Written Submission
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Committee Members,

Thank you for your invitation to join you for today's meeting.

I am pleased to have the opportunity to talk to you today, and applaud the Committee's work to provide thoughtful recommendations to the Securities and Exchange Commission on the problems facing smaller public companies.

As many of you know, I am the Chairman and CEO of WR Hambrecht + Co. WRH + Co is an innovative broker-dealer focused on providing open and fair access to financial markets for technology and emerging companies. Through our impartial auction-based offerings, we have tried to change the traditional investment banking landscape by allowing the market to determine pricing and allocations.

Because of our expertise in bringing small, fast-growing companies public, policymakers repeatedly have asked for our views concerning how best to encourage public capital formation and job creation. For several years preceding the enactment of the JOBS Act, we have endeavored to raise awareness of the capital-raising issues facing smaller public companies, and advocate changes to the offering process to permit innovative companies to access the capital they need to remain independent, continue their growth and create jobs.

In the last year and half, your Committee has made important contributions to continuing the dialogue on capital formation for smaller companies, and your recommendations on improving access to the public markets for smaller companies have focused attention on many of the most pressing issues that concern the companies that we talk to and meet every day. Today, I would like to spend my time with you discussing what I believe are the next steps in reinvigorating the capital formation process for smaller companies following the adoption of the JOBS Act, including rulemaking required under Title IV of the JOBS Act necessary to make Regulation A+ a reality, and some recommendations for reforming the initial public offering process that are intended to restore the confidence of ordinary investors in our capital markets, level the playing field for all investors by making more information publicly available during the public offering process, and improving the integrity of, and the pricing and allocation process for, IPOs.

To facilitate our discussion, I have prepared some slides that highlight some of my principal concerns.

The Death of the Small IPO

For several years now, I have spoken with policymakers about the fact that high quality initial public offerings under $50 million have become quite rare, particularly compared with offerings above that threshold. This Committee also has heard from others, including David Weild and Professor Jay Ritter, that have cited statistics regarding the decline of the IPO market in the United States.

In the aftermath of the financial crisis, there has been even more consolidation in the financial services sector, with the largest banks becoming even more significant. This consolidation and the changes in market structure, which I will address later, have had a dramatic impact on the IPO process. Average IPO deal sizes remain large. A leading investment bank, even post-JOBS Act, will not readily undertake a small IPO. This has contributed to the disappearance of listed small-cap and mid-cap companies. As shown in the slides, the number of listed companies has declined even from 2010 to 2013. It is reasonable to expect that the changes to the holder-of-record threshold made by the JOBS Act, and the ability to undertake more private offerings, will impact the number of public companies in the United States.

Venture-backed companies continue to turn to other liquidity alternatives because most of their portfolio companies will not be able to undertake IPOs. There has been a fundamental breakdown in the VC model. Early stage investors and VCs have long relied on IPOs as liquidity opportunities. Meanwhile, more and more private companies are choosing to, or have no option other than to, defer their IPOs.

Venture investors have provided the principal means for funding emerging technologies, and funding innovation. The critical role of venture-backed companies for the U.S. economy has been well recognized. The National Venture Capital Association (NVCA) in its most recent study on the economic impact of venture-backed companies has demonstrated that annually from 2008 to 2010 venture-backed companies have generated revenue equal to 21% of the U.S. GDP. Of course, venture-backed companies provide jobs. During the same period, venture-backed companies employed 11% of the total U.S. private sector workforce. Perhaps more important, most job creation by emerging companies occurs in the years immediately following their IPOs. Research commissioned by the NVCA indicates that 92% of job growth for companies occurs post-IPO.

More recently, a Kauffman Foundation report found that in the ten years after going public, the average company increased employment by 60%, representing a 4.8% compound annual growth rate.

The lack of a liquidity opportunity in the form of an IPO has left many venture-backed companies with few alternatives, other than M&A alternatives. If this trend continues, there is a very real probability that it would lead to decreases in jobs, and to fewer, larger and more dominant companies. Various academics have suggested that there may be efficiencies associated with larger companies, and that getting bigger faster is more important than in prior periods. However, it is difficult to attribute the decline in smaller IPOs to this theory.

The JOBS Act

The recognition that we needed to address these serious issues, and restart the innovation cycle in the United States in order to ensure that U.S. technology and innovation do not fall behind the rest of the world, motivated an otherwise deeply divided Congress to act together and pass the JOBS Act.

The JOBS Act was an important step toward promoting capital formation, and responding to the needs of smaller, emerging companies.

Many market developments and technological advancements have occurred over the last twenty years that have affected capital formation. Market participants and the SEC representatives have commented regularly on the need to modernize the regulation of securities offerings in order to facilitate capital formation and keep pace with change. However, there has been only relatively modest change. The regulations affecting offerings by the largest, and most mature companies, well-known seasoned issuers, or WKSIs, have undergone the most significant changes with Securities Offering Reform in 2005. Securities Offering Reform implemented changes relating to offering communications, but it did not help smaller companies with capital formation. Smaller companies were facing increased compliance costs following the passage of Sarbanes-Oxley in 2002 and the adoption of governance rules by the exchanges. Smaller public companies were finding it increasingly difficult to access the public capital markets. The high cost of underwritten offerings and difficulties associated with obtaining analyst research coverage, especially after reforms to the regulation of analyst research reports in 2003, made it undesirable for smaller public companies to undertake public offerings.

Compared to these changes to the registration process for very large companies, relatively few changes had been made to the regulation of exempt offerings despite the growing importance of the private capital markets to smaller companies and obvious deficiencies in private placement regulation that inhibit capital formation, such as the prohibition on general advertising and the Exchange Act holder-of-record threshold. Smaller companies, which are more dependent on private capital formation, were disproportionately and negatively affected by these issues.

The principal legacy of the JOBS Act may well be its effect on exempt offerings through the required relaxation of the prohibition on general solicitation, the offering exemption for crowdfunding, the change to the holder-of-record threshold, and Regulation A reform. We share the sense of urgency expressed by the Committee to have the SEC finalize the rules required to eliminate the ban on general solicitation and general advertising in Rule 506 and Rule 144A.

The IPO On-Ramp

The centerpiece of the JOBS Act, the Title I "IPO on-ramp" provisions, already are proving a success with more than 150 companies taking advantage of the accommodations made available by Congress for emerging growth companies (EGCs).

When an issuer qualifies as an EGC, it may take advantage of a number of benefits in connection with its IPO and subsequent public reporting and corporate governance.

For example, an EGC will not be subject to the Say-on-Pay, Say-on-Frequency or Say-on-Golden Parachute vote required by the Dodd-Frank Act. An EGC is not subject to any requirement to disclose the relationship between executive compensation and the financial performance of the company, or any requirement to disclose the CEO's pay relative to the median employee's pay. An EGC is not be required to adopt any update to FASB's Accounting Standards codification after April 5, 2012 that has different effective dates for public companies and private companies until those standards apply to private companies. Under this provision, EGCs are able to take advantage of the extended transition period in those situations where there are different effective dates specified for private companies. An EGC is not subject to any potential rules or standards requiring mandatory audit firm rotation or a supplement to the auditor's report that would provide additional information regarding the audit of the company's financial statements (auditor discussion and analysis), should such requirements ever be proposed or adopted by the Public Company Accounting Oversight Board (PCAOB). None of these accommodations weakens the corporate governance framework for EGCs, but they do serve to eliminate a psychological barrier that arose post-Sarbanes-Oxley for many smaller companies that caused them to defer their IPOs.

The ability to submit a registration statement for confidential review also has proven to be valuable to companies. The SEC Staff worked quickly to put in place a seamless system for confidential submissions. The review process has been working efficiently. For companies that are concerned about any stigma that may result from having to withdraw an IPO filing, the confidential review process provides them with additional comfort. They can work with their counsel and advisers and move the process forward without committing publicly to a transaction.

During the confidential phase, or afterward, a company now can test the waters and pre-market. Although the market is still proceeding cautiously with test-the-waters discussions, the ability to engage institutional investors is valuable to issuers that would like to share their story and get feedback. Over time, I would expect that the market will grow more comfortable with these pre-marketing discussions.

The disclosure accommodations also have been helpful to issuers. Most issuers have relied on the ability to omit more detailed discussions relating to executive compensation. There is more work to be done on streamlining IPO and offering related disclosures, which I will discuss later.

Finally, the IPO Task Force recognized that research analyst coverage is essential for public companies, and Title I of the JOBS Act attempts to promote access to research by eliminating the artificial IPO quiet periods and making pre-deal research reports possible. However, this is another area where more work needs to be done.

Smaller Company IPOs and the On-Ramp

Before the IPO on-ramp provisions were even contemplated, in fact, even before the JOBS Act was contemplated, we were engaged actively in discussions focusing on the need to revise and revitalize Regulation A in order to promote public capital raising by smaller companies.

I testified before the House Committee on Financial Services in December 2010 on the need to modernize and amend Regulation A as a means of addressing the capital raising needs of smaller companies.

Although the JOBS Act did not amend Regulation A in the manner we advocated, the Act does expressly contemplate the prospect of a capital-raising alternative similar to Regulation A in Title IV. Section 401 of the JOBS Act creates a new subsection (2) to Section 3(b) of the Securities Act of 1933, as amended (the "Securities Act") that requires that the SEC adopt an exemption allowing companies to issue publicly up to $50 million in securities, subject to certain conditions and requirements.

This Committee has not recommended that the SEC take action on Regulation A+, and, in fact, you might wonder why Regulation A+ is needed given the availability of the IPO on-ramp provisions.

Well, I know you share my concern about the availability of capital for smaller companies. For smaller companies, the IPO on ramp is still too steep a climb.

As I mentioned earlier, the dynamics of investment banking have changed. There are fewer investment banks. The boutique firms and the smaller regional firms have disappeared. The financial incentives have changed for the firms that remain. Most investment banks are not interested in $50 million (or smaller) IPOs; however, smaller offerings often result in enormous successes.

It is easy to forget that many of our most successful companies, household names, came to life as public companies through small IPOs. These offerings would not get done today.

In July 1986, Adobe Systems filed to sell to the public 500,000 shares at $10 to $11 dollars – approximately $5 million. The company was only four years old and had 49 employees. The public markets provided the capital for the company to grow to over $4 billion in revenue with close to 10,000 employees. Probably far more important than the jobs created at Adobe itself, were the jobs created at the thousands of companies using its PostScript and Illustrator software. Public financing allowed Adobe to stay independent of any particular OEM (e.g., Apple, Xerox, or Microsoft) ensuring that the dissemination of its technology would not be limited by the strategic decisions of a single computer manufacturer.

Adobe is not the only industry leader to have raised only a small amount in its IPO. Starbucks, Yahoo, AOL, Peet's Coffee, Whole Foods, Panera Bread, Odwalla, Intel, Amgen, Oracle and Cisco all raised less than $50 million in their IPOs. By today's standards these offerings would be considered too small for any investment bank to undertake, forcing the Starbucks and Adobes of the future to rely on private investments or strategic acquirers to fund (and sometimes limit) their growth. Worse yet, many small, promising companies are relegated to relying on finders or smaller broker-dealers promoting, as "public" alternatives, reverse mergers, SPACs, or back-door quotations on the OTC Bulletin Board.

The JOBS Act does not really change the options for these small, promising companies. Perhaps, post-JOBS Act, these companies might look to complete a series of Regulation D offerings, or look to crowdfunding to supplement the money raised in Regulation D offerings. Neither option (Regulation D offering or crowdfunding) would provide any liquidity opportunity for the company's venture backers.

So, for these smaller companies, that only need to raise up to $50 million to carry out their business plan, an IPO, even with the on-ramp, even if an investment bank were prepared to undertake a small offering, would still prove too expensive and burdensome a process. Of course, after completion, there would be no assurance that there would be any market makers for its securities and no assurance that there would be any research coverage. Economic incentives would make it unlikely.

Based on our discussions with venture capital firms and lenders to small growth companies, we believe that there are approximately 5,000 private companies that should be candidates for IPOs in a properly functioning public capital market.

Regulation A+

We believe that Regulation A+ would provide an important capital-raising alternative for smaller companies. In fact, for many smaller companies, a Regulation A+ offering, with an accompanying exchange listing, would function as an IPO.

Of course, this would require a thoughtful approach to rulemaking.

To this end, we have provided our comments to the SEC and met with SEC Staff to discuss a framework for Regulation A+ that would:

- incorporate disclosure requirements;
- require SEC review;
- include the possibility (for those companies that seek to become reporting companies) of an exchange listing; and
- involve a coordinated SEC and state process.

Creating a viable and flexible offering framework also will require working with the exchanges and promoting research support.

Our comment letter and the slides outline our principal recommendations for Regulation A+.

We believe that a Regulation A+ offering that results in a public company with an exchange listing would be favored by early-stage and venture investors as a liquidity opportunity. Also, it should be favored by anyone concerned with investor protection and job creation.

With Regulation A+ structured as a realistic potential mechanism for gaining liquidity, venture capital investors will be more likely to invest in promising new companies. They will know that there is a lower dollar threshold (lower than the $100 or $150 million that has become the de facto IPO minimum) than that essentially required for the traditional S-1 approach. The possibility of a quicker entry into the public markets will encourage VCs to deploy capital into enterprises at earlier stages of development. Regulation D offerings, even with the growth of private secondary markets, cannot offer this liquidity.

From an investor protection perspective, the debate concerning general solicitation has been surprising. But I have been even more surprised by the suggestion that Regulation A+ may create investor protection issues. State securities regulators and others have suggested that only offerings made to QIBs or "qualified purchasers," as defined under the Investment Company Act of 1940, should be exempt from state review. The GAO Study on the current Regulation A showed that there are many factors that have limited the utility of Regulation A, including the $5 million threshold and the state securities considerations. Any new Regulation A+ framework should be flexible, while providing for substantial public disclosure. Otherwise, an issuer will just turn to a Rule 506 offering to accredited investors (with no information requirement) that is exempt from state securities review. Or, an issuer may turn to a "back-door" IPO through an OTC-BB listing. Neither of these approaches will lead to more strong, innovative public companies. Or, good jobs.

While other provisions of the JOBS Act have rulemaking deadlines, such as the provisions relating to crowdfunding, the provisions of Title IV have no rulemaking deadline.

I would like to encourage the Committee to consider the important role that Regulation A+ offerings could play in reviving the small company IPO market and reinvigorating the capital markets, and urge the Committee to recommend that the SEC Staff address the required rulemaking promptly, ahead of crowdfunding.

<u>The IPO Market</u>

I would like to conclude with a few thoughts on the IPO market generally. There is additional work to be undertaken to revive the U.S. IPO market and to restore investor confidence in the IPO market.

In 2003, I participated on the NYSE/NASD IPO Advisory Committee. The New York Stock Exchange and the NASD convened the Committee at the request of the SEC Chairman with the stated objective of reviewing the IPO underwriting process, especially issues relating to price setting and allocations, and recommending changes to the SEC. Many of the Committee's recommendations ultimately were adopted and helped to restore integrity to the IPO process. It is time that we consider closely additional changes that will help revitalize the U.S. market.

As I noted at the outset today, there have been many, many factors that have contributed to the decline of the U.S. IPO market. These include the consolidation in banking, which I have discussed; the shrinking of the institutional brokerage business; the perceived dysfunctions of the underwriting business; an increased short-term or trading bias that has resulted in increased shorting activity, front running and market volatility; the increased costs of an IPO and the increased costs associated with being a public company, including litigation costs; structural changes which have cut or driven the ordinary investor out of the market; and the disappearance of regional exchanges. These are by no means all of the changes. We could catalogue additional factors that have played a part in the decline of IPOs, but I believe that these are the most significant.

Here are some recommendations for the Committee to consider:

Eliminate deep discount pricing in IPOs. Underwriters have an incentive to underprice IPOs in order to create "guaranteed profits" for certain clients. This underpricing attracts trading-oriented accounts that are not interested in holding shares of the IPO issuer as a long-term investment. The issuer also raises less proceeds than demand would allow. In order to eliminate underpricing in IPOs, underwriters should be held more accountable for the pricing determinations. This could be accomplished by introducing a "best execution" rule for IPOs, which are currently exempt from the best execution rule. The SROs have been quite successful at promoting better broker-dealer pricing in the equity secondary market. For secondary market trades, broker dealers are required at all times to seek the "best market" – regardless of their individual economic interests. The use of new technologies has made it easier to access these alternatives, with significantly increased liquidity and substantial reductions in transaction costs. In contrast, the traditional IPO book-building process remains closed and opaque. The IPO market pricing mechanism currently resides outside of the framework of rules and regulations that govern conduct to insure best execution to both buyer and seller. The notion that an underwriter is a principal given the "bought deal" nature of the underwriting transaction is not compelling, since the vast majority of deals are fully sold immediately to new buyers. Underwriters will typically wait until an IPO is oversubscribed before they make their firm commitment to the issuer, which essentially makes the IPO resemble an "agency" transaction. We should do everything we can to bring this market under similar rules so that the underwriter has a fiduciary duty to find the best execution for an IPO.

Make IPO shares available through a selling group to bona fide buyers. IPOs are allocated principally to institutional investors. Underwriters allocate stock to their preferred clients. In recent years, hedge funds have become important clients for investment banks. In fact, one might say that hedge funds may be more important clients than the IPO issuers. If an underwriter is permitted to limit the recorded demand for an offering to select clients and to allocate shares at its whim, it will inevitably be tempted to underprice. This underpricing creates a guaranteed profit, which ensures that potential investors will emerge to bid on the value created. Even if, as expected, the SROs limit excessive underwriter compensation in the form of inflated commissions, potential investors or other related parties will find other ways to compensate an underwriter for that value. Some portion of an IPO should be made available to ordinary investors through selling group members.

Require underwriters to provide the issuer and the SEC with the final IPO allocations. Underwriters should be required to provide the issuer and the SEC (confidentially) with the final allocations so that there is additional transparency regarding the distribution of IPOs.

Encourage alternatives to the book-building process, including auctions. In Congressman Issa's letter to then SEC Chair Mary Schapiro following the Facebook IPO, Congressman Issa raised a number of interesting questions about the book-building process, which remains the dominant approach in the United States. Outside of the United States, some modified book-building approach prevails wherein ordinary investors have an opportunity to participate. An auction component may help in this regard. We have had limited experience with auctions to date; however, if one looks at the most successful IPOs of the last several years, it is notable that there are [six] auction IPOs among this group. Auction-based approaches permit ordinary investors to participate, and help remedy underpricing and similar pricing discrepancies.

Level the playing field for ordinary investors. We need to continue to find ways to level the information playing field in order to promote investor confidence in the IPO process. The general regulatory trend has been to eliminate the selective disclosure of information to various investor classes. Regulation FD has been successful in putting individual investors on the same level as institutions in terms of access to information on public companies. The legacy IPO process is conspicuously exempt from that requirement. Regulation FD should be made applicable to IPOs. In addition, the SEC should require that an issuer's road show presentation be made publicly available, so that all investors can access the road show presentation and listen to management explain the investment proposition and respond to institutional investor questions. Finally, all research regarding an IPO should be made available to all investors.

Review disclosure requirements. Title I of the JOBS Act requires that the SEC undertake a study of the disclosure requirements in Regulation S-K. I would encourage the SEC Staff to consider the current state of IPO disclosures. Most IPO prospectuses are now hundreds of pages, with thirty to forty pages of risk factors. The same can be said of the offering documents for many follow-on offerings. Investors are suffering from an information overload. It becomes quite challenging for an ordinary investor to identify the principal or most material risks to a company's business if the investor has to read through thirty to forty pages of risks. Issuers should be made responsible for identifying the principal risks and, in the context of the MD&A discussion, the principal trends affecting their business.

Reform the litigation process. Of course, many issuers and their counsel would be reluctant to remove any risk factor from an IPO prospectus given the litigation environment. We live in an incredibly litigious country. We cannot expect to rationalize disclosures and address information asymmetries without addressing the litigation environment. I have been told that many investment banks are concerned about taking advantage of the disclosure accommodations available to emerging growth companies under the JOBS Act because disclosures will be questioned in hindsight. Likewise, I have been told that investment banks are concerned about publishing research too soon after an IPO due to liability concerns.

Conclusion

When it enacted the JOBS Act, Congress took an important step toward promoting capital formation, fostering innovation, and creating good jobs in the United States. Yet one step in the right direction will not be sufficient to deliver on the promise that the JOBS Act holds for emerging companies. It is now up to the SEC to take the next steps and move promptly to adopt final regulations to implement the mandate in Title II of the JOBS Act and remove artificial restrictions on offering communications in connection with Rule 506 and Rule 144A offerings, and complete the required study on the disclosure requirements contained in Regulation S-K.

While there is no specific deadline for the SEC to undertake rulemaking on Regulation A+, I hope that this Committee will join me in recommending that the SEC Staff make Regulation A+ a high priority. Crowdfunding has certainly captured the imaginations of many and certainly presents a populist and democratic approach to capital-raising that may be appealing to many. However, crowdfunding will not be able to provide emerging companies with sufficient capital to grow and will not provide early stage and venture capital investors with a liquidity opportunity. A Regulation A+ offering that raises up to $50 million in offering proceeds and involves a contemporaneous exchange listing provides substantial funding to fuel a start-up's growth. And, the Congressional mandate was clear: Congress intended to facilitate capital aggregation and promote investment in emerging companies. The IPO "on-ramp" will not necessarily be appropriate for issuers of all sizes, across all industries. Finally, we should continue to take steps to restore the confidence of ordinary investors in the IPO process, and level the playing field by making information about IPO issuers available to all investors.

Many thanks for allowing me to join you today.