage wise
9 and process wise and then a third piece, curious if
10 you can share a bit about a lot of the discussion
11 today has been around underrepresented founders and
12 underrepresented minorities.

13 And so I presume that equity crowd funding
14 is opening up funding opportunities for
15 underrepresented founders. So wondering, you know,
16 what trends are you seeing there when you look at the
17 requirements of social media presence and other types
18 of requirements, does that present a barrier to those
19 founders or is it actually less cumbersome than
20 traditional funding mechanisms?

21 MR. COOK: Yeah, good question. So in terms
22 of success rate overall, we're seeing across the
23 industry kind of 70 to 80 percent of people that host
24 a Reg CF offering are getting successfully funded, so
25 quite high. Honeycomb is in that similar range as

1 well. In terms of the successful repayment rate,
2 we've been historically about 96 percent successful
3 repayment. That is roughly a charge off rate that's
4 three times lower than comparable SBA loans, so
5 government backed, taxpayer backed loans, our charge
6 off rate is substantially lower than them, kind of in
7 the same sub 250K range.

8 Around the access to capital for diverse
9 founders, last year in our impact report, we were
10 really glad, we were really proud to show 85 percent
11 of the businesses we worked with were minority owned,
12 women owned and/or based in low to moderate income
13 communities.

14 If you expand that to include veteran-owned
15 and LGBTQ+ owned, that's over 90 percent of the
16 business that we worked with last year. I can't speak
17 to that data across -- Dr. Chang would be better to
18 speak across -- to that data across regulation
19 crowdfunding, but we definitely see that founders from
20 diverse backgrounds have a harder time getting access
21 to traditional capital, I don't think it's a secret to
22 anyone here in the room and they get really excited
23 about regulation crowdfunding as an alternative.

24 MR. MARISCAL: Just as a quick follow-up,
25 would you -- and I presume the answer is yes, but

1 would a productive recommendation from the Committee
2 be this sort of permanent race of the cap on when
3 founders need to provide accredited or audited
4 financials?

5 MR. COOK: I think it would be a tremendous
6 benefit.

7 MR. MARISCAL: Yeah.

8 MR. COOK: Especially for younger smaller
9 businesses, which are disproportionately from founders
10 of diverse backgrounds and it becomes this really
11 important stepping stone to get them to an SBA loan,
12 to other traditional funding sources. But, you know,
13 bank lending doesn't really start until about 250K, so
14 there's a missing rung on the ladder and Reg CF can be
15 a piece to help fill that in.

16 MS. DUIGNAN: Marcia?

17 MS. DAWOOD: I'm going to take you off the
18 hotseat, George. I have more of a question, I guess,
19 for Stacy and the SEC team. So I'm curious, I'm
20 trying to wrap my head around like the \$124,000 number
21 of the limits. First of all, it's curious that it's
22 \$124,000 in income for those limits and then it's also
23 \$124,000 for the amount of money that you can raise.
24 So that must've been a really popular number. I hope
25 somebody played the lottery on it.

1 But, you know, and then when the -- like
2 during COVID when it was raised to \$250,000 and to
3 George's point that you said that there were a lot of
4 people that really utilized that and they were able to
5 be successful, but then it went back down.

6 So I'm guessing that the \$124,000 mark was
7 so that there would be -- that would be protecting
8 investors because you want them to see the financials
9 if they were raising a lot more money but considering
10 that most of the investors are only going to put in a
11 couple hundred bucks, maybe \$1,000 at the most on
12 average, then kind of what is the thought process
13 behind like actually raising that? Because it seems
14 like, to me, oh, well, we should -- we should raise
15 that limit, but I don't know that I understand enough
16 of the background to be able to say that that's a good
17 idea or not.

18 MS. BOWERS: I don't know that I know the
19 exact answer to your question. I mean I can say that
20 there are requirements that crowdfunding be inflation
21 adjusted every five years. I'm looking at Julie also
22 to make sure I'm saying that right. Yes. So I mean I
23 think to your point, Marcia, and I honestly don't
24 know, but I think that could be part of why you see
25 the similar numbers. Yeah, it was all \$100 -- it was

1 \$100. So with the -- with the inflation adjustment,
2 it played out.

3 MS. DAWOOD. And so was the -- was that
4 limit, though, put in place for the amount of money
5 that could be raised as a strict investor protection
6 or, you know, with them not being able to see an
7 audited financial or at least a reviewed financial?

8 MS. BOWERS: Is your question about the
9 overall limit or is your question about the limit for
10 the financials, at which point the financial
11 statements go from being --

12 MS. DAWOOD: Yeah.

13 MS. BOWERS: -- not required for an audit
14 to --

15 MS. DAWOOD: Yeah.

16 MS. BOWERS: So it was raised during COVID to
17 \$250,000.

18 MS. DAWOOD: Right.

19 MS. BOWERS: And then that -- it was
20 extended for a temporary period of time and then that
21 extension lapsed. It just wasn't extended again.

22 MS. DAWOOD: And did we -- is there any
23 information or data around that time period when it
24 was at \$250,000? Were there problems for it being at
25 \$250,000? Was there pushback from investors at all

1 that they wanted to see more financial information?

2 MS. BOWERS: I don't know.

3 MS. DAWOOD: Just curious.

4 MS. DUGNAN: Okay. So, you know, I think
5 these are really good questions, just in the interest
6 in time as we have a little bit less than 20 minutes
7 until lunch.

8 I would just like to recommend that going
9 forward, we maybe go around or raise hands. You know,
10 I'm not going to force everyone to come up with an
11 idea. But why don't we try and narrow down a few of
12 the items where we think we could make positive
13 change, whether it's on investor protection or on
14 reducing their regulatory burden for issuers.

15 Yes, Bart?

16 MR. DILLASHAW: Just sort of piggybacking on
17 that, but I wanted to -- since Commissioner Peirce
18 sort of called this one out specifically, she asked
19 questions about the curation, the limitations on that,
20 George to, I guess, pick on you real quick, is that a
21 limitation? Is that something that when we're going
22 around talking about recommendations that should also
23 be mentioned?

24 MR. COOK: Yeah. For a little context, as a
25 registered funding portal, we can't give investment

1 advice for understandable reasons. We're not
2 registered investment advisors, we're not broker
3 dealers or most of us are not broker dealers.

4 So there's limitations on what type of
5 recommendations we can make on the platform and some
6 of -- there's logic to it, but there's also some
7 restrictions.

8 MS. DUIGNAN: And is that an area that we
9 might want to explore for recommendation, the funding
10 portal's ability to provide sort of basic curation and
11 guidance on deals?

12 MR. COOK: I believe so, especially as we
13 see the number of offerings growing very rapidly,
14 particularly within the top five portals. It can be
15 really overwhelming to land on a site and see 100
16 different offerings and have to -- the more a portal
17 could kind of direct people to the things they're
18 interesting, the more likely we are to get capital
19 flowing to businesses.

20 FEMALE SPEAKER: And do you get sort of a
21 standard set of or common questions that might guide,
22 you know, what would be an example of impersonal
23 advice that you think people are looking for from your
24 platform?

25 MR. COOK: It can be things as simple as we

1 know that if someone invests in a small business in
2 Cleveland, they might be looking for other investment
3 opportunities in Cleveland.

4 We're not allowed to just put Cleveland
5 opportunities in front of them. We have a lot of -- a
6 tremendous number of our investor base will reach out
7 to us and say hey, we're really interested in
8 investing in green businesses, show us more of those,
9 or we're really interested in investing in black owned
10 businesses, show us more of those. And there's
11 limitations on how we can curate that.

12 FEMALE SPEAKER: Can I ask a question, a
13 follow on question to that, George? Would you be able
14 to put in filters, such that the investor that went in
15 there, they could search on Cleveland, they could
16 search on green and just those companies would come
17 up?

18 MR. COOK: Yeah, absolutely.

19 FEMALE SPEAKER: Okay.

20 MR. COOK: And that's -- for investors to
21 pull that information is very easy. In order for us,
22 though, as a platform to push that information --

23 FEMALE SPEAKER: Push it.

24 MR. COOK: -- that's where the limitations
25 are.

1 FEMALE SPEAKER: But you can push the fact
2 that the filters are there, right?

3 MR. COOK: Certainly, yeah.

4 MALE SPEAKER: And George, from your
5 perspective, what are the -- I mean it would seem that
6 you would be taking on some of the liabilities
7 involved in being an investment advisor. What are the
8 biggest concerns that you would have if you were able
9 to give, you know, educational and direction to folks
10 in regards to the path that they could take?

11 MR. COOK: Yeah. We don't -- speaking for
12 Honeycomb, like we don't intend to become an
13 investment advisor, just more giving people the
14 ability to choose the things they want to see. At any
15 given time, we can have upwards of 100 businesses'
16 offerings on our platform, so it can be difficult to
17 sort that out. The filters are a starting point, but
18 being able to --

19 MALE SPEAKER: Yeah, I was taking it from a
20 totally different direction. I was taking it more
21 from the direction of, you know, the education
22 question that came up and how do we advise individuals
23 that are actually trying to benefit from the platform
24 to actually raise capital?

25 And so you wouldn't ever want to go down a

1 path of actually advising those individuals. And
2 that's the angle that I'm, you know, wanting to ensure
3 that there aren't any liabilities or concerns that you
4 would have as a platform?

5 MR. COOK: So as a platform, we're required
6 to have quite comprehensive educational materials,
7 every portal is, which we do, of course. And then we
8 try to go above and beyond that, but I don't know that
9 we want to go -- exactly, yeah.

10 MS. DUGNAN: Sue?

11 MS. WASHER: Yeah, I've got one last
12 question -- I thought I had it on, sorry. You made a
13 comment at the last meeting that while crowdfunding
14 was increasing and the numbers were increasing, at the
15 last meeting, you mentioned that it's still a very
16 small percentage of people that were eligible to
17 become a crowdfunding, a CF investor, were actually
18 participating.

19 Can you speak at all about how we might be
20 able to have better participation and better awareness
21 amongst people that they can go fund their local small
22 business this way?

23 MR. COOK: Yeah. I think one of the biggest
24 limitations we see there is that understandably, the
25 way an issuer can talk about their offering is very,

1 very limited, to the point that they're not allowed to
2 say if it's debt or equity or a revenue share. And
3 the indirect advertising has been a real complication.

4 As you can imagine, there's a lot of really fun feel
5 good stories through local media that come out of
6 these offerings.

7 If a reporter decides to put the terms of
8 those deals into an article and a business owner
9 simply puts that on their Instagram feed, we have
10 received warnings from FINRA that they must take those
11 down.

12 So even if another source, a reputable
13 source pulls information from outside of the funding
14 portal and puts it out into the world, the business
15 owner can't even associate with that from an arm's
16 length. And that hurts the ability to educate
17 potential investors and get people excited about the
18 opportunity.

19 MS. DEVRIES: You know, if I may, it's just
20 tying these thoughts together because one of the
21 topics and questions I think that we were emailing
22 about before this meeting were some of the other
23 recommendations and ideas that have been explored in
24 the past and one of them was the idea of should pooled
25 vehicles be able to raise capital on Reg CF platforms.

1 And I think it's, you know, interesting as we're
2 having this discussion, right, because, you know, the
3 internet platforms, right, do not want to take on a
4 fiduciary duty, but you think about the risk
5 associated with making an investment or a loan to a
6 single issuer and so one of the things, you know, I
7 wonder about is perhaps an elegant solution is being
8 able to offer investment in pooled vehicles that are
9 well diversified on the platform so that way, you're
10 diversifying away any risk of loss and then these
11 entities, the pooled vehicles that have other
12 regulations could be in a position to market those
13 pooled vehicles.

14 So thinking about ways that we might be able
15 to grow the pie, provide more access, provide more
16 security, less downside risk and open up more
17 opportunities for more businesses that perhaps might
18 not exactly meet some of the screening criteria's
19 different platforms, but when in a diversified basket,
20 you know, conditions are set differently. I'd be
21 curious to know any thoughts that some of the
22 committee might have about that. Also, just from the
23 SEC team, just any background on discussions that you
24 might have around pooled vehicles on Reg CF platforms.

25 FEMALE SPEAKER: I'll just say that

1 generally, and this is just speaking anecdotally, what
2 we've heard is that what was done in 2020 in the
3 harmonization release to allow, you know, the SPB has
4 not been felt to be working as well as some might've
5 hoped.

6 MS. DEVRIES: That's good to know. When I
7 think of an SPB, I think of, you know, we can only
8 have a single company in it versus multiple, but that
9 is really interesting.

10 I would've thought that that would've had
11 more update in terms of equity offerings on the SPB
12 side.

13 MALE SPEAKER: And Bailey, you're thinking
14 more mutual fund type approach right?

15 MS. DEVRIES: Right.

16 MALE SPEAKER: Where there's the --

17 MS. DEVRIES: The private funds, limited
18 partnerships, you know --

19 MALE SPEAKER: Yeah.

20 MS. DEVRIES: -- more like traditional, you
21 know, seed stage type fund, but investing earlier
22 where it might make investments in or provide, you
23 know, revenue-based loans to say, you know, 20, 30, 40
24 different companies, I mean depending on the size of
25 that vehicle and the number of -- that it's taking.

1 MS. DUGNAN: Okay. Herb?

2 MR. DRAYTON: Just a quick question for our
3 colleagues from the SEC. The testing the waters
4 permitted before Form C is filed, with that, you still
5 have to do the audited reviews? No, you don't?
6 That's the question.

7 FEMALE SPEAKER: No, that's simply an
8 opportunity to before you filed your Form C and made
9 the decision to do a crowdfund to go out and sort of
10 test to see is it going to be viable, is it worth your
11 time to do that. But if they proceed forward with the
12 reg --

13 MR. DRAYTON: Then you have to do the audit,
14 okay.

15 FEMALE SPEAKER: Right, right, yes.
16 Depending on the amount you're raising, if they then
17 proceed forward and do the actual crowdfund, then yes.

18 MR. DRAYTON: Okay. And Madam Chair, one
19 for consideration is possibly doing something similar
20 to what the SSBCI did with the technical assistance.
21 If we can look at providing some technical assistance
22 for these businesses to cover that cost for those
23 reviewed financials, that may be an area that could be
24 helpful to small business owners.

25 MS. DUGNAN: Okay, great. Can you

1 elaborate on that a little bit?

2 MR. DRAYTON: Yeah. With the SSBCI, they've
3 got a bucket of money that they commit to CDFIs and
4 VCs to invest in small businesses, but they also have
5 a bucket of money that they've committed to community
6 development organizations to help them with technical
7 assistance to pay for some legal services, pay for
8 finance, pay for financials, financial literacy and to
9 pay for some marketing.

10 And each state determines how much they're
11 actually going to commit and these are grant dollars.

12 So they will certify vendors within their areas and
13 then advise a small business, go to them and says hey,
14 I want to get my business right so that I could apply
15 for VC or angel investing.

16 They could reach out to that financial
17 partner and tell them, hey, review Herb's financials,
18 make sure they are ready to be presented to an
19 investment agency and those are grant dollars that are
20 provided to the small business owners. And in this
21 instance if we know that those reviewed financials are
22 \$5,000, we're talking grants with vetted organizations
23 within a community where the community development
24 organization would pay for those reviewed financials
25 so they could then apply for resources from the

1 crowdfunding platform.

2 MS. DUGNAN: Thank you. All right,
3 wonderful. And just one more question that I wanted
4 to cover. You know, I think that we're possibly all
5 interested in evaluating the sensibility of the level
6 set currently for financial statement requirements
7 versus the cost, but what are the ongoing financial
8 reporting requirements for people who have raised
9 money with Reg CF?

10 FEMALE SPEAKER: So they have to -- on an
11 annual basis as I walk through, they have to file an
12 annual report 120 days after their year-end and those
13 do require financial statements and one of you correct
14 me if I'm wrong, I believe in the annual reports, and
15 maybe George, you know, they are just certified by a
16 chief executive officer -- I don't -- unless they have
17 audited financial statements and then they provide
18 those, but I don't -- I apologize for not having the
19 rules completely memorized. So they do -- so they do
20 still have to provide the financial statements in the
21 annual report but with a lesser requirement in that
22 initial offering.

23 MS. DUGNAN: And is this something that
24 they are required to provide to their investors or to
25 the SEC?

1 FEMALE SPEAKER: The annual reports filed
2 with the SEC and then it becomes accessible to the
3 investors and I believe they have to post the annual
4 report on their website.

5 MS. DUGNAN: All right. Wonderful. Great.
6 So we only have a few more minutes before lunch, it
7 might be a good opportunity to kind of go around the
8 room and see if anything that might form the basis of
9 a recommendation is jumping out at people, so why
10 don't we start with Sue and we'll go around?

11 MS. WASHER: Yeah, I think as you alluded to
12 Erica, I would be very much in favor of raising the
13 limit. I mean just raising \$124,000, having to have
14 all of those costs, it doesn't seem like a good cost
15 of capital decision.

16 And I think a lot of companies aren't doing
17 it because that cost of capital is so high. So I
18 would be very much in favor of raising that. I also
19 really liked Herb's idea about rolling this into
20 vehicles that are already out there. So even if we
21 raise the cap and they have to have a review, they
22 could apply for a grant through these vehicles to
23 cover the cost of that review. So I think those two
24 things are really important.

25 And I don't know how to solve it, but this

1 idea of not being able to let anybody know, you know,
2 so that more people could participate in the raise,
3 that's probably something that warrants more
4 discussion, but that certainly seems like there should
5 be some way to course correct that.

6 But I think those two things, raising the
7 limit and allowing SSBCI -- IBC, I can't get those
8 initials right -- allowing them to provide grants, I
9 think those two things together would be very helpful.

10 MALE SPEAKER: I think those are great
11 ideas, Sue. I was thinking about the grant idea also
12 in regards to how we can help people prepare. There's
13 a couple programs back in Kansas City that -- mostly
14 for technology companies, but they're grants,
15 nondilutive grants that help people to prepare for
16 larger fundraising, so I really like that idea.

17 You know, a couple of things that I believe
18 we should explore is really the structure of the deal
19 and the terms associated with it. I don't know how
20 deep we can go. The marketing side of it is -- I have
21 mixed emotions.

22 I've seen people be able to leverage the
23 marketing to be able to get more people to
24 participate, but I've also seen exceptional marketers
25 also be able to raise and not necessarily execute on

1 the other side. So there's a little bit of a
2 balancing act there in regards to how do you protect
3 the investors and, you know, there's some execution
4 associated with the marketing, but, you know, I echo,
5 you know, what Sue says with, you know, those two
6 additional points.

7 FEMALE SPEAKER: I'll echo my co-executive
8 members and I would also add, I'd be interested to
9 know about what information investors are looking for
10 and how we could provide that without running afoul of
11 investment advice regulations.

12 MALE SPEAKER: I agree with the
13 recommendations.

14 MR. COOK: I don't think anyone's surprised.
15 I would agree with increasing the limitations around
16 reviewing audited financial, at least to 250K for
17 renewed financials and I do think evaluating the
18 ability for indirect advertising and kind of
19 advertising by accident whenever terms work their way
20 into third party materials would help get Reg CF out
21 to more potential investors.

22 FEMALE SPEAKER: Yeah, I'd agree with the
23 recommendations. We have an awareness problem, I
24 think, with all of this about getting funding to early
25 stage companies and we'll probably talk about it a lot

1 more this afternoon when we talk about angel
2 investing, but you know the -- and I definitely hear
3 your point on the marketing, you know, and where do
4 we -- where do we draw that line.

5 So I don't know, maybe there's something
6 that we could do or the SEC could have -- the SEC has
7 so many amazing resources. Maybe we need to educate
8 people that this is -- that this is an asset class,
9 not necessarily market the individual deals so much
10 but actually see -- let people see that this is a
11 possibility for them. To Commissioner Peirce's
12 remarks earlier that we do have a perception in our
13 country that you have to be wealthy and you have to be
14 well-connected in order to invest in an early stage or
15 in a private company. So I'd be interested to take
16 that a little bit further.

17 MR. DRAYTON: Madam Chair, I endorse my
18 colleague's recommendations.

19 MALE SPEAKER: I'll echo everybody else.
20 Just to mention something else and sort of a technical
21 matter that I would sort of say to the SEC when
22 they're looking at this, the other thing within Reg CF
23 I guess always giving me a little bit of background
24 worry when I'm talking with clients is the 13G
25 requirements of having more than -- you know, which

1 basically says if you have more than 500 nonaccredited
2 investors that it could force you to start acting like
3 a public company.

4 There are carveouts for Reg CF, but I think
5 those expire after some income threshold or if -- I
6 would just say, you know, without a recommendation
7 sort of mention that that's probably something else to
8 look at because as Reg CF takes off and you get
9 more -- right now, I don't think it's much of an issue
10 that people are coming close to that 500 person
11 threshold, but I could definitely see that being an
12 issue if this gets popular.

13 MALE SPEAKER: Yeah, nothing substantial to
14 add. I think I agree with everything that everybody
15 said.

16 I think the only thing that I would also
17 question is around that publicity marketing sort of
18 wanting more information around that because you
19 provided, I think, great insight, George, but I'm
20 still not clear as to how that effects founders
21 specifically, so just understanding that a little bit
22 more would be helpful as we continue to discuss.

23 MALE SPEAKER: Yeah, I think what everyone'
24 saying, it makes sense. I'd be interested to learn a
25 little bit more about what happened when the

1 thresholds were raised, what the outcomes were,
2 whether that led to more investor confidence, more
3 downside or what the risk was and what the outcomes
4 were. I don't think we received any data with how the
5 raising of the threshold impacted the companies that
6 were operating.

7 The other thing I would like to see more
8 data on is the success rates of the amounts that are
9 raised, right? So if there's -- do we have and I
10 think George might've mentioned this, but it would be
11 interesting to see if we're raising these thresholds
12 if there's a corollary with the outcomes and how
13 successful a company is.

14 I do agree that if a company is
15 undercapitalized, that opens it to other risks, but we
16 also want to be careful not to increase or create this
17 motivation to increase now that, you know, to \$250,000
18 a company might not need it, now we overcapitalize and
19 we're raising too much money. So I think these are
20 important things to weigh and just in considering
21 where that balance lies.

22 MALE SPEAKER: I agree with everyone else.
23 I also went to George's website, which this is a
24 scenario that I'm not familiar with, and I found it
25 sort of interesting to look at what he has here.

1 Thank you very much, George. Thank you.

2 MALE SPEAKER: One of the most amazing things
3 that came out of Dr. Chang's research was looking at
4 the crowdfunding and the companies that are issuing on
5 it, which is very excellent research on that. What it
6 also showed is that there is not as well an
7 understanding of who the investors are. In FINRA, the
8 FINRA Foundation through COVID, we started looking at
9 the investors. We do an actual financial capability
10 study every three years and during COVID, we looked at
11 new investors in COVID and our most recent study was
12 in January, investors of color and looking at how
13 they're investing.

14 The good news from this investor research is
15 we are seeing younger investors getting more involved
16 in the markets and they're making more diversified
17 choices. They're investing in crypto, they're willing
18 to take chances.

19 The problem is is that there's not a lot of
20 data on the investors in the crowdfunding and maybe
21 this is a way to take a look at who they are, what
22 they're willing to invest in and if they younger
23 investors are willing to invest in crypto and take
24 more risk, should they be available in taking a look
25 at what's happening in crowdfunding?

1 MS. DUGNAN: That's an excellent point and
2 just building on that, I think it would be interesting
3 to do more analysis broadly to understand alignment
4 across the stakeholders from those that are seeking to
5 issue, from the platforms to the investors to see, you
6 know, where there is alignment, what are the
7 commonalities in the factors in when those companies
8 are successful and so trying to do a more in depth
9 correlation analysis, you know, is it that we're
10 finding that companies that, you know, are X years old
11 or in certain industries and maybe they're doing an
12 equity issue, that those are more appealing to X set
13 of investors who have more money and, therefore,
14 they're more successful.

15 So who is it working for, where are things
16 well-aligned with how things are set up today? And
17 where are there sell points, so who is it not working
18 for? Because I think one of the really elegant things
19 about Reg CF is that it was designed to be a
20 capability that could potentially solve for lots of
21 different problems for accessing capital. But what we
22 don't know is where is it working well and what are
23 all of the other stall points at a more granular
24 level. We're just talking more about thematic about
25 the people but not the overall mechanics and alignment

1 of incentives across the system. And so I do think
2 that there's a great opportunity here for more in
3 depth research and analysis that could inform policy
4 and regulatory decisions.

5 FEMALE SPEAKER: I think I would add onto
6 both of those as well, I think having more data, and
7 I'm also interested in understanding how the
8 intermediaries are assessing as they go through the
9 process about what companies and what issuers they're
10 allowing to do a crowdfund on their site and I think
11 it would be interesting to have more data sort of
12 about that process to lend insight.

13 And I think building on this of like, you
14 know, are people being vetted out and why or how are
15 they being vetted out of that process?

16 MALE SPEAKER: Bailey, I've been thinking
17 about your idea around -- just to streamline it, I'm
18 going to call it a portfolio, you know, to diversify
19 risk and it would be interesting to understand if
20 people are not participating at the levels that they
21 should participate because of the risk of not success,
22 right, or not getting their money back or not seeing
23 some return because if they are, they potentially, the
24 diversifying of this, you know, I called it a mutual
25 fund in our worlds, right, but this portfolio can help

1 to diversify the risk, so I don't know if that's
2 something we can, you know, explore, but I think it
3 would have to be driven by if the reason people aren't
4 participating is because of their fear of, you know,
5 success or the return on the investment, so I just --
6 you know, I was thinking through that and thought I'd
7 throw it out.

8 MS. DUIGNAN: Yeah. And, you know, I think
9 on that, it's very important, you know, to think about
10 why we have diversification as part of portfolio
11 theory, that's because there's a tremendous amount of
12 data around public market stock returns that has
13 proven that diversification works for public market
14 stock portfolios and some other asset classes.

15 We can't just sort of wholesale without
16 returns data assume that it's going to work for
17 crowdfunding deals. So I think that's really
18 important to point out that we don't conflate the two
19 without having the data and on that note, I do think
20 it's really important that somebody, somehow can
21 actually find some real returns data on crowdfunding
22 deals. It seems like we have a lot of information but
23 no information around what actual returns to investors
24 have been and so I think that information would not
25 only be really important to investors going forward,

1 right, to have some, you know, historical looking
2 numbers but also how, you know, we make
3 recommendations in the future, so wonderful. Any last
4 minute thoughts or shall we break for lunch and resume
5 at 1:15? Okay. Wonderful. Great job this morning.
6 The committee will be breaking for lunch. Thank you
7 to everybody who is with us on Zoom or Webex, probably
8 Webex and we look forward to seeing you again at 1:15.
9 (Whereupon, at 1:15 p.m., a luncheon recess
10 was taken.)

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