

THE UNITED STATES SECURITIES AND EXCHANGE COMMISSION

SMALL AND EMERGING COMPANIES  
ADVISORY COMMITTEE

Wednesday, February 15, 2017

9:30 a.m.

U.S. Securities and Exchange Commission  
100 F Street, NE  
Washington, D.C. 20549

1 APPEARANCES:  
 2 Michael S. Piwowar, Acting Chair  
 3 Kara M. Stein, Commissioner  
 4 Sara Hanks  
 5 Shelley Parratt  
 6 Betsy Murphy  
 7 Robert L. Aguilar  
 8 Brian Hahn  
 9 Jenny Kassar  
 10 Catherine V. Mott  
 11 Jonathan Nelson  
 12 Patrick A. Reardon  
 13 Lisa Shimkat  
 14 Annemarie Tierney  
 15 Laura Yamanaka  
 16 Michael Pieciak  
 17 Michele Schimpp  
 18 Sebastian Gomez  
 19 Julie Davis  
 20 Richard I. Alvarez  
 21 Martin A. Hewitt

1 PROCEEDINGS  
 2 MS. HANKS: Okay. Good morning and welcome.  
 3 Welcome to the Advisory Committee on Small and  
 4 Emerging Companies. And first I need to ask Sebastian if we  
 5 have a quorum for the meeting. Are we quorred?  
 6 MR. GOMEZ: We do, Sara.  
 7 MS. HANKS: Okay, excellent.  
 8 I am Sara Hanks and I am here without my co-chair,  
 9 Steve Graham, this morning. He is by the side of his wife,  
 10 Joanne, who is recovering successfully from a major surgery.  
 11 Steve, if you're watching this, know that everybody  
 12 in this room is thinking of you and sending thoughts and  
 13 prayers for Joanne's continued recovery, and we are looking  
 14 forward to seeing you next time.  
 15 We have a wide-ranging agenda today. We are  
 16 starting this morning with a discussion on the limited  
 17 liquidity in secondary markets for holders of shares of  
 18 smaller companies. We want to focus in particular on two  
 19 types of companies, companies that are providing annual and  
 20 semiannual reports following a Regulation A, Tier 2 offering;  
 21 as well as SEC registered and reporting companies who are  
 22 filing quarterly reports but are not listed on any exchange.  
 23 We have asked two preeminent blue sky lawyers to  
 24 present to the committee in order to help us navigate these  
 25 issues, because as you know one of the problems in this area

1 APPEARANCES(CONT):  
 2 James A. Hutchinson  
 3 Glen Giovannetti  
 4 Yanev Suissa  
 5 Joanne Rutkowsky  
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1 is that there is no state preemption for resales of these  
 2 securities.  
 3 Following that, we are going to return to a topic  
 4 of long-held interest to many of us, the broker-dealer status  
 5 of finders; that is, people who help small companies find  
 6 sources of capital. During our October meeting, we received  
 7 an update on this topic from Stephen Luparello, the then-  
 8 director of the Division of Trading and Markets. It was  
 9 clear at that time that there was nothing in the immediate  
 10 works in terms of rulemaking or other division action to  
 11 redefine the definition of broker-dealer. So we are going to  
 12 spend some time this morning discussing whether we'd like to  
 13 reiterate, once again, a recommendation for action in this  
 14 space.  
 15 After lunch, we're going to take up a question that  
 16 many have been asking, which is why are more companies  
 17 choosing to stay private. Or, to put it a different way, why  
 18 aren't more companies choosing to do an IPO. We are going to  
 19 be joined by a lawyer, accountant and a venture capitalist  
 20 who have lots of direct experience with companies making  
 21 these decisions and it's going to tee up a very interesting  
 22 discussion.  
 23 Finally, I am hoping that we are going to finalize  
 24 our recommendation to the Commission regarding diversity on  
 25 corporate boards and the ways that the SEC's disclosure

1 requirement in this area could be improved.

2 But before we move into the agenda for the day, we

3 are pleased to have with us this morning for opening remarks

4 Acting Chairman Mike Piowar and Commissioner Kara Stein.

5 Chairman Piowar.

6 COMMISSIONER PIOWAR: Thank you, Sara. Good

7 morning, everyone. And, Steve, if you're listening, as Sara

8 mentioned, all of us are sending our best wishes your

9 direction.

10 I've always enjoyed these advisory committee

11 meetings and I am pleased to be here in my new role as acting

12 chairman.

13 I'd like to extend a special welcome to our newest

14 committee member, Michele Schimpp, who is representing the

15 Small Business Administration. We very much appreciate

16 having the SBA's insights and we look forward to working with

17 Michele. Welcome.

18 No matter where you are in the United States, small

19 and emerging companies raise the tide for so many people to

20 succeed. The freedom to innovate and grow has always been

21 fundamental to American success. And we, as regulators, must

22 constantly assess how our work meets the needs of today's

23 innovators. That's why this committee is so valuable.

24 Committee recommendations put forward in early 2012

25 about lifting the ban on general solicitations, expanding

1 Regulation A and raising the Section 12(g) registration

2 thresholds helped lead to the enactment of the JOBS Act. In

3 2015, the committee recommended that the Commission modernize

4 Rule 147 to help facilitate interstate offerings and I'm

5 pleased the Commission did just that.

6 As of last month, the related rule -- amended Rule

7 504 is now in effect, and the new Rule 147A will go into

8 effect in April, providing more options for companies looking

9 to raise capital.

10 The committee also recommended raising the

11 financial thresholds in the smaller reporting company

12 definition to expand the number of smaller companies that

13 qualified for scaled disclosures. In line with that

14 recommendation, the Commission proposed amendments to raise

15 those thresholds last year.

16 The list of your valuable recommendations and

17 discussion topics goes on and on. And it seems Congress was

18 so impressed with your efforts that in December it codified

19 the committee into law. The bipartisan Small Business

20 Advocate Act of 2016 put into the Exchange Act two new

21 provisions. The first establishes the Office of the Advocate

22 for Small Business Capital Formation, headed by a new

23 advocate for small business capital formation. The second

24 establishes a Small Business Capital Formation Advisory

25 Committee. These are parallel provisions to the Dodd-Frank

1 act that established the Office of Investor Advocate and the

2 Investor Advisory Committee.

3 I am proud to say that we are already taking steps,

4 including working with our appropriations committees, to

5 stand up the new office. I anticipate that we will begin the

6 search for a new advocate for small business capital

7 formation in the near future. The law requires that the new

8 advocate be someone who is not a current SEC employee, so I

9 hope you all will encourage good candidates that you may know

10 to apply.

11 In the meantime, we want you to continue down this

12 exciting path. The charter of this advisory committee

13 doesn't expire until September and I know that between now

14 and then you will continue your efforts to bring forward

15 ideas to facilitate capital formation for small and emerging

16 companies.

17 Your agenda today, as Sara mentioned, secondary

18 market liquidity, finders and why companies are not going

19 public reflect important topics facing small and emerging

20 companies. Secondary market liquidity for shares being held

21 by investors in Reg A securities is becoming an increasingly

22 important issue.

23 Between June 19, 2015, the day when amendments to

24 Reg A took effect, and January 31 of this year, there were

25 181 offerings filed using Regulation A. One hundred and

1 three which have been qualified by SEC Staff for the issuer

2 to begin making sales; 28 issuers have reported selling

3 approximately \$259 million in the aggregate.

4 I look forward to any recommendations on ways to

5 remove frictions that may stand in the way of investors being

6 able to readily exit their investment.

7 I'm also pleased that you are discussing why more

8 companies are choosing not to go the route of an IPO. While

9 the menu of capital raising choices available today for small

10 businesses presents more flexibility and more alternatives

11 than ever before, there is always more we can do to provide

12 robust public capital markets.

13 I look forward to your input on these and the other

14 topics on your agenda today.

15 Thank you again for your service on this committee

16 and your continued commitment to facilitating capital raising

17 by small businesses.

18 MS. HANKS: Thank you.

19 Commissioner Stein.

20 COMMISSIONER STEIN: Thank you. I also want to

21 extend my thoughts and good wishes to Steve and his wife.

22 Welcome, Michele.

23 Good morning to everyone else. In this dynamic

24 environment, I think the ability to work on consensus topics

25 is even more important. This committee remains focused on

1 fostering and supporting healthy marketplaces for fledgling  
2 smaller companies while protecting investors. And this is a  
3 focus that we can all stand behind. And your commitment and  
4 work towards this goal, as always, is much appreciated.

5 Today's agenda reexamines topics that have been  
6 previously discussed. But we now have the added benefit of  
7 the inflow of initial information and data about how certain  
8 JOBS Act regulations are working in practice.

9 One aspect of your discussion concerns secondary  
10 market liquidity for smaller companies that are using the new  
11 Reg A Plus reg, you know. And secondary market liquidity, I  
12 think, from my perspective, is a rather complicated topic.  
13 For example, our Equity Market Structure Advisory Committee  
14 has also looked at this issue.

15 One of the things that's been most interesting to  
16 me is the availability of more data and current research that  
17 seems to be informing us on the role of information and  
18 transparency and the relationship to secondary market  
19 liquidity and firm value for OTC firms.

20 While your discussion today may be primarily  
21 focused on state securities laws and their impact on  
22 secondary market liquidity, I don't think it needs to end  
23 there. Blue sky requirements that apply to secondary sales  
24 of Reg A securities also are intended to provide a layer of  
25 protection for investors against fraudulent activities within

1 each state in which the transactions occur. I think from my  
2 perspective, state laws have often provided a protective  
3 guardrail in an attempt to balance efficient capital  
4 formation with robust investor protections.

5 That said, I mean, I think it's fair to examine  
6 whether the current blue sky regime may negatively be  
7 affecting secondary market liquidity. I'm particularly  
8 interested in learning more about how compliance with state  
9 securities laws is working for Reg A, non-exchange listed  
10 securities.

11 I look forward to the discussion of the pros and  
12 the cons of blue sky laws and what if any improvements need  
13 to be made.

14 Finally, if there are inefficiencies with blue sky  
15 compliance regimes, how can the current regime be adjusted?  
16 For example, is there a means by which NASAA, working with  
17 the states, can improve the availability of manual exemptions  
18 across more states?

19 The other item on your agenda that I'm sure will  
20 generate significant discussion concerns the relative lack of  
21 IPOs as compared to prior periods. What does the data  
22 reveal? What are the current observations and explanations?

23 I can tell you again from my perspective, depending  
24 on what market participant you talk to, they have very  
25 different explanations.

1 One thing I'm interested in is has the JOBS Act  
2 provisions that changed the registration thresholds or  
3 basically that have allowed for greater private capital  
4 raising contributed in any way to companies remaining private  
5 for a longer period of time? And I think that's another  
6 thing we should be thinking about, is how different JOBS Act  
7 provisions interacted with one another.

8 I look forward to the discussion and I hope we'll  
9 delve into the very factors that are changing this whole  
10 ecosystem of our markets for capital formation, including the  
11 effects of the economic environment and the regulatory  
12 structure.

13 Finally, you will also consider recommendations on  
14 broker-dealer finders and board diversity. I very much look  
15 forward to the discussion and those recommendations.

16 And thank you again for your time and commitment to  
17 helping us think through these issues.

18 MS. HANKS: Thank you, commissioner.

19 Now we are going to quickly turn to the SEC Staff,  
20 from the Division of Corporation Finance. We send our best  
21 wishes to Keith Higgins, who has moved on after more than  
22 three years as the division's director. I am reliably  
23 informed that he left just in time to enjoy staying up late  
24 on a school night to watch the New England Patriots win the  
25 Super Bowl, which I am equally reliably informed is something

1 to do with American football. Who the hell knows.  
2 (Laughter.)

3 MS. HANKS: The division is now in the capable,  
4 skilled and steady hands of Acting Director Shelley Parratt,  
5 and we are very pleased to have her this morning.

6 Shelley.

7 MS. PARRATT: Thank you, Sara.

8 Good morning. Good morning Acting Chairman  
9 Piwowar, Commissioner Stein, and the committee members. I am  
10 very happy to be here with you this morning.

11 This is my first time speaking at one of your  
12 advisory committee meetings and, as part of the leadership of  
13 the division's disclosure review program, I have always  
14 appreciated your thoughtful discussions and have carefully  
15 watched you develop recommendations. I am pleased to have  
16 this opportunity to thank you in person for your time and for  
17 sharing your experience and insights with the Staff, the  
18 Commission and the public.

19 Each and every Staff member in the Division of  
20 Corporation Finance takes seriously the agency's charge of  
21 facilitating capital formation while at the same time  
22 protecting investors. We will be listening closely to your  
23 discussion this morning on ideas to improve secondary market  
24 liquidity for investors which, in turn, should help  
25 facilitate capital formation for issuers. We also look

1 forward to your afternoon discussion and welcome any ideas  
2 you may have that would promote further activity in the IPO  
3 market.

4 Before closing, I want to acknowledge the other  
5 members of the Corporation Finance Staff at the table with  
6 me. To my right, Betsy Murphy, a very important member of  
7 the division's senior leadership. Next to Betsy is Sebastian  
8 Gomez, the chief of the Office of Small Business Policy. And  
9 to his right is Julie Davis, the senior special counsel in  
10 that office.

11 As you are all well aware, I need to give the  
12 standard disclaimer for any Staff member speaking today,  
13 which is that any remarks made by any of the SEC Staff  
14 members reflect his or her own views and not necessarily  
15 those of the Commission or any other member of the Commission  
16 Staff.

17 And with that, I'd like to thank you for letting me  
18 join you this morning and I look forward to listening to your  
19 discussions.

20 MS. HANKS: Thank you, Shelley.

21 So we're going to move on to the secondary market  
22 liquidity. As you've known, over the course of the last few  
23 years in a variety of formal and informal ways, this  
24 committee has taken up issues surrounding the lack of  
25 sufficient liquidity in the securities of small companies.

1 Today, we would like to focus more narrowly on the topic of  
2 secondary liquidity in the context of issuers that are  
3 subject to ongoing reporting requirements and thus have  
4 updated information available in the marketplace.

5 In the case of a company that's done a Regulation A  
6 offering, they are obligated to file on EDGAR annual and  
7 semiannual ongoing reports and current reports. Companies  
8 that have done a public offering, i.e., registered public  
9 offering, they are subject to the ongoing disclosure regime  
10 which includes quarterly reports.

11 The availability of these ongoing updates means  
12 there is available information to help establish pricing and  
13 transparency in the secondary market. Yet, as we have heard  
14 in our previous discussions, investors in Reg A securities  
15 are likely to have a difficult time when they are ready to  
16 resell their shares. One key factor in this space is the  
17 friction that comes with having to find state exemptions for  
18 each trade, since blue sky -- state blue sky laws do apply to  
19 secondary sales.

20 We have invited today two highly regarded attorneys  
21 who specialize in blue sky matters and can help educate us on  
22 the current legal framework.

23 First, I would like to introduce Richard Alvarez,  
24 principal of the Law Office of Richard Alvarez. Richard  
25 currently serves as vice chair of the State Regulation of

1 Securities Committee of the ABA, American Bar Association.

2 And next to him is Martin Hewitt. Martin is chair  
3 of the same state regulation securities committee of the ABA.  
4 Martin may look familiar to you because he often attends  
5 these meetings and the SEC staff think maybe he's a member of  
6 the advisory committee fan club.

7 (Laughter.)

8 MS. HANKS: We're very happy to have both of you  
9 here to share your expertise and help us delve further into  
10 this very important topic.

11 And I think Richard, you're going to go first?

12 MR. ALVAREZ: Yes, I will. Thank you, Sara.

13 MS. HANKS: Thank you.

14 MR. ALVAREZ: Unfortunately, I didn't bring my own  
15 membership key for the advisory committee. Martin decided  
16 not to share that with me.

17 MS. HANKS: We're designating you a member right  
18 now.

19 MR. ALVAREZ: Thank you, Sara. That's very  
20 gracious.

21 (Laughter.)

22 MR. ALVAREZ: Good morning, everyone. Thank you  
23 for inviting Martin and I to speak with you today on the  
24 topic of blue sky compliance that is applicable to Reg A  
25 Plus, Tier 2 offerings and, more broadly, to the securities

1 of nonlisted, nonreporting, publicly traded companies.

2 I would like to particularly thank acting  
3 Commissioner Piwowar and Commissioner Stein for their  
4 comments and certainly for their continued support in  
5 promoting the work done by this advisory committee.

6 Our presentation this morning will offer our views  
7 on the effects of state blue sky regulations on promoting or  
8 hindering secondary market liquidity for Reg A Plus, Tier 2  
9 offerings. And our discussion will hopefully be in the  
10 structure of a point, counterpoint presentation. We're not  
11 quite Kudlow and Cramer, for those of you who have long  
12 memories, but hopefully providing countervailing viewpoints.

13 Let me start basically at the end. I believe that  
14 secondary market liquidity for Reg A Plus offerings, and for  
15 securities of nonlisted, nonreporting public companies will  
16 never be fully achieved unless the blue sky laws and  
17 regulations that are applicable to secondary market  
18 transactions in these securities are preempted by federal  
19 law, either through congressional action or through SEC  
20 rulemaking, to revise and enhance existing provisions dealing  
21 with transactions in these securities in the secondary  
22 markets.

23 For the reasons I will explain in detail further on  
24 in our presentation, it is clear to me from the vantage point  
25 of over 30 years having dealt with blue sky -- state blue sky

1 law issues, that while likely unpopular with many state  
 2 regulators, the existing state regulatory framework that is  
 3 applicable to secondary trading activities for certain types  
 4 of securities and market participants has become overly  
 5 burdensome, rooted in a view of a national securities market  
 6 that defers to larger, more mature companies at the expense  
 7 of newer and untested companies. This bias has the effect of  
 8 stunting growth and innovation and is not, in my view,  
 9 responsive to both the rapid evolution of the markets  
 10 resulting from technological innovation, and to the shifting  
 11 imperatives of Congress reflecting the desires of their  
 12 constituents for greater opportunities for capital formation  
 13 and investment opportunities.

14 This is not to say, of course, that these  
 15 imperatives demand that investor protection, which is one of  
 16 the principal mandates of state regulators, should be  
 17 diminished or eliminated. However, to me, it does mean that  
 18 as securities markets evolve and the objectives of the  
 19 markets overall change by emphasizing the importance of  
 20 capital formation and job creation through more robust  
 21 marketing opportunities for issuers and investors alike,  
 22 existing regulation should also evolve. Oftentimes,  
 23 evolution cannot be incremental. Disruptive change is  
 24 sometimes necessary.

25 At this point, I would like to sidebar for a moment

1 to give a brief overview of the state of play regarding state  
 2 regulatory secondary market trading exemptions. As we all  
 3 know, the securities of companies who are listed on a  
 4 national securities exchange enjoy full preemption.  
 5 Certainly, the listing standards and the abundance of  
 6 available real time information for those companies offers  
 7 the basis for reducing the amount of needed regulatory  
 8 scrutiny.

9 Preemption is also available for securities that  
 10 are the subject of nonissuer secondary market transactional  
 11 exemptions under Section 4(a)(1), that is for transactions by  
 12 a person other than an issuer, underwriter or a dealer, and  
 13 for broker transactions executed in reliance on 4(a)(3) of  
 14 companies who report under 13 and 15d of the Exchange Act.

15 We should note here that for securities that are  
 16 sold in reliance on 4(a)(3), while enjoying covered  
 17 securities status, there are a handful of states that  
 18 obligate an issuer to file a notice to claim preemption, if  
 19 you will, for securities to be eligible to be traded in their  
 20 state in reliance on that preemptive provision.

21 There is also a federal preemption of state  
 22 regulation enjoyed by transactions in securities made in  
 23 reliance on Section 4(a)(4) of the '33 Act, which deals with  
 24 unsolicited broker transactions. It would seem obvious that  
 25 that exemption has some limitations, particularly in the

1 context of a desire to create and develop a robust secondary  
 2 market in -- in outstanding securities. Certainly, if a  
 3 broker cannot solicit its customers, it cannot create a  
 4 market. And certainly if a -- if a broker seeks to share its  
 5 research for a particular company with its clients, that will  
 6 also defeat an assertion that the transaction, if it were  
 7 initiated by the client, would be wholly unsolicited, making  
 8 that exemption unavailable.

9 There is also an institutional investor exemption,  
 10 which all of you are familiar with. Again, that focuses on  
 11 the nature of the investor as opposed to the type of  
 12 transaction. Although transactions with institutional  
 13 investors don't enjoy covered security status, it is a  
 14 universal exemption at the state level. The trouble, of  
 15 course, in mentioning that exemption in the context of Reg A  
 16 Plus, Tier 2 offerings or for the securities of small  
 17 emerging growth companies is that that category of investor  
 18 is not normally found making investments for those -- in  
 19 securities of those issuers. So I question whether, in the  
 20 discussion about developing a robust secondary liquid market  
 21 for Reg A Plus, Tier 2 issuers and securities of  
 22 nonreporting, nonlisted public companies, whether the  
 23 institutional investor exemption has any real validity.

24 Last but certainly not least is the exemption that  
 25 Sara mentioned, the so-called manual exemption. Most of you

1 are familiar with the state exemption that is currently  
 2 available in, depending on who you speak to, 39 or 44 states.  
 3 And there, that simple statement demonstrates why this is  
 4 such a problem area. There is not even unanimity on which  
 5 states actually offer an exemption that us usable for  
 6 secondary market purposes.

7 Well, what does the manual exemption provide? It  
 8 offers an exemption for secondary trades in -- by -- by  
 9 nonissuers through a licensed broker-dealer, provided that  
 10 the issuing company has financial and other information  
 11 published in a -- in a designated standard manual. Up until  
 12 the middle of last year, the two main reporting manuals were  
 13 Emergence and Standard and Poor's. Standard and Poor's has  
 14 given up the ghost and is no longer involved in this space.  
 15 However, I do understand that the OTC Markets has been  
 16 developing its own manual to replace -- I suppose to replace  
 17 the Standard and Poor's manual. And that is their Best  
 18 Markets. And, as I understand it, with Vermont -- Michael --  
 19 his state leading the way, it is now an accepted manual in 19  
 20 jurisdictions. I think that's right. With two others on  
 21 board to adopt the manual as part of its manual exemption.

22 The obvious problem for purposes of our discussion  
 23 this morning with the manual exemption is the, A, the lack of  
 24 complete coverage in all 54 U.S. jurisdictions of that  
 25 exemption. And, further, the fact that even among the states

1 that have adopted a manual exemption, there are substantive  
2 differences in how those exemptions are applied, focused on  
3 the -- the type of uniform securities act that the state  
4 follows. There are, for those of you who don't know, two  
5 uniform acts that the states generally model their statutes  
6 after. One is a 1956 vintage act, that has been around for  
7 quite some time, obviously. And the second is a more  
8 current, updated version adopted in 2002, which about 20  
9 states have adopted.

10 But again, the exemptions under both of those model  
11 acts differ. Perhaps not substantially, but sufficiently  
12 that the lack of uniformity doesn't lend itself to promoting  
13 a national secondary trading exemption that is usable for  
14 companies that don't enjoy federal preemption.

15 A secondary market that must rely on these  
16 disparate exemptive provisions at the state level will, of  
17 course, be fragmented and far from the liquid secondary  
18 markets enjoyed by larger capitalistic companies. The  
19 question then is why are robust liquid secondary markets for  
20 smaller companies important? Whether owning securities in  
21 large or small companies, investors generally don't want to  
22 hold their investments indefinitely. A liquid secondary  
23 market allows investors to realize gains, minimize losses,  
24 generally make decisions to manage their portfolios and  
25 investments. A liquid secondary market also helps issuers

1 since even the prospect of a liquid secondary market makes it  
2 more likely that they will attract needed investment capital  
3 from potential investors, who are assured of an exit ramp for  
4 their investment, thus providing capital to foster job  
5 creation and entrepreneurial innovation. Regulatory  
6 impediments to a robust secondary market frustrate those  
7 objectives.

8 This picture is not all wine and roses, however.  
9 An unchecked market will undoubtedly offer opportunities for  
10 unscrupulous operators to game the system, to the financial  
11 disadvantage of the groups that would benefit the most from a  
12 less rigid regulatory scheme, smaller companies and their  
13 investors.

14 So how to balance these equally important but  
15 competing interests? A robust and liquid secondary market as  
16 currently exists for exchange-listed and SEC reporting  
17 company securities must be based on realtime availability of  
18 information about a company. The ability of an investor to  
19 find, examine and rely on information that he or she deems  
20 critical to an investment decision foster investor confidence  
21 in the markets, as much as the knowledge that regulators are  
22 standing by to protect their interests.

23 Certainly, though not ideal, the states' manual  
24 exemption recognizes this fact, since it relies on the  
25 availability of accurate, current information about an issuer

1 as the basis for the availability of that exemption.  
2 However, the lack of uniformity, as I mentioned before,  
3 between and among the states in applying this exemption,  
4 coupled with the fact that more than a dozen states don't  
5 even recognize the exemption, frustrates investor efforts in  
6 many states to make investments based on what should be a  
7 coordinated, consistent regulatory environment.

8 Here then are my suggestions for addressing the  
9 lack of a meaningful secondary market liquidity for Reg A  
10 Plus, Tier 2 securities. I'll address that first.

11 In my view, federal preemption should be extended  
12 to include all secondary market trades in securities for the  
13 securities of a Reg A Plus, Tier 2 issuer. This can be done  
14 through SEC rulemaking, by refining the definition of  
15 qualified purchaser under Section 18 to include any person  
16 who, in a secondary market transaction, buys or sells a  
17 security of a Tier 2 issuer that is current in its reporting  
18 obligations. This would result in any such security being a  
19 covered security under Section 18 of the '33 Act, thereby  
20 allowing a secondary market for such securities to develop  
21 without the regulatory burden of having to ensure compliance  
22 with state law requirements for secondary market trades.

23 The current definition of qualified purchaser which  
24 is any person to whom securities are offered or sold in Tier  
25 2 offering contains a limitation on the amount of Tie Two

1 securities a nonaccredited investor can purchase in a Tier 2  
2 offering. It's my belief that that QP definition should be  
3 revised to make clear that this limitation would not apply to  
4 investor purchasing Tier 2 securities in a bona fide  
5 secondary market transaction.

6 To continue to allow disparate state regulatory  
7 requirements to apply to secondary market transactions in  
8 what are at the initial offering covered securities  
9 frustrates the objectives of promoting creation and growth of  
10 vibrant, small emerging companies by continuing to impose  
11 restrictions on the secondary market for these securities.  
12 While taking the step to grant full preemption of state  
13 securities laws to all transactions for Tier 2 securities is  
14 significant, the impediments imposed by continued regulation  
15 of secondary market transactions in Tier 2 securities to the  
16 ultimate success of Reg A Plus will, to a large extent, be  
17 tied to relieving the duplicative and nonuniform state  
18 regulatory structure that exists today with a more market and  
19 investor-friendly approach.

20 Each Tier 2 issuer has substantial initial  
21 disclosure and ongoing reporting requirements which should  
22 work to relieve concerns of inefficient -- insufficient  
23 information available in the market for these issuers, which  
24 is vital to the success of a robust secondary market.

25 I also have a proposal that I'd like to share with

1 the committee for facilitating secondary market trading by  
2 nonreporting, nonlisted publicly trading companies. For  
3 these issuers, available information may not be as fulsome as  
4 the type of ongoing reporting required under Title IV and  
5 certainly under the Exchange Act. State concerns over the  
6 type and quality of information for these companies argues  
7 for an increase in the reporting that should be required of  
8 these non-Reg A, Tier 2 nonreporting issuers.

9 The possible solution, in my mind, lies ironically  
10 in the very regulatory structure that impedes the formation  
11 and maintenance of liquid secondary markets for these types  
12 of issuers. A standard disclosure system comprised of a  
13 national standard securities manual modeled after the  
14 disclosures currently required to included in the manuals  
15 that are accepted under state manual exemptions as the basis  
16 for supporting preemption of state law requirements over  
17 secondary market trading of securities of nonreporting,  
18 nonlisted, non-Reg A Plus, Tier 2 issuers. By requiring  
19 these issuers to include information that is consistent with  
20 what existing manuals currently require, state concerns about  
21 a lack of current available information should be addressed,  
22 particularly if the states are partners in the development of  
23 such a national standard manual.

24 An example of a model that may be useful here,  
25 which I had mentioned earlier, is the recent success enjoyed

1 by the OTC Best Markets manual. Though I'm not endorsing  
2 this particular vendor, my intention is to mention it as an  
3 example of a disclosure delivery system that offers a way for  
4 nonreporting companies to deliver the breadth and depth of  
5 information that will help investors while also demonstrating  
6 to the states that their concerns about disclosure as a basis  
7 for assuring that investors can make fully informed decision  
8 about companies they seek to invest in are being met.

9 Rulemaking that requires nonreporting public companies to  
10 publish information as required under current standards and  
11 including securities of issuers that meet these heightened  
12 disclosure and reporting requirements could be added as a  
13 category of covered security in connection solely with  
14 secondary market trading of those securities.

15 I certainly recognize that this proposal would  
16 increase the cost to small issuers. Of course, they would  
17 have to pay fees in order to have their information included  
18 in this new standard manual. However, on balance, the cost  
19 would be significantly less than would be incurred if such an  
20 issuer were to become a reporting issuer. Moreover, the  
21 preemption problem for the states is, in my view, addressed  
22 by having the states participate in setting the standards for  
23 disclosure. Since a majority of states already offer a  
24 manual exemption, assuming the new national manual provides  
25 the same or greater information, the regulatory concerns of

1 most states should be satisfied.

2 In closing, I would urge the advisory committee to  
3 recommend to the Commission that each of these proposals be  
4 seriously considered as a means of starting or restarting the  
5 conversation around market liquidity for Tier 2 and  
6 nonreporting company issuers.

7 MS. HANKS: Thank you.

8 MR. HEWITT: First of all, I would like to thank  
9 Acting Chair Piwowar and Commissioner Stein and all of you  
10 for having us here today.

11 I want to take a different view of this and step  
12 back from the P word, preemption, for just a moment.

13 The question that I think is really important is  
14 what are the concerns of regulators generally, and  
15 specifically the states? And what I believe the problem is  
16 at this point is -- is a concern by the states and others  
17 that there is not sufficient information available to the  
18 small investor on the buy side. The sell side, obviously  
19 they hopefully know, although that's questionable, too, and  
20 I'll bring that up in a moment. That there isn't sufficient  
21 information for somebody to make an educated investment  
22 decision.

23 And I believe, as someone pointed out -- I've been  
24 here at just about all the meetings -- a while back, I  
25 believe that Acting Chair Piwowar made an interesting

1 observation. I hope I have this right. And you were talking  
2 about the fact that in some ways, we are no longer looking at  
3 capital formation and investor protection, but protection  
4 from fraud and prohibition of investing. And that is  
5 something that sort of got me thinking back then and I've  
6 been thinking of since. And to me, the question could be  
7 further refined of not investor protection, because investors  
8 I don't believe have to be protected, per se. What they need  
9 is to be empowered. And by that, I mean have sufficient  
10 information to make intelligent investment decisions.

11 I think that there are concerns from the states  
12 that when you do not have sufficient information, there are  
13 certain various things that can take place. And although not  
14 necessarily in the Reg A Plus market, although I think to a  
15 certain extent it could be, in publicly traded, nonlisted  
16 REITs and BDCs, what often happens -- and again, it's a  
17 similar sort of lack of liquidity situation, you end up with  
18 what's called a mini tender, where vultures of some sort or  
19 other -- I'm probably not picking the best word -- would make  
20 an offer to unsuspecting investors to sell their securities  
21 way below the value of whatever it is at that time, even if  
22 it's depressed from the actual purchase price.

23 That is troubling on many levels. Because, yes,  
24 there are disclosure requirements under Reg A Plus. But are  
25 they as robust as they would be for a listed company? That

1 is a question that I think has to be considered.

2 Also, to the extent that when you have a private

3 offering, if somebody is interested in buying, to get

4 information on a company, what you end up having is the

5 bigger players have access to information that the small

6 investor doesn't have. So in fact if what we're concerned

7 about is a level playing field and investor empowerment, I

8 think before we get to a discussion of preemption, we have to

9 first think about what it is that is needed as a minimum for

10 investors to be able to, in fact, make that intelligent

11 decision.

12 And I think to a certain extension -- to a certain

13 extent, 4(a)(7) was a good indicator of that, which Sara

14 knows that better than anyone. That had had the backing of

15 NASAA because it had certain informational requirements,

16 including knowledge of the, you know, who's running the

17 company, is it a going concern, you know, up-to-date

18 financials.

19 So my concern is more a shift away from how we

20 normally look at the situation and trying to look at this in

21 a slightly different way which is, instead of concentrating

22 on preemption, we should all be discussing, together, not

23 separately as in leave the states out of it with preemption,

24 what is it that we can all agree on as information required

25 at a minimum, as I said, to make a cogent investor decision?

1 At this point, there are plenty of times where in fact you

2 have situations in which the investor has very little

3 information. Reports to be filed are one thing, but if they

4 just have the most basic of information, is that really what

5 they need to make the decision? And I suspect it is not, at

6 least not in all cases.

7 So one thing that we would have to consider, and I

8 know I'm saying it a few times, but when -- when -- another

9 way of looking at it is this way. What is it that all of us

10 would like to see before making an investment decision? And

11 doesn't every investor have a right to have that which we all

12 think we need to see personally, sitting around this table?

13 And to the extent that we do, the question isn't necessarily

14 preemption. And I'm not sure the states would even have a

15 problem with preemption to the extent that their concerns

16 about the information required is actually addressed.

17 Now, as Richard said, if you want to -- you know,

18 whether you have a more far-reaching manual exemption, that

19 is -- that is acceptable to all parties, I don't think that's

20 a bad place to -- to start. I think that in many ways, it

21 has worked, except for there are a few holdout states. And

22 for whatever reason. But to the extent that there has to be

23 preemption, I think it has to be more not as in removing

24 people from the table, but making sure that everyone is able

25 to see -- to say what it is that their concerns are.

1 I know that one of the states has one time said to

2 me that we want to facilitate investment, not speculation.

3 With that information, it can only be called speculation.

4 And I think that really drives home the point.

5 So I think that if there's any recommendation I

6 have, it isn't so much to worry about preemption, per se.

7 It's to worry about addressing the concerns of the states as

8 to information that, at a bare minimum, we should have in

9 some sort of manual, et cetera. But how we get there is a

10 matter of discussion.

11 I just think everyone rushes too quickly to

12 preemption, to go to preemption, without considering several

13 things, including what is it that the states are concerned

14 about. So I won't take up too much time, because I know

15 we've both plowed through a lot of it already.

16 MS. HANKS: Thank you both.

17 If I could just sort of kick off the questions

18 here, since we're focusing on the information that's

19 available before we get to the P word, does anyone here have

20 any experience in how different disclosure under Reg A

21 ongoing reporting is to what's in a manual? And I've got to

22 confess, it's been a long time since I looked in manuals.

23 Maybe I was a junior associate sometime back in the '80s when

24 I last looked at these things.

25 Seems to me, and I'm hoping someone can challenge

1 this, that when you look at the disclosure that's made under

2 Regulation A, and we've had now several companies go through

3 a year's worth of disclosure, you've got ongoing reporting,

4 you've got annual reporting with audited financials, you've

5 got semi-annual with unaudited financials, you've got 1Us.

6 You've got a lot of companies filing 253G2s, supplement

7 information to keep the information rolling.

8 How do those compare? Is there anything in -- is

9 there any way in which Reg A is not what you would want to

10 see in a manual? Because I remember those manuals, you just

11 go through and it was kind of unreadable. Can we compare and

12 contrast those two sources of information?

13 MR. HEWITT: I'm actually glad you brought up the

14 fact that they're unreadable. That's the other problem, is

15 that whatever information is available has to be in plain

16 language, which I know is always a goal. But it seems the

17 more that we try to make plain language the goal, the

18 document becomes thicker and thicker, which is great for

19 killing trees but that's about it.

20 The comparison between the two, I couldn't tell you

21 to the nth degree. But I think what you also have to look at

22 is obviously Reg A Plus, these offerings are of companies

23 with little or no history. And of course, if you're just --

24 if somebody is flipping out of that in six months to a year,

25 where is that investor during the interim report supposed to

1 get the information to the purchaser? And I think that's the  
2 concern that, although there may be information out there, is  
3 it of sufficient detail and also of sufficient  
4 comprehensibility to be of any use to the investor?

5 MS. HANKS: But would that be any different under  
6 the manual requirements? I am totally not up to date with  
7 manual requirements.

8 MR. ALVAREZ: Sara, I think that it's fair to say  
9 that the reporting requirements that Tier 2 issuers are  
10 subject to, while something less than '34 Act reporting, is  
11 something more than what is included in a manual. The manual  
12 includes things like balance sheets, officers and directors,  
13 description of business, things that you would normally see  
14 that is a synopsis of a company. And I think part of the  
15 thinking on the manual exemption is that that is certainly a  
16 starting point for an investor. It is a collection of  
17 information that, if an investor wants more information, then  
18 they can -- they can go and find it either on EDGAR or  
19 wherever else.

20 But I think it's fair to say that Reg A Plus, Tier  
21 2 issuers fall somewhere greater in their -- in their  
22 reporting responsibilities, and of the information that they  
23 -- that they are required to report under Reg A Plus than  
24 they would need to under -- in a manual. I would perhaps  
25 defer to Michael who may have more intimate experience with

1 companies might not be able to bear. Where the manual  
2 exemption under S&P, I think, the initial fee was maybe like  
3 5,000, so it was much less expensive to be qualified under  
4 Standard and Poor's than it is to do qualification under the  
5 alternate reporting standards, but you do get a trading  
6 market.

7 So I think it's really important to understand it's  
8 not just that you put information out and it's in a book  
9 someplace. That's no longer the case. It is literally it  
10 has to go out through a regulator and that is how they track  
11 that information has been updated. And there is a cost  
12 associated with that.

13 MS. HANKS: Michael?

14 MR. PIECIAK: Thank you, Sara. And good morning,  
15 everybody.

16 So I think to that question, specifically about  
17 what the differences are, when you're talking about the  
18 reporting requirements in the manual, I think, probably the  
19 Reg A, Tier 2 reporting, the things that are reported are  
20 pretty equal if not greater, as Richard had said. You know,  
21 I think some of the other requirements, getting beyond what's  
22 in the manual as components of the manual exemption, like the  
23 fact it goes through a broker-dealer, that would be a  
24 distinction and difference.

25 To Annemarie's point, I mean, there is -- you know,

1 what his manual requires.

2 MS. HANKS: Well, we'll go to Michael and --

3 MS. TIERNEY: I'm potentially in a unique  
4 situation, which is I actually got a security qualified under  
5 the manual exception three years ago. I think that I'm not  
6 mistaken but they no longer publish the information in a  
7 book. What they do is they will only allow you to qualify  
8 for the manual exemption, at least S&P, while they were still  
9 doing the business, if the information was being disseminated  
10 by a regulator. So the only entities who could qualify for  
11 the manual exemption at all were banks, thrifts, entities  
12 that were required to publicly provide information through a  
13 regulator, or companies that were qualified to trade on OTC  
14 Markets under the alternative reporting standards.

15 So you can't just qualify for the manual exemption;  
16 you actually have to be regulated in order to qualify for the  
17 manual exemption. So I think that's a really important point  
18 to understand. You can't just put out Reg A Plus, Tier 2  
19 materials to the SEC and qualify for the manual exemption,  
20 unless the manual exemption has been amended to make that  
21 clear.

22 So secondly, I think that, at least the alternative  
23 reporting standards under OTC required more information than  
24 Reg A Plus, Tier 2. But that was to provide, you know, a  
25 trading market. It also has a \$20,000 a year cost that some

1 there is sort of a baseline in terms of what type of company  
2 can qualify for the manual exemption. And I believe, I had  
3 to -- you know, I had to look back at our statute but, you  
4 know, there's a period of time in which it has to be  
5 operating and there's a period of -- there's an asset value  
6 which has to be on its balance sheet. So there is sort of a  
7 minimum standard. But I'm not familiar with the requirement  
8 that has to be either bank holding company or an insurance  
9 company, but --

10 MS. TIERNEY: It wasn't that. It was that the  
11 information had to be disseminated by a regulator. It  
12 couldn't just be on the company's website. That was very  
13 clear to us from S&P. We had a public website, we said can  
14 we put the information on the website to qualify? And they  
15 said, no, you have to be -- that information has to be  
16 disseminated through a regulated entity. So it was OTC, it  
17 was the banking regulators and it was OTC Markets were the  
18 only options that would satisfy that condition, according to  
19 S&P three years ago.

20 MR. ALVAREZ: But we're talking about the access to  
21 the information under the manual exemption?

22 MS. TIERNEY: So again, and this is three years  
23 ago, and S&P I don't believe is doing this anymore. What S&P  
24 said to us is, send us your offering document, we'll review  
25 that. But you have to have a system for disseminating

1 information on an ongoing basis, and it needs to be through a  
2 regulator; it could not just be our website.

3 MR. ALVAREZ: But the -- but the exemption, the  
4 manual exemption at the state level, is predicated on an  
5 independent third party publication containing information  
6 that is provided by the issuer, plain and simple. Right?  
7 The problem, of course, in the context of the discussion on a  
8 liquid trading market for these types of issuers is the fact  
9 that not all states cover the -- recognize a manual  
10 exemption. And even in those states that do recognize the  
11 manual, we have a variety of different requirements, whether  
12 it's a 90-day waiting period or restricting trading to  
13 securities by nonaffiliates.

14 So having the manual, the existing state manual, be  
15 the basis for creating a robust, secondary liquid market in  
16 these kinds of securities, I don't -- I'm not confident is  
17 achievable. Which is why I suggested that the P word or why  
18 the P word has again raised its ugly head. Anyway --

19 MR. HEWITT: However, I think one of the things we  
20 have to consider is we're talking about the manual exemption  
21 right now, which is all well and good, and perhaps there is  
22 one that can be the gold standard. But in the meantime part  
23 of what happens, part of what I think the states are  
24 concerned about, you know, obviously part of the thing about  
25 being an empowered investor is also having the ability to get

1 guidance from an adviser of some sort.

2 But there is a push for preemption and removal of  
3 the broker-dealer or adviser so that, at the end of the day,  
4 it's a one-on-one transaction. And the question is, the  
5 person who is selling, there's no oversight there whatsoever.  
6 They are not -- they are not a representative of the company,  
7 they are not part of the issuer. They are selling and there  
8 is very little that, at this point, as far as I am concerned,  
9 that an unsuspecting and uneducated investor can rely upon in  
10 that situation. At least if there is a broker-dealer  
11 involved, you would hope that there is a minimal amount of  
12 guidance.

13 So I think that while we're talking about the  
14 manual exemption, we have to also consider a slightly  
15 different point which is, if it's on a one-to-one basis, how  
16 is that investor being protected by the seller?

17 MR. ALVAREZ: Counterpoint?

18 MR. HEWITT: Go ahead.

19 This is Jane Curtin and Dan Aykroyd sort of stuff  
20 going on here, but that's okay.

21 (Laughter.)

22 MR. ALVAREZ: The one-to-one transaction is already  
23 covered under 4(a)(1), all right? And that -- and we have  
24 federal preemption for those kinds of transactions. I mean,  
25 you know, the one-to-one transaction doesn't concern me, and

1 I don't think is impacted by the problems that we've spoken  
2 about relating to blue sky law. I think the challenge is  
3 trying to figure out how to fit the current federal/state  
4 regulatory scheme to facilitate a liquid secondary market  
5 where, you know, people come and go into the market, whether  
6 through market participants or otherwise, without any  
7 significant impediment, which is what we see today.

8 We see smaller companies struggling to convince  
9 their investors that they will have an exit strategy, because  
10 there is no comprehensive, uniform way for a company to -- to  
11 tell a broker or to tell investors that their securities can  
12 be bought and sold in Iowa, as an example. And I don't mean  
13 to pick on Iowa if Iowa is listening.

14 (Laughter.)

15 MR. HEWITT: Pick on Vermont instead.

16 MS. HANKS: Patrick.

17 MR. REARDON: I can't remember. Tier 2 requires  
18 you to have a transfer agent? Does it require the company to  
19 have a transfer agent?

20 MR. HEWITT: Yes, I think so. Isn't that --

21 MS. HANKS: Only in certain circumstances. Let's  
22 assume that --

23 MR. REARDON: If you had a transfer agent, I mean,  
24 you could condition execution of the transfer that the  
25 transfer agent gets some sort of proof or representation that

1 there was an exemption. So that is a thought that I've had,  
2 and you see that under Rule 144, that the transfer agent  
3 won't transfer the trade -- won't register the trade unless  
4 there's an opinion or a form, or used to be. I'm not sure  
5 what exactly they require now. But that seems to me to be  
6 something you should think about.

7 But I want to add this general observation and then  
8 make another observation. First of all, illiquidity creates  
9 a discount. So if you can't go and sell, then the value of  
10 your company is less. And so we all need to keep that in  
11 mind.

12 And the second thing is that my observation has  
13 been that when regulation steps up and says you cannot do  
14 something, and it's something that business people want to  
15 do, and you can't do it, or it's very difficult to do it,  
16 that's when you get noncompliance. That's when people start  
17 looking, sneaking off from their lawyers or whoever their  
18 broker is, and they go and they go around the law and do the  
19 deal.

20 And I've said this before. I think our policy,  
21 state and federal, is that we facilitate compliance. I mean,  
22 we shouldn't make compliance so hard that people opt to  
23 violate the law just because it's difficult to do. Or  
24 impossible to do. In some cases, you're just saying  
25 impossible.

1 MR. HEWITT: Well, because you have conflict of  
2 laws between states or state and federal.

3 MR. REARDON: Yeah. I mean, it's just got -- you  
4 know, there needs to be -- there needs to be something there.

5 And the other thing is that I think -- I don't mean  
6 to pick on you, but I think maybe the blue sky people are --  
7 you know, we have two conflicting interests here. We have  
8 investor protection and we have capital formation. And I  
9 think when you go into any securities regulator, SEC, FINRA,  
10 state securities law, and you ask, okay, how many people here  
11 have ever signed the front of a business check, have you run  
12 a business, and you're going to get very few hands raised.

13 So you need to educate the people in these  
14 regulatory agencies that capital formation is part of their  
15 goal. Just saying no and protecting the investor is not --  
16 is not -- at the end of the day, if you do that, there's no  
17 business in all your trade or treasuries.

18 MR. HEWITT: But here's the thing to respond to  
19 that is first of all you said that they are conflicting. And  
20 I don't necessarily agree with that statement. Because if  
21 there's not sufficient -- not investor protection, because  
22 again I think it's investor empowerment. If there isn't  
23 sufficient empowerment if there's all just the emphasis on  
24 capital formation, then there would be some nefarious people  
25 out there, they are there. Then what happens is the

1 integrity of the market fails and people won't invest and  
2 there goes your capital formation.

3 The point being is it's a balancing act and it's a  
4 very delicate one at that. But I don't think anyone is  
5 saying that these people shouldn't be able to invest. I  
6 don't think the states are saying that. I think the issue is  
7 really one of information and education. How you get there  
8 is what the discussion has to be about with all the  
9 regulators -- all the regulators in the room. That's  
10 basically what I'm saying. But I don't think you can say  
11 that those are conflicting at all. Because without one, the  
12 other is going to fail either way.

13 MR. REARDON: Ultimately, you're right, yes.

14 MR. HEWITT: Thank you.

15 MS. HANKS: We'll get to Jonathan in a second.

16 I just wanted to respond on behalf of transfer  
17 agents, who probably all turned white when you said --  
18 (Laughter.)

19 MS. HANKS: We're looking at trying to make  
20 something less friction -- we're trying to reduce friction.  
21 And I think taking free trading securities and requiring the  
22 transfer agent to do something, I think that's going to  
23 reintroduce friction. So I just wanted to make that point.

24 MR. ALVAREZ: Right, and isn't that a broker's job,  
25 too?

1 MS. HANKS: To reduce friction or to increase it?

2 MR. ALVAREZ: No, I mean, to the point of asking  
3 for --

4 MS. HANKS: Yes, I think, you know, if you're  
5 looking at who in this transaction has a role in doing the --  
6 is there information, it's got to be brokers as opposed to --  
7 and they do have those requirements -- as opposed to imposing  
8 these new rules on transfer agents.

9 We'll go to Jonathan.

10 MR. NELSON: Is -- one of my experiences in a  
11 heavily regulated industry when I was a nurse and I worked in  
12 five different states, and every state had a specific  
13 licensure that you had to maintain as a nurse. But a number  
14 of states had actually gotten together and they had said, you  
15 know what, we're going to give each other reciprocity. Where  
16 if you actually qualify in this state as a nurse, it's a  
17 relatively simple process to go through and get licensed in  
18 another state. There is also a series of states called  
19 compact states, I think there's about 23 states where they  
20 said, we will just honor everybody else's licenses.

21 I think one of the interesting things about, you  
22 know, the SEC and government is, you know, yes, we regulate.  
23 But I also think that we have the ability to ask for -- to  
24 convene. Do state securities regulators get together on a  
25 regular basis?

1 MR. ALVAREZ: Absolutely they do.

2 MR. NELSON: Okay. I mean, has there been  
3 discussion? And, I mean, forgive my ignorance. Is there  
4 discussion about can we create a program where there is  
5 reciprocity across these states?

6 MR. ALVAREZ: No. Plain and simple. With all due  
7 respect to Mike and NASAA --

8 MR. HEWITT: What there is, is a -- I'm going to  
9 botch the words because I just can't think of it at this  
10 point -- there's a uniform process, at least on the  
11 registration level, with the states now, when you go through  
12 a Reg A Plus, Tier 2. So it's not like -- Tier 1, excuse me.  
13 It's not like there's just a morass. I think that the states  
14 are certainly working towards the goal of more uniformity.

15 And, of course, the punch line to the '56 Act and  
16 the 2002 Uniform Securities Act is nothing is uniform by the  
17 time the legislators get done with it. That's part of the  
18 problem.

19 The one thing I just wanted to address very quickly  
20 though is, when it came to the one-to-one transaction, I  
21 still think that there is a potential there, preemption or  
22 not, for the small investor to be taken advantage of by  
23 somebody who just wants to dump their stock. And I think  
24 that's probably a concern of the states, although I can't  
25 speak for them.

1 But in terms of what you're saying, especially with  
2 the nurses' licenses, in fact, now lawyers, there's a common  
3 bar exam, much to my chagrin, having studied for a couple of  
4 them. So there is more and more reciprocity in various areas  
5 within the states now. Has it gotten -- has it risen to the  
6 blue sky law area yet? Not to that level. But that doesn't  
7 mean that they are not working or trying to get, you know,  
8 the states together to make it more uniform or more user  
9 friendly.

10 Because, again, I don't think the states are trying  
11 to prohibit capital formation. I think, as you said,  
12 sometimes -- or I think Patrick said, sometimes you can  
13 actually protect the investor ultimately by just not letting  
14 him invest, and therefore there will be no problem. But that  
15 doesn't really solve the issue. Which is why it's a true  
16 balancing act.

17 And again, although I keep on drumming this point,  
18 is that we have to make sure that those issues -- those  
19 scenarios that have resulted in investors being defrauded are  
20 addressed.

21 I mean, we can't do away with all fraud. The key  
22 is to minimize it as much as you can. It's like a  
23 perfectionist isn't perfect, they just try damned hard not to  
24 make as many mistakes as everyone else.

25 MR. ALVAREZ: But counterpoint, in answer to your

1 question, I mean, as the discussion about the standard manual  
2 illustrates, that exemption has been around from the  
3 beginning of time. Okay? It's an accepted exemption. But  
4 there are 54 different jurisdictions. Each one of them has  
5 their own view about what that exemption means.

6 Yes, I get that investor protection is a  
7 significant interest that needs to be -- that needs to be  
8 recognized. But I question whether this lack of uniformity  
9 as a basis for regulation is protecting anyone.

10 I mean, certainly the states continue to retain  
11 their fraud authority. And if there is a bad actor and an  
12 investor is harmed, they will complain to their state  
13 regulator. And that regulator has the full -- the full  
14 breadth of its -- of its securities law arsenal to go after  
15 those fraudsters. But different to, you know, your  
16 experience with nursing licenses, the states jealously guard  
17 their own interests, particularly by insisting that they  
18 alone understand the specific needs of investors in their  
19 particular jurisdiction. Which I don't doubt. But -- and  
20 perhaps has validity in the context of primary offering  
21 review. I get that.

22 In the case of a secondary market transaction,  
23 particularly for companies where there will be information  
24 available, for example a Reg A Plus, Tier 2 issuer, which has  
25 fulsome disclosures under the new law, or nonreporting public

1 companies that have information included in a national  
2 manual, okay, the needs, the particular needs of the state, I  
3 think, need to take a backseat is the wrong word, but a  
4 backseat to the interests of developing a market, a liquid  
5 market in securities that benefits everyone, not just the  
6 people in Iowa, not just the people in Vermont.

7 MR. NELSON: I just -- every single lawyer that  
8 I've ever talked to about if you're going to actually sell a  
9 security and go under the blue sky laws, they're just like,  
10 dude, don't. That's just the third rail.

11 MR. ALVAREZ: Give them my number.

12 MR. HEWITT: No, give them mine, actually.  
13 (Laughter.)

14 MR. NELSON: No, but it essentially -- I do not  
15 think that there is an efficient market at all, because you  
16 just can't create it. And I think ultimately that this ends  
17 up hurting the smaller, less wealthy states, and it  
18 essentially starts concentrating business in large, wealthy  
19 cities because it tends to become who you know and it tends  
20 to be who you went to school with and if you went to a school  
21 with a bunch of wealthy people, then you can essentially go  
22 and start a business and create a security and end up selling  
23 it. And if you're poor and you want to start a business, you  
24 really can't start a business unless you can completely  
25 bootstrap it without any capital.

1 I'm just saying it feels very, very, very broken to  
2 me. And can we convene these state regulators and just say,  
3 dudes, let's just sit in a room and let's just work it out?

4 MR. HEWITT: Well, you've got to understand, first  
5 of all NASAA has several meetings throughout the year of the  
6 states. But again, you put all of us in this room, we have  
7 different ideas slightly, or greatly. But I think one thing  
8 you have to understand, I've been in the securities industry  
9 now for 35 years, which frightens me on many levels. But,  
10 you know, there was a day when there was an us-versus-them  
11 mentality between the states and practitioners and issuers.  
12 But over time, I have seen that shift dramatically.

13 And, you know, one thing that NASAA is trying to  
14 do, and they do meet with several groups throughout the year  
15 and, you know, we're always trying to talk about, quote, low-  
16 hanging fruit, what can we accomplish. And this is one of  
17 those areas where I don't think anyone is saying that there  
18 shouldn't be more information or there shouldn't be more  
19 easily understood information. I think it's a matter of  
20 having that discussion. But not everyone in their own little  
21 corner but, you know, out in the open and having the robust  
22 discussion. But I don't think the states are all sitting  
23 there going, oh, wow, how can I make myself so different as  
24 to totally derail anyone trying to either sell a security or  
25 raise funds to build a business? I don't think that's the

1 mentality.  
2 MR. ALVAREZ: But wasn't that discussion had during  
3 the lead-up to the adoption of Title IV? And, you know, my  
4 recollection is that there was -- there was --

5 MS. HANKS: That's fine. I just want to get to  
6 Laura. She's been trying to get a word in. Between the who  
7 of you, sort out who goes first.

8 MS. TIERNEY: I just want to take this back to I  
9 think something the committee has talked about several times,  
10 which is what is the public policy benefit of requiring a  
11 Tier 2 reporting company to also qualify for a manual  
12 exemption or to list under the alternative reporting  
13 standards on OTC Markets? That prohibition means, as  
14 Jonathan is saying, there's no opportunity for another market  
15 to develop, there's not an opportunity for another broker-  
16 dealer or an ECN or any other party in the market to try to  
17 create an efficient trading system for what are generally  
18 publicly offered and should be publicly traded securities.

19 So I think we go back to the original conversation  
20 I think back around the JOBS Act, there was a real push to  
21 get preemption for Tier 2 securities where the information  
22 being made publicly available. That ended up coming off the  
23 table in the final vote. But we've had, you know, some time  
24 now to look at how the market is adjusting.

25 I've made the comments before at least one or two

1 Annemarie, but I'm putting a little comment about the  
2 insurance and the state just to educate people.

3 I did a stint in dealing with insurers, regulatory  
4 compliance for insurance companies in all 50 states. And  
5 just from a cost perspective, regulatory compliance --  
6 because each of the states are different, very much like  
7 we're talking about here, only they're a little bit more  
8 advanced in their compliance. They've gone through all the  
9 thing, we're going to get together, we're going to, you know,  
10 work together, and they come up with this common thing and  
11 they put it together and they put it on top of all their  
12 existing requirements.

13 So it's fine. It created jobs. It's great. It's  
14 a cost that gets passed on to the consumer, a cost of  
15 operating for the company. So in the company that I worked  
16 at, I probably had about 15 percent dedicated only to state  
17 compliance reporting. So think about what that means, 15  
18 percent of that body count that we had. And if we are  
19 actually only making a 6 percent bottom line in some bad  
20 years, because it's insurance, at best maybe 20, that  
21 compliance component, even though it's not for the whole  
22 company, was costing.

23 So therefore what happens? If you want a company  
24 to do business in all 50 states, you've got to be big. And I  
25 worked with a big company and they said, we just wanted to be

1 times that we did a real deep dive and look at Reg A Plus  
2 after it got enacted. And all of the banks that we spoke to  
3 for the most part said that they would not be touching Reg A  
4 as an offering option for their client companies, because  
5 their investors cared about liquidity. Unless there was  
6 clear liquidity for those securities, people are not going to  
7 invest in the securities.

8 And idea that right now, if you're investing in one  
9 of the 103 companies that have been qualified to issue Reg A  
10 Plus securities, there is no trading market for those  
11 securities. How is that beneficial to the people who are  
12 investing in them? They're stuck in securities unless the  
13 company goes through a process. And I fully support and  
14 respect OTC Markets, they are providing a great option. But  
15 they are the only option for trading these securities. And  
16 you have to go through a process, you have to pay a, you  
17 know, not insubstantial annual fee, and you have to provide  
18 more disclosure than is actually required in an offering or  
19 in the ongoing voluntary reporting. It just doesn't seem  
20 like there's a public policy or an investor protection  
21 benefit that I see that's being provided by that kind of  
22 activity. And it's a detriment to Reg A Plus and to the  
23 market developing, and I don't see why that is beneficial to  
24 the market or to investors.

25 MS. YAMANAKA: So I actually really agree with you,

1 able to say that we were listed in all 50 states. It gave  
2 them additional market branding, et cetera. Or you had small  
3 companies, insurance companies, and they only specialized in  
4 one. Sounding familiar here? Right. And so therefore,  
5 anybody in the middle, it's economically unfeasible.

6 So we want to tilt at that windmill, I think it's  
7 great. But, you know, better people probably have tried  
8 before. So unfortunately, as much as it pains me to say  
9 this, federal is probably the only way to go with that point  
10 in time.

11 However, the second point that I want to get to is,  
12 we're talking about increasing the availability of -- just  
13 increasing the market, right? So we don't worry about the  
14 institutional investors out there, they can take care of  
15 themselves. We don't worry about the small people, you know,  
16 that are doing the one-offs who actually know the business  
17 they're investing in. And again, now we're talking about the  
18 mid. And the mid just disappears, right?

19 And so to Annemarie's point, I want to reiterate,  
20 before we get down into the details and whatever, if we have  
21 our goal to accelerate the investment at the mid level, which  
22 means they're theoretically much more knowledgeable than the  
23 individual investor but don't have the funds and scalability  
24 of the larger investor, there's probably something in between  
25 regarding a regulatory perspective that we could take, which

1 I totally understand about working within the context we  
2 have, because I don't think we're going to be able to change  
3 things wholesale.

4 So whatever we can do to increase the potential for  
5 market, because Patrick, I think, I agree with your point.  
6 If businesspeople feel that it's a viable investment  
7 alternative, they will figure out a way to create that market  
8 offline with its own inherent set of risks. Or -- which will  
9 probably -- it could be 90 percent of the time, it really  
10 works. The 10 percent that fail spectacularly will be enough  
11 to kill it eventually. And then as an economy, all we do is  
12 hurt. So that's my only comment.

13 MR. REARDON: If I could add to that, I think if  
14 you're looking for something to sell preemption on, I think  
15 increased role for the states in fraud, in chasing fraud, in  
16 coordination with the SEC and the Justice Department, I don't  
17 know how you would do that. But I think everybody agrees  
18 that there is plenty of fraud out there to go and chase those  
19 people.

20 Are the Russians doing this?  
21 (Laughter.)

22 MR. REARDON: Anyway, I think -- that's my only  
23 comment. I don't have anything really to add. But I mean,  
24 that does seem to me we're belly button gazing and thinking  
25 deep thoughts, that is one I've thought. Put the states in

1 know, on the one hand, as you mentioned, you know, what  
2 happens if you focus too much on capital formation. But if  
3 you focus too much on investor protection, you know, the  
4 opportunities to invest, the opportunities to grow your  
5 retirement, to create jobs, that goes away too, which is not  
6 good for the investor. So that balance is very important.

7 Martin alluded to the coordinated review that the  
8 states implemented in Tier 1 Reg A. This, in our opinion,  
9 takes the burden off the individual issuer, puts it on the  
10 states to coordinate and get specific comments out to  
11 issuers. We've created a capital formation roundtable that  
12 meets once a year. We bring in industry, listen to ideas,  
13 listen to what, you know, is achievable and what we can push  
14 forward. And there's a number of initiatives just in the  
15 last couple years that have come out of those discussions.  
16 We've worked more collaboratively with the SEC in recent  
17 years, Rule 147A and other initiatives, and I hope we can  
18 continue to do that. So the states have been very proactive  
19 in this area.

20 And we have been, you know, very engaged. I mean,  
21 the OTC Markets, just to comment, you know, OTC Markets came  
22 to us in March or April last year to Vermont and said, you  
23 know, the S&P manual is going away, there's only Emergence  
24 now. We looked at that as state regulators and said, there  
25 should be more options. We were concerned about that. We

1 fraud and get them out of regulating transactions.

2 MS. HANKS: Thanks, Patrick.  
3 We'll go to Michael and then Jenny.

4 MR. PIECIAK: Thank you, Sara. I just wanted to  
5 address quickly a point that was made by Patrick and  
6 Jonathan, just to give some information about what the states  
7 do and whatnot. And in the insurance regulator context, you  
8 know, I mean, the state regulators are the only regulator of  
9 the insurance market and the states do coordinate quite  
10 efficiently on the insurance side, in my opinion. There's  
11 accreditation for states. They have to have certain  
12 requirements or they're not part of the NIAC.

13 And similarly on the NASAA side, you know, we have  
14 two annual meetings a year, we have a board of directors, we  
15 have a whole structure that works up issues through  
16 committees up to the board, you know, disseminated out to the  
17 membership. And I encourage you to come to a NASAA meeting,  
18 you know, when you have an opportunity to. And I'm sure we'd  
19 appreciate inviting you.

20 But you know, again, sort of on the same vein and  
21 to Patrick's point, I mean, you know, the states have been,  
22 in my opinion, have been very responsive in this capital  
23 formation arena in the last few years and we take to heart  
24 this issue of the balance, you know, the balance between  
25 investor protection and capital formation. Because, you

1 were the first movers. They came to us in March, we had a  
2 rule implemented in July of that same year. Nineteen states,  
3 as Richard has said, have followed suit. Three others have  
4 announced they're going to. So the states do act and we do  
5 communicate regularly and, you know, try to lead these  
6 initiatives in a quite ongoing basis.

7 MS. KASSAN: I have a question about state and  
8 regional secondary markets. I know in the past, we had a lot  
9 of more local exchanges, state level exchanges. Gone.  
10 They're gone, right.

11 But I'm just curious, yes it's a wonderful thing to  
12 have a national trading market. But, you know, there is some  
13 benefit to being able to buy and sell securities in your own  
14 state. So I'm just curious if that has been tried at all.  
15 You know, what was the success of that? Is that something we  
16 could consider reviving?

17 MR. ALVAREZ: I think the demise of the regional  
18 exchanges was clearly an economic issue. I mean, you know,  
19 it costs a lot of money to do that stuff. And while there  
20 may be some theoretical benefit to reviving a concept of a  
21 regional exchange, I mean, Reg A Plus, Tier 2 is billed as a  
22 platform for national securities offerings. Right? So at  
23 least in the context -- and correct me if I'm wrong. But at  
24 least in the context of Reg A Plus, Tier 2 offerings,  
25 regional exchanges I don't think would necessarily solve the

1 problem.

2 You know, and then I suppose the one way that you

3 could implement that is to designate whatever regional

4 exchanges are formed as national securities exchanges under

5 Section 18. But if I remember my Section 18 provisions

6 correctly, any national exchange has to meet the same

7 standards or similar standards to the NYSE and NASDAQ. So,

8 you know, I wonder whether we could ever get back to what

9 used to be the Midwest Exchange, the Pacific Exchange, the

10 Cincinnati and the like.

11 MS. KASSAN: I'd love to hear Michael's comments on

12 that, too. And also whether this has been discussed at

13 NASAA. And maybe it doesn't have to be an exchange. Maybe

14 it could be some kind of, you know, bulletin board or

15 something like that.

16 MR. PIECIAK: Yeah, I mean, I guess my initial

17 reaction is to sort of piggyback on Richard's is to say the

18 economic component, not just of running the exchange but, on

19 the other side, I mean, the supply, the demand, I mean, the

20 business element, I mean, the illiquidity, the lack of people

21 wanting to buy these securities. And I don't think -- I

22 think that's probably a discussion that we should have in

23 terms of secondary trading now in this larger discussion as

24 well.

25 Because regardless of, you know, the regulations or

1 whatever in place, I mean, is there actually a demand? You

2 know, people want to achieve liquidity and sell their

3 investment. But is somebody willing to buy it? And when

4 we're talking about, you know, what we're talking about

5 today, we're talking about smaller companies, small

6 investors, mom and pop investors that are doing the initial

7 buying and doing the subsequent buying and selling, so these

8 are not institutional investors, they're not largely

9 sophisticated investors. And I think that's why the investor

10 protection elements, you know, are important to

11 consideration. So, you know, I think it's economic. And,

12 you know, and business, in terms of the supply and the demand

13 of those securities.

14 MS. TIERNEY: Just a couple points. One is, and I

15 think that Richard mentioned this in passing when he was

16 talking about the different exemptions for secondary trading

17 at the state level. There is a complete disconnect between

18 the secondary trading exemption at the state level for

19 broker-dealers and at the federal level. So the context of

20 IPOs, for example, and I think Reg A Plus original offerings,

21 a broker-dealer who has a preexisting relationship, and I

22 think I've said this to the committee before, a broker-dealer

23 that has a preexisting relationship with a client, has done

24 suitability, understands their investment criteria, has

25 confirmed the status of the investor, can market any

1 opportunity in the primary context to their clients as long

2 as they believe that they're suitable for them.

3 It is the exact opposite in the secondary context,

4 because of the state law blue sky requirements, which are

5 that a transaction through a broker-dealer must be

6 unsolicited. That means that if I am a broker-dealer, I can

7 go out to every one of you if we have a relationship, say

8 would you like to buy Reg A Plus primary offering? But I

9 can't touch any of you to ask you if you want to buy those

10 securities in secondary market. That doesn't make any sense.

11 It has never made sense to me. These are clients of broker-

12 dealers.

13 And again, preemption solves that problem.

14 Preemption allows a broker-dealer to go out and touch their

15 existing clients -- not in a personal way, but in a

16 figurative way --

17 (Laughter.)

18 MS. TIERNEY: -- and ask them, are you interested

19 in investing in these securities? That is the only way we're

20 going to develop a robust secondary market around these types

21 of securities. Brokers have to be able to do their job, they

22 have to be able to locate buy side interest, they have to

23 make sure that the investment is suitable for their

24 investors. That's how you get the investor protection. You

25 have the disclosure point already out there, then you have

1 the broker-dealer protection.

2 And to Jenny's point, I don't think you're going to

3 see national exchanges come back into the fray. As a result

4 of electronic trading -- sorry, regional exchanges. Because

5 of electronic trading, the cost structure is just not there,

6 I think, to support regional exchanges, which is why most of

7 them were acquired, you know, as a matter of financial

8 interest.

9 Yeah, but I think what you are seeing is maybe an

10 increased proliferation of platforms, web-based platforms

11 that are in the primary space that could be in the secondary

12 space for Reg A Plus securities, crowd funding portals.

13 There are a multitude of players who are out there who would

14 be able to create a business model around this if it made

15 economic sense, if they had the preemption for the secondary

16 trading.

17 MS. HANKS: I think we're saying on that point, if

18 you look at how many ATSS there are at the moment, I was just

19 counting them the other day from the most recent update, I

20 think there's like 41. And some of those -- and some of

21 those are out clients -- are looking to be secondary markets

22 for Reg A securities as well.

23 MS. TIERNEY: And they can't, because of the blue

24 sky preemption on --

25 MS. HANKS: It is more difficult for them because

1 of that. Yeah.

2 MS. TIERNEY: And to the extent that like when we

3 -- when I worked on getting the security approved for, you

4 know, for blue sky manual purposes, it's a big deal that you

5 can't do it in all 50 states. We should not underplay that.

6 That's a big deal. What if you're an issuer in a state that

7 doesn't have a manual exemption? You can't actually -- why

8 would anybody buy your securities if they know for sure you

9 can't ever get secondary liquidity? It is a big deal that it

10 is not in every state. It is a big deal that it's a

11 patchwork of requirements that it takes significant

12 expertise, such as these gentlemen, to hire a lawyer to walk

13 you through the requirements in every single state.

14 We did that when I was at Second Market. We did a

15 big deep dive into the secondary markets. You guys have seen

16 me. I presented to NASAA. It is a patchwork of

17 unintelligible requirements that are driven by legislation,

18 securities commissioner interpretations, that sort of thing.

19 It is not consistent across all 50 states.

20 So again, don't underplay the fact that OTC is only

21 approved in potentially 19, you know, states. That's a big

22 deal and that is a real friction impediment to a market being

23 created around Reg A Plus securities.

24 MS. HANKS: Michael?

25 MR. PIECIAK: So I think, I mean, I just wanted to

1 address the one point on the unsolicited broker. And I'm not

2 an expert in this arena. But there's certainly securities,

3 as you've probably heard the phrase, that are not bought but

4 are sold, you know? And I think that's sort of the driving

5 impetus behind the unsolicited portion of the broker-dealer

6 unsolicited exemption.

7 I mean, on the OTC piece, I'll just mention, you

8 know, those 19 states -- three more are within the last seven

9 or eight months --

10 MS. TIERNEY: Fifty percent --

11 MR. PIECIAK: Yeah, but I mean, you know, the speed

12 in which we've done it, I think, is pretty rapid. And

13 particularly when you look at some other historical context.

14 So, you know, I think that's an element to take into place.

15 And then I think the other point, I just don't want

16 us to lose -- I made this point already, but I don't want us

17 to lose this idea about the information requirements that

18 these investors need to make an intelligible investment

19 decision. You look at the SEC. Joshua White, I think it

20 was, had an interesting report recently, study, that looked

21 at the OTC, and I would encourage everybody to read it. But

22 essentially he looked at the three tiers. And as you move

23 down in the tiers, the outcome for the investor and also the

24 liquidity, you know, decreases. And I won't put an adjective

25 there. I won't say if it's rapidly decreasing.

1 But there's a -- there's a corresponding decrease

2 in investor outcome when there's less information. There's a

3 corresponding decrease in liquidity when there's information.

4 So I think, you know, the requirements and the framework that

5 we're talking about are not all just for investor protection.

6 I mean, they're investor protection. But, you know, they're

7 also for the efficiency of the capital markets and ensuring

8 there's sufficient information there for the flow of funds,

9 flow of information, flow of securities.

10 MR. HEWITT: So what you're saying is information

11 drives the markets?

12 MR. PIECIAK: That's what this report would

13 suggest.

14 MR. HEWITT: Yes, exactly. And that's why, as I

15 was saying earlier, it has to do with making sure that the

16 investor is empowered to be able to make those decisions.

17 Without that information, they're not going to buy anything.

18 MR. ALVAREZ: And doesn't that argue for preempting

19 the nonuniform current state regulatory scheme with a -- with

20 a category of covered securities specific to Reg A Plus, Tier

21 2 issuers who are subject to fulsome information

22 requirements? I mean, would you be satisfied as a regulator

23 that the information that Reg A Plus, Tier 2 issuers are

24 required to provide under statute sufficient for purposes of

25 allowing a secondary market transaction in your state, if

1 they were -- let's assume that they were included in your

2 manual. They would -- they would meet that requirement and

3 it would be fine?

4 MR. PIECIAK: Yeah, I mean, speaking as a solely

5 Vermont regulator, you know, our manual exemption, you know,

6 requirements are self-executing, as I think they are

7 everywhere. So, you know, what that means for those on the

8 committee is that they don't file a notice filing with us,

9 they don't get a prior approval, they don't -- you know, they

10 don't contact us. They look at the requirements, they meet

11 them, they execute the transaction. Which, you know,

12 provides efficiency on the transaction side.

13 So, you know, for Vermont, if those guard rails

14 stayed in place, you know, whether it's in our statute or

15 federal statute, you know, the guard rails are in place and

16 the investors are protected, the information is out there.

17 But, you know, there are certain -- you know, that's the

18 Vermont standard. And I can't say the same for even those in

19 New England or those in another part of the country.

20 MR. HEWITT: But that's all the more important fact

21 that that -- in coming up with whatever that federal fix

22 might be, it has to be in consultation with the states that

23 there is a standard upon which the states can agree. And

24 then there's really no need at that point; you're satisfied

25 with the information being provided and you take it from

1 there.

2 But I don't -- as you said, these are self-

3 executing, point one. But point two is, the -- the -- I

4 don't think the issue is preemption or not, as I said

5 earlier. I think it's making sure that there is consistent

6 information. If that takes the form of preemption, I would

7 think as long as it's in consultation with NASAA and the

8 states and something they could get behind, well, at least

9 that's an easier road to take, I think.

10 MR. ALVAREZ: But the framework already exists.

11 The informational framework already exists at the state level

12 in a majority of states. And the effort here would be to --

13 to unify what is a fragmented regulatory scheme. Right? And

14 if the only way to achieve that is through preemption, well,

15 you know, it's an unfortunate situation, I suppose, if you're

16 a state regulator. But the majority of state regulators

17 currently offer exemptions for secondary market trades,

18 provided there is information available, 39, 44, whatever the

19 number is.

20 So in order -- in order to get to that goal line of

21 full compliance, 54 jurisdictions, so that you can then give

22 the secondary markets for these kinds of issuers a fighting

23 chance to survive, well then perhaps preemption is the fix.

24 MS. HANKS: Can we stay on the point of preemption

25 and the secondary markets here? Because a point you made

1 earlier, Richard, was if we do preemption, we should do

2 preemption on the basis of qualified purchasers being just

3 someone who buys a Reg A, period, no restrictions on the

4 investment levels as there are on primary markets.

5 And this is a question for both of you. Is this

6 secondary market -- why would you make that distinction? Is

7 there less pressure in a secondary trade? And I don't think

8 I'm hearing that from Martin. Or is the information somehow

9 more sufficient in a secondary trade than it is in a primary

10 trade? Why make that distinction and how is the secondary

11 trade different than the primary?

12 MR. HEWITT: Well, I think with the secondary

13 trade, at that point, you know, you're one generation, so to

14 speak, removed from the issuer and from the IPO. And the

15 need for -- for more robust disclosure I think is probably

16 more critical on the secondary trade, if I understand your

17 question correctly.

18 MS. HANKS: So you would need more information --

19 MR. HEWITT: Not necessarily more, but equal to.

20 Because what happens is, you know, as -- once you're done

21 with the IPO, the company, the issuer, has their money. Now

22 we're just talking about moving money and securities between

23 investors. And the question is, since you can't go -- the

24 investor cannot go and call up the chief financial officer of

25 the issuer, you know, and kick the tires, so to speak, in the

1 same way, for instance, an institutional investor might, I

2 think what you're saying is you need sufficient information.

3 What that is, again, is obviously up to discussion and

4 disagreement.

5 But I think that's why it's important at the

6 secondary level to make sure that while you may not have

7 disclosure equal to that which is on a national exchange,

8 although to me that's the gold standard. I understand

9 there's a lot of expense involved with that and it could be

10 prohibitive to produce that information. There still has to

11 be sufficient information such that the investor is going in

12 with his or her eyes wide open as to the risks and the

13 rewards.

14 MS. HANKS: And that's different than in the

15 primary situation? I'm trying to sort of drill down on the

16 one on one thing here.

17 You've got a buyer who has just gone out there and

18 posted some securities and said -- I'm sorry, a seller, who

19 has posted securities. I'm selling securities. And then

20 there's a seller who comes along -- and there's no broker

21 involved, so they're searching. They're going, oh, this is

22 an interesting company. Is there a different dynamic there

23 in the secondary market than there would have been in the

24 primary?

25 MR. HEWITT: Go ahead.

1 MS. TIERNEY: You would police that, right?

2 MR. HEWITT: What's that?

3 MS. TIERNEY: If there was a prohibition in the

4 secondary market, right now, you know, an issuer has an

5 obligation, I think, to make sure that -- it's unclear, I

6 think, under Reg A who has the obligation to make sure that

7 the cap is not exceeded. But how would you do that in a

8 secondary sense --

9 MS. HANKS: I mean, it's self-certification anyway.

10 MR. ALVAREZ: Right, but the question is whether or

11 not, as you said, there's a difference. I would venture to

12 say that in a primary distribution, the investor is relying

13 on the issuer to provide the information that it needs to

14 make that -- to make that investment. And in the secondary

15 market, it's just, you know, a normal contract. And, you

16 know, you have a good to sell and I can decide whether or not

17 to buy it based on whatever information is out there. The

18 fact that I am or am not a qualified purchaser or a suitable

19 purchaser should not matter, because those funds are not

20 going to the issuer, which is where suitability requirements

21 are normally found.

22 MS. HANKS: You think that makes a difference from

23 the investor protection point of view? And that's actually a

24 question for Martin.

25 MR. HEWITT: I think there's -- at that point,

1 there has to be some watchdog, some minimal amount of -- and  
2 I hate to use the word protection -- of empowerment of the  
3 investor, so that they -- at that point, they're really just  
4 left to their own resources. If they can find the  
5 information, great. If they can't, that's too bad.

6 And to the extent that they decide to buy from this  
7 person, well, why are they buying? Is it because they've  
8 done thorough research or is it just because they're -- you  
9 know, it's a dartboard investment? And for the small  
10 investor, a dartboard investment can be devastating to their  
11 retirement. So my concern is that, as you move further away  
12 from the issuer, the investor really is going at it  
13 haphazardly and not necessarily getting all the information  
14 that could be out there, whether it's accurate or not. I  
15 mean, they're getting this from the seller at that point.

16 So there is only so much due diligence the small  
17 investor can do for his or herself. And I think that's the  
18 concern to me, which is why a universal manual exemption,  
19 which I don't think we disagree on necessarily, is certainly  
20 a step in the right direction. Now, whether or not that  
21 takes the form of preemption, you know, that depends. Again,  
22 as long as if you can get the states on board --

23 There are some areas in which, look, even Bill  
24 Beatty in his testimony before Congress on May 1, 2014,  
25 clearly stated there are some times, there are some instances

1 in which it is not a priori wrong that there is preemption.  
2 It's not that it should never occur. The thing is to make  
3 sure that what you are doing is well thought out and  
4 addresses the issues that the states, if they were not  
5 preempted, would address.

6 And I think that's one of the key considerations  
7 here, is to figure out exactly how much information, what  
8 sort of information, how it's verified for the small  
9 investor. The larger investor can get all the information he  
10 or she wants. That's not an issue. The question is, what is  
11 the smaller investor getting, from whom and how can they rely  
12 on it. That's my concern. And I suspect that might be the  
13 concern of the states. But I'm not speaking on their behalf.

14 MS. HANKS: Is it Annemarie or Laura who is --

15 MS. YAMANAKA: Actually, I just wanted to just  
16 bring in a comment. No matter what we do or we choose not to  
17 do, I think we really need to understand what the implication  
18 is to the general economy and all the states. So right now,  
19 as how it's -- in my opinion, how it's laid out, it favors  
20 certain economic areas. So even if we stay status quo, we  
21 don't do anything else, to Jonathan's point and, frankly,  
22 everybody here, the money is going to stay where the money  
23 knows, has the relationship, in certain economic centers.  
24 And what we will do is continue that process as we go along.

25 And then actually to the point, Martin, you know,

1 when you were asking Sara about that secondary -- you know,  
2 what's the difference between the first and secondary,  
3 Annemarie and I were talking. We're going, well,  
4 statistically, the longer a company has been in business,  
5 isn't that a sign in and of itself that it has a higher --

6 MR. HEWITT: But the question is, how long are  
7 these companies necessarily in business before somebody flips  
8 out of the stock? That's what I'm talking about.

9 MR. ALVAREZ: We don't ask those questions about  
10 listed company securities.

11 MS. YAMANAKA: Exactly.

12 MR. HEWITT: And it should be noted that during  
13 2008, during the crash, almost a third of the stocks on the  
14 New York Stock Exchange went away. So it's not that there's  
15 any guarantee there either. And that's something that's  
16 important for people to understand. The small investor, I  
17 mean, not all of us; we get this. Is that an investment is  
18 not a guaranteed rate of return. And the problem is a lot of  
19 investors think that they invest, they sit there and the  
20 money rolls in. So that is another educational standpoint.

21 MS. YAMANAKA: So the question to me occurs, are we  
22 here -- and are we really just trying to protect a certain  
23 layer of investor? Or what about the balance on the other  
24 side, too, to encourage business? I really --

25 MR. HEWITT: I think it's a balancing act.

1 MS. YAMANAKA: It is both. That's what I'm saying.

2 MR. HEWITT: Right, right.

3 MS. YAMANAKA: So I think that when we're talking  
4 about -- and I could be wrong, Martin, totally wrong. I want  
5 to protect the investor to the extent that the investor  
6 should be protected.

7 MR. HEWITT: I don't disagree with that.

8 MS. YAMANAKA: A part of me says that -- you made  
9 the comment -- and I really don't mean to sound adversarial  
10 about this. But, hey, if someone is taking their whole  
11 investment portfolio --

12 MR. HEWITT: Shame on them.

13 MS. YAMANAKA: -- and they're buying stock in the  
14 secondary market, we've got a bigger issue. Right?

15 So really, the realistic, where we're trying to  
16 target our efforts here is to that middle layer of investor  
17 that has funds, okay, that is knowledgeable and can actually  
18 flow a lot of capital into that to grow companies.

19 MR. HEWITT: Well, that's not growing the company  
20 on the secondary market.

21 MS. HANKS: I'll let Jenny get a word here.

22 MS. KASSAN: I just thought of an idea. So I just  
23 thought, you know, we've created a regime where there's this  
24 new type of platform, under Title III of the JOBS Act. What  
25 if there was a platform for secondary trading of Reg A

1 securities that, if things were traded, you know, in the same  
 2 way with the, you know, the platform for Title III, there is  
 3 preemption. But the platforms have to meet certain  
 4 requirements, they have to do certain kinds of investor  
 5 education. Could that be a potential solution?  
 6 MR. ALVAREZ: Yeah. But on the crowd funding side,  
 7 there are very, very discrete and particular requirements on  
 8 who can operate a portal. You know, that's -- and I think  
 9 that that --  
 10 MS. KASSAN: It's not that hard to become a portal,  
 11 believe me.  
 12 MR. ALVAREZ: Okay.  
 13 MS. KASSAN: You should see some of the portals out  
 14 there. Sorry, no offense.  
 15 (Laughter.)  
 16 MR. ALVAREZ: I don't know. I -- I guess I'm  
 17 biased. I view crowd funding a little differently than I  
 18 view standard securities offerings. And in the context of  
 19 Reg A Plus and Reg A Plus, Tier 2 specifically, as I -- as I  
 20 commented earlier, I think the expectation is that this new  
 21 regulatory scheme will promote a national type of a  
 22 securities market. And it should look more like what we are  
 23 accustomed to seeing, exchange listed, reporting company  
 24 securities, rather than what is currently in place for crowd  
 25 funding which is, in -- at least for me, a blue sky lawyer, a

1 totally different animal.  
 2 MR. HEWITT: And I think crowd funding for a lot of  
 3 blue sky attorneys is -- yes, thank you -- it's a scary area  
 4 because there's so much potential for chicanery there, as  
 5 opposed to Reg A Plus. But that doesn't mean that there are  
 6 not issues to address there as well. But I think the crowd  
 7 funding platform is not necessarily -- although it's a good  
 8 idea, I don't know how it would actually work because, again,  
 9 it's apples and oranges in terms of the caliber of what is  
 10 being offered.  
 11 MS. KASSAN: Right, I'm making the analogy of a  
 12 platform that has to be qualified by the SEC and, in exchange  
 13 for meeting a bunch of requirements, there's preemption of  
 14 state level filings.  
 15 MR. ALVAREZ: Right. But Sara mentioned, there are  
 16 a boatload as ATs out there that could serve as that  
 17 platform.  
 18 MS. TIERNEY: They're already registered broker-  
 19 dealers.  
 20 MR. ALVAREZ: They're registered broker-dealers,  
 21 right. And then the question becomes, if you're looking to  
 22 use that as a vehicle to preempt state law, under Section 18,  
 23 there are particular criteria that have to be met for these  
 24 ATs and these exchanges to be able to have securities listed  
 25 on them be deemed covered securities.

1 MS. HANKS: Jonathan, you had a question?  
 2 MR. NELSON: I also think a great way to lose a lot  
 3 of money in a private market investment is to make like two  
 4 investments or one. And the proper way to do it is to  
 5 actually build a portfolio of 20 to 25 companies, so you have  
 6 things like angel groups and that sort of stuff that actively  
 7 encourage a lot more of this type of investment.  
 8 And so I think that the current regulatory scheme,  
 9 not only does it not foment capital formation, but with the  
 10 very, very, very low, almost nonexistent volume of secondary  
 11 transactions, investors are actually really hurt because they  
 12 can't build portfolios. And one of the frequent comments  
 13 that I hear from angel investors who are actively building  
 14 these portfolios is liquidity.  
 15 And so we're essentially dependent on a very active  
 16 merger and acquisition market, which ends up consolidating  
 17 companies, which ends up decreasing the number of jobs,  
 18 because the merger and acquisition process is about  
 19 consolidation, making large companies much more profitable.  
 20 And so the current way that we have is investors  
 21 aren't making money. When they can make these sorts of  
 22 investments, they're at very high risk to actually lose the  
 23 money. We're not having capital be formed for small  
 24 businesses. And we're having a lot of these really large,  
 25 massive corporations be formed and we're having less and less

1 public companies.  
 2 You know, and if the Angel Capital Association, how  
 3 much money is actually invested on an annual basis by angels?  
 4 Do you guys have that data?  
 5 MS. MOTT: Last year, it was around 27 billion.  
 6 Right, 27 billion?  
 7 MR. NELSON: And I think venture is about 50  
 8 billion a year. So that's about 75 -- but the lottery is a  
 9 \$65 billion a year business. And I know that the lottery is  
 10 targeting poor people and they are losing a ton of money at  
 11 that.  
 12 I don't know, it feels like something is very  
 13 broken. And if we're expecting these small businesses to  
 14 create these jobs, especially in non-urban areas, I really  
 15 think that something's just got to change.  
 16 I would be interested, like on the committee, you  
 17 know, preemption versus not preemption, I'm just interested  
 18 in going around the table, what do people think should be  
 19 done.  
 20 MS. HANKS: That was going to be my next question.  
 21 Because we've got like 10 minutes left and I would like to  
 22 see if we could make this into a recommendation. Are we  
 23 interested in giving a recommendation?  
 24 Bear in mind that the people that we give  
 25 recommendations to here is the SEC, not to the states.

1 MR. ALVAREZ: Sara --  
2 MR. PIECIAK: Before the recommendation, could I  
3 just make one statement? Which is that, you know, I  
4 mentioned this in my earlier statements. But the SEC and the  
5 states have had a really collaborative, productive  
6 relationship, I think for a long time.

7 Go ahead, Sebastian.

8 MR. GOMEZ: I second all that.  
9 (Laughter.)

10 MR. PIECIAK: And particularly as of late. And we  
11 very much enjoy working with Betsy and Sebastian and when  
12 Keith was here. And, you know, so when you are considering  
13 the recommendation, you know, looking for ways for the states  
14 and the SEC to collaborate on this issue together I hope will  
15 be part of the consideration?

16 MR. ALVAREZ: Sara, if I could just make one other  
17 editorial comment? Recall that the original Regulation A  
18 died on the vine principally because of concerns relating to  
19 burdensome state requirements. Okay? No one used that form  
20 and it went away. So this latest iteration should be given a  
21 chance to grow.

22 And to Mike's point, I mean, as I suggested in my  
23 comment about perhaps a solution being the establishment of a  
24 national manual, the states certainly have a role to play in  
25 that. They need to have a seat at the table, because they

1 are the policemen. Those are the folks who are going to be  
2 enforcing the fraud actions when these investors lose their  
3 money.

4 And, you know, if it involves a recommendation to  
5 preempt Tier 2 securities in secondary market transactions,  
6 well the states should be involved in that discussion as  
7 well.

8 MR. HEWITT: So we are in complete agreement now.

9 MS. HANKS: Duly noted, regarding the state/SEC  
10 dynamic we want to encourage.

11 But can we just go around the table and hear what  
12 people have to say, especially the people we haven't heard  
13 much from this morning?

14 MR. AGUILAR: Sure, I'm all for having a  
15 centralized information portal, I guess, for lack of a better  
16 word, that would allow these secondary transactions to  
17 happen. I think definitely the states should be involved in  
18 that, in what the standard is. But there needs to be some  
19 sort of regulation on it. And if we're -- if we're taking  
20 the states out of that decision and then having them regulate  
21 it, that's not a very good solution. So I guess my answer  
22 is, yes, I'm all for having a central information repository.

23 MR. HAHN: I don't think we're going to get  
24 anywhere without state involvement. I do like the preemption  
25 for the Reg A Plus, Tier 2. But I do think, you know,

1 anything is going to have to have state involvement with  
2 that. You know, coming from a small company like that,  
3 worrying about trying to -- trying to raise money in  
4 different states, it is a big concern from our standpoint.  
5 And it would be very, very difficult to have to go state to  
6 state to state to go through this. But again, it's going to  
7 have to be a joint effort here.

8 MS. HANKS: Jenny, preemption, not preemption?

9 MS. KASSAN: I don't know, I think -- I think there  
10 is room for a lot of creativity here. I like the idea of  
11 some kind of a pilot program, maybe just within a single  
12 state. I think Jonathan and I would volunteer to help out  
13 with that in our state, California. And look at -- you know,  
14 because California is a huge economy. If we limited  
15 secondary trading to just California, we might learn a lot  
16 from that without having to do preemption and then maybe go  
17 from there.

18 MS. MOTT: Sara, I'm in favor of the preemption.  
19 One of the things I think about, again coming from, you know,  
20 investors' point of view, is I look at the impact on the  
21 economy, what happens when we get a liquidity event. And we  
22 put that money into play, into other companies, other startup  
23 companies. Or we put it into play buying a piece of real  
24 estate. Or we put it into play to buy other things. So what  
25 you get is the multiplier effect on the economy.

1 And when you can't -- when you don't have  
2 liquidity, you impact the economy. And we don't know what  
3 that impact is. So I'd be very much in favor of something  
4 that's capital efficient. It's a balance. It includes the  
5 states. And it's another opportunity for us to have a very  
6 vibrant economy.

7 MS. HANKS: Thank you. Jonathan.

8 MR. NELSON: I think the best way to create a  
9 market is to make it as big as possible and have as many  
10 buyers at the table and as many sellers at the table as  
11 possible. The last time I talked to someone about doing a  
12 California state exemption, the California state regulators  
13 said that they were ready to do dozens of these approvals  
14 every single year. That just doesn't feel like a very large  
15 volume.

16 And it's not saying that they're not doing an  
17 amazing job and that it's not a very hard job, and it's a  
18 thankless job, because if there's fraud you get spanked and  
19 if there's capital formation, no one cares that you did your  
20 job.

21 But I think that these markets need to be as big as  
22 possible and they need to be as liquid as possible, otherwise  
23 the investors get spanked.

24 MR. REARDON: Michael, I don't know who first said  
25 that a genius is somebody who sees a trend coming and runs to

1 embrace it. I mean, we're dealing with ancient laws. I  
 2 mean, 1933. Even I wasn't born back then.  
 3 (Laughter.)  
 4 MR. REARDON: But they don't fit where we are right  
 5 now, okay? And it seems to me that there are two choices,  
 6 either preemption, which your group doesn't want, and I  
 7 understand, or we've got to have something that does work  
 8 that involves the states.  
 9 My approach would be that there's some period of  
 10 time -- two years strikes me as reasonable -- that NASAA,  
 11 your organization, gets together and comes up with something  
 12 that's 50 states -- or 53, is that the number of agencies, 54  
 13 -- buy into and you're willing to live with. And then we all  
 14 get hand in hand and go walking up to Congress and do  
 15 whatever we can to make it happen.  
 16 But I think if your organization doesn't do that,  
 17 preemption is coming and then you won't have any jurisdiction  
 18 over it at all. We have to have some sort of liquidity for  
 19 these investors.  
 20 And I hate fraud. I really do. I mean, I've  
 21 thrown away many clients that were coming to me that they  
 22 weren't going to do the right thing and I've said, hit the  
 23 bricks. So, I mean, believe it or not, I seem like a  
 24 ruthless businessman, but I'm not; I'm on your side. But  
 25 that's what I see the trend as being and you all just have to

1 run and embrace it.  
 2 MS. SHIMKAT: I'm not quite as eloquent as Patrick,  
 3 but I think throughout the entire discussion though, and  
 4 being from Iowa, or the typical flyover Midwest, I want to  
 5 make sure that as we move forward with the recommendation  
 6 that we take into consideration that a lot of these  
 7 regulations and items that we've been discussing, many were  
 8 based upon a reactionary -- or a fear of fraud and  
 9 protecting. So we need to make sure that, you know, is it  
 10 protection or is it elimination?  
 11 So we need to make sure that as we take that next  
 12 step, that we are looking at everything. And so I don't mean  
 13 to sound like on the fence or Switzerland or anything like  
 14 that, but I do have to agree with Catherine and that would be  
 15 where I stand.  
 16 MS. TIERNEY: I think it's really important for the  
 17 committee to remember that Reg A Plus has three options,  
 18 right? You have Tier 1, where there's no information being  
 19 disseminated after the offering takes place. There's Tier 2,  
 20 where there is no information voluntarily disseminated after  
 21 the offering takes place. In both of those situations, I  
 22 would love to see the states come up with some kind of common  
 23 approach to information requirements that allows for  
 24 secondary transactions to occur in all 50 states, a hundred  
 25 percent. With respect to Tier 2, voluntary reporting, going

1 to Robert's point, the centralized information portal is  
 2 EDGAR. Those companies are filing public information with  
 3 the Securities and Exchange Commission that is available on  
 4 the SEC's website. So that information is out there. As  
 5 long as those companies are voluntarily reporting, I don't  
 6 see how the states' interest to require information  
 7 dissemination through a manual is more efficient or effective  
 8 than dissemination through the SEC's EDGAR website with SEC  
 9 oversight, enforcement and everything else to create fraud  
 10 prevention and investor protection.  
 11 So my vote would be preemption for Tier 2  
 12 securities that are voluntarily reporting on an ongoing  
 13 basis. Once that voluntary reporting stops, then they fall  
 14 into the other buckets and they have to satisfy the state  
 15 requirements. But again, I want to reiterate my point about  
 16 the fact that broker-dealers cannot create secondary markets  
 17 in these securities and also that the manual exemption is not  
 18 available in every jurisdiction, so it could definitely be  
 19 detrimental to capital formation for small companies in  
 20 states where they cannot actually legally provide secondary  
 21 transactions, even under Tier 1 or Tier 2 nonreporting.  
 22 MS. HANKS: I just want to point out that with  
 23 respect to the word "voluntarily," I mean, there is an  
 24 obligation, in most circumstances, to keep going.  
 25 MR. GOMEZ: Actually, as Sara said, it's not just

1 the first year. It's an obligation in which there's an  
 2 ability to suspend that reporting obligation or terminate  
 3 that reporting obligation on the specific categories. So I  
 4 think when we say "voluntarily," I think it's in a different  
 5 sense as voluntarily, just because I want to. The rules do  
 6 require them to do it.  
 7 MS. TIERNEY: That's what I meant. To the extent  
 8 the company is disseminating information through the SEC,  
 9 they should be in the preemption bucket, yeah.  
 10 MS. HANKS: I just didn't want to get any of --  
 11 MS. TIERNEY: I'm using the wrong terminology --  
 12 MS. HANKS: Yeah, I didn't want to let any of my  
 13 clients get the wrong idea when I tell them they have to do  
 14 this.  
 15 (Laughter.)  
 16 MS. HANKS: Laura?  
 17 MS. YAMANAKA: Well, first off, I want to say I  
 18 don't think we're going to do anything without the states,  
 19 and I do appreciate their job. I have family members who  
 20 work for the states. So I think it's a very important  
 21 function, actually, that occurs. And we're stronger when we  
 22 work together, right? And I'm glad the SEC and the states  
 23 have been working actually much better than the insurance  
 24 people, so that is very -- so kudos and props.  
 25 So with all said and done, I think when I look at

1 our perspective and what we need to do from an overall basis,  
2 unfortunately, because I hate to put down regulation on top  
3 of regulation -- market that is controlled, that protects the  
4 investors, while encourages investment, you know, at that  
5 next level.

6 Because that's the gap we're missing. You know,  
7 when we see -- you know, Jonathan gave a great example of how  
8 it's supposed to work. And unfortunately, I think we have a  
9 little bit of a gap here, because use of capital -- number of  
10 companies that are forming are down, the number of people who  
11 are going -- organizations that are going IPO is down, the  
12 number of large entities actually is down through  
13 consolidation. The actual numbers look really good, but it's  
14 not just a matter of dollars, right? Sometimes it is a  
15 matter of law, large numbers. So -- preemption.

16 MS. HANKS: Thanks, Laura.

17 Mike, I'm not going to ask you whether you approve,  
18 but is there anything that you and Michele, too, would like  
19 to add before we move on?

20 MR. PIECIAK: Well, I do want to thank Richard and  
21 Martin. They did a nice job presenting the points and  
22 counterpoints. The only other -- the only other thing I  
23 wanted to mention which I didn't get to bring up was the  
24 relative newness of this general concept of allowing  
25 investors to invest in smaller what would previously be

1 market. So I'm very much persuaded by a uniform platform of  
2 information in order to try to put more vibrancy and  
3 predictability into this segment of the market.

4 In terms of preemption, I really would like to  
5 defer to all of you. My gut instinct is that there is  
6 something very inefficient about all 54 units trying to get  
7 to this uniformity, but hesitant to move in the preemption  
8 direction prematurely.

9 MS. HANKS: Thank you.

10 Okay, all right. So with that I think I'm going to  
11 put some thoughts together and we'll discuss this afternoon  
12 whether we move on with a recommendation. I'll try and pull  
13 all of these things together and see whether you agree with  
14 the way that I've summarized it.

15 We're going to move on to the discussion of the  
16 broker-dealer status of finders. And so thank you to Richard  
17 and Martin. Really appreciate it.

18 So moving on to the broker-dealer issue, we've  
19 talked many times about the finders issue, urging the  
20 Commission to take steps to clarify the current ambiguity in  
21 broker-dealer regulation for people who act as intermediaries  
22 in private placements or find potential investors. And one  
23 of the reasons we care so much about this is the fact that,  
24 to the extent a small company uses someone to help find  
25 capital and that person should have been registered as a

1 privately held, potentially, or private offerings or private  
2 companies. And I think we see it on the primary market side  
3 and I assume it's the same thing on the secondary market  
4 side, that from an investor demand perspective, these  
5 exemptions are so new that, you know, investors are saying,  
6 wait a minute, I didn't think I could invest in something  
7 like that, or I've always been told this is the case. Or  
8 they don't know what a Reg A offering is, they, you know,  
9 don't know what a crowd funding offering is. So I think  
10 there's some element of investor education and further sort  
11 of maturity in these arenas that need to happen as well. And  
12 in terms of secondary liquidity ever happening, regardless of  
13 what the regulatory framework is around it. So I just want  
14 to put that out as an additional point.

15 MS. HANKS: Thanks. Michele, anything you'd like  
16 to add there?

17 MS. SCHIMPP: Thank you very much. Really  
18 fascinating to walk into this, and I feel like it's part of  
19 an ongoing dialogue and trying to catch up on this.

20 Completely persuaded on the side that this would be  
21 filling an important gap area in our economy. We see that  
22 the area where access to capital is most needed is in that  
23 area of like one million and below EBITDA. And so, despite  
24 all of our efforts on SBA's side to encourage investors to  
25 get more early stage, more local, we're still not meeting the

1 broker-dealer and wasn't, then that deal is, by its nature,  
2 rescindable, which is a terrible source of uncertainty for  
3 small companies to have to live with. But they do it and  
4 they do it all the time, and we've talked about this, just  
5 because they are so desperately in need of capital.

6 So the prior iteration of this committee made a  
7 recommendation to the Commission along those lines just  
8 before the committee was renewed in September 2015. I think  
9 you've all got a copy of that at your desks. Shout if you  
10 don't have it.

11 Some of us were members during the development of  
12 that recommendation and others have joined since then.

13 I would also note that the American Bar Association  
14 Task Force on Private Placement Brokers has existed for some  
15 like 17 years now. It has also urged clarity in this area,  
16 with some progress. The M&A broker no-action position, which  
17 was very much appreciated. But there are still areas of  
18 significant uncertainty.

19 Knowing the importance of this issue to so many of  
20 us, we wanted to do a sort of bring-down, to see whether we  
21 wanted to reissue this recommendation, since we have a new  
22 chairman and senior leadership coming in to the SEC, new  
23 Congress in session. It seems that if we're not satisfied  
24 with the status quo -- and I think I hope I'm not jumping the  
25 gun in saying that many of us are not satisfied -- that we

1 want to make sure that this issue is not overlooked.

2 So with that, does anybody want to reiterate some

3 of the points they've made? And I don't know if -- we have

4 representatives here from Trading and Markets. Do you guys

5 want to say anything?

6 MS. RUTKOWSKY: It's Joanne Rutkowsky from Division

7 of Trading and Markets. I know Steve Luparello, our former

8 director, spoke to you last fall and he just pointed out that

9 we totally hear you but there are also two competing

10 regulatory concerns. One is capital formation and the other

11 is the protection of investors, particularly retail

12 investors.

13 And so I think the one thing we would ask you as

14 you go forward is to sort of address, if you could, the

15 protections for the retail investors.

16 And with that, I mean, we're here to answer

17 questions if we can.

18 MS. HANKS: Thank you.

19 MR. REARDON: I'll be happy to speak. Jenny --

20 I'll defer to you.

21 MS. HANKS: I think Jenny and then you, if that's

22 okay.

23 MS. KASSAN: I just had a quick question on the

24 fourth point before the recommendation. It says, deal only

25 with accredited investors. But I don't think the

1 recommendation actually says that. So I personally would be

2 very concerned about limiting this to people that deal only

3 with accredited investors. So I just wanted to see if we

4 could get some clarity on that, because it looks like it's in

5 the preamble but not in the recommendation itself.

6 MS. HANKS: I think the thinking there was to the

7 extent an exemption were to be developed, then it would be

8 appropriate to take the investor's status into account. But

9 I'm interested to hear -- and again, to answer Joanne's

10 request, I mean, to the extent we were to encourage a broker-

11 dealer -- a limited broker-dealer exemption and it were not

12 to have -- be depending on the investor's status as

13 accredited or sophisticated, how would you protect the

14 investor?

15 MS. KASSAN: This kind of goes back to our

16 discussion about accredited and, you know, whether the

17 definition of accredited is actually protecting investors.

18 But I just think it's something we should think about.

19 I think limiting -- you know, most of my clients, I

20 work with small businesses to raise money. And most of my

21 clients raise money from both accredited and unaccredited

22 investors, usually under Rule 504 and state-level exemptions.

23 And I think if this recommendation only applies to companies

24 raising money from accredited investors, I think it really

25 limits the applicability to companies that, you know, want to

1 talk to more than just accredited investors.

2 MR. REARDON: Commissioner Stein, I want to direct

3 this to you particularly, because I think this is -- at the

4 Commission level is where this belongs.

5 We had, as far as I'm concerned, a very

6 unsatisfactory conversation with Mr. Luparello at our last

7 meeting and, as I told him, I think this is the worst case of

8 bureaucratic waiting for Godot I've ever seen. They've been

9 sitting on this for 16 years, 16 or 17 -- I count 19. I

10 don't know. But it's a long time. And it's obviously

11 they're dissembling and wasting taxpayer time and they have

12 no intention of ever moving on this. That is, the Division

13 of Trading and Markets. I don't know if that comes from the

14 Commission or not.

15 But I do know this, that a tremendous amount of

16 taxpayer time has been wasted on this and if they could have

17 just said, we're never going to act on this and we're just

18 playing you, stringing you along, it would have been very,

19 very helpful and we could have done something else, or gone

20 and licked our wounds and forgotten about the idea. But

21 instead we've had this constant teasing and even today we're

22 hearing more from the Division about what do you want to talk

23 about and we understand your concerns. I don't think they

24 are about our concerns over there, frankly, ma'am. I think

25 that you've got your own agenda and the public and the

1 taxpayer be damned.

2 And I -- I have no -- as far as my recommendation

3 for the Division -- I'm not speaking to the commissioners but

4 to the Division -- I'm trying to think of a recommendation

5 that's not obscene. I mean, I am -- I am so frustrated with

6 this. I -- I don't think anybody over there really cares.

7 They're pretending to be listening. And I'm convinced that

8 if anything is going to be done on this, it will come from

9 Capitol Hill.

10 MS. HANKS: Patrick, if we could -- I'm glad we

11 skipped the bit about the -- the obscene bits, so thank you

12 for that.

13 But to address this, I mean, I think there are some

14 legitimate concerns. I mean, we see, and we have raised this

15 every time, we're concerned about the small companies who are

16 absolutely desperate. And there's the guy at the golf club

17 who knows some folks and can introduce them.

18 Do you have an answer to that, though? What if the

19 guy at the golf club is like, well, I know some folks and

20 they're all part of my -- my Elks Club or whatever, and I

21 know they're pretty rich. What about investor protection?

22 Are we saying that we don't need it there? Or is there an

23 alternative way that we can loop into this recommendation?

24 MR. REARDON: Oh, we've got the recommendations by

25 the American Bar Association that were promulgated 10 years,

1 roughly 10 years ago. David Burton over at Heritage  
2 Foundation has recommendations.

3 I mean, as far as I'm concerned, we don't need to  
4 till that soil again. There are recommendations and you can  
5 go and get any number of them. If you'd like for me to bring  
6 them to the next meeting --

7 MS. HANKS: I think we actually have them. And --

8 MR. REARDON: I mean, I don't see why we need to  
9 put the mental horsepower into making recommendations that  
10 will be ignored once again.

11 I mean, I just -- you know, I've been banging my  
12 head against the wall for 16 years. I might decide it's time  
13 to stop. I mean, I haven't been working on this for 16  
14 years, but people have. And I'm not -- I'm not willing,  
15 frankly, to do any more head banging. I'm -- I've given up.

16 I'm completely dissatisfied that any regulatory  
17 action will ever be taken on this; 16 years is enough.

18 MS. HANKS: I will note that a couple of the  
19 members of the ABA task force have celebrated the eightieth  
20 birthdays while they were waiting for --

21 MR. REARDON: Yes, and I know two of those lovely  
22 ladies and --

23 MS. HANKS: All right. So nothing other than  
24 what's already in the record with respect to --

25 MR. REARDON: What's already in the record. As I

1 But so long as they keep saying, nobody has been  
2 arrested for doing that, you're going to have this dichotomy  
3 where you've got the guys who are playing by the rules and  
4 paying for it, and the guys who are kind of getting away with  
5 it and everyone is saying there's nothing out there. So  
6 certainty, even if it's bad certainty, to a certain extent,  
7 is helpful. But that's just my own opinion.

8 I would be interested to know who else in the room  
9 would like even bad certainty.

10 MS. KASSAN: I have a quick question going back to  
11 the whole question of blue sky law. Even if there was  
12 certainty at the federal level, wouldn't we still have to  
13 deal with state-level requirements?

14 MS. HANKS: You're absolutely right. I mean, to  
15 the extent -- to go back to an earlier discussion, to the  
16 extent there's no preemption, and I don't see that. One of  
17 the things that we've seen again in the online community is  
18 people saying, well, those platforms have their no-action  
19 letters. But we, state regulators, that's just their silly  
20 federal thing; we don't recognize it. And in State X, as far  
21 as we're concerned, they're still broker-dealers. So we do  
22 have uncertainty at the state level as well.

23 MS. KASSAN: Yeah, that happened with a company  
24 called ProFounder in California. I remember that.

25 MS. HANKS: It was California and not the feds who

1 said too in that meeting, this topic has been studied as much  
2 as anything but the Bible and the Torah, so it's time for  
3 action or just say we're not going to do anything.

4 MS. HANKS: And saying we're not going to do  
5 anything, I think part of the problem, one of the reasons  
6 that we do keep circling back to this is that there is a  
7 certain amount of uncertainty. And there's at least one no-  
8 action letter out there, and we know that no-action letters  
9 only apply to the specific pop star that they apply to. But  
10 to the extent there are still people out there relying on  
11 that and saying that statement is still out there, that no-  
12 action letter has not been withdrawn, and there are people  
13 doing these deals and doing the golf club deals, one of the  
14 things that I've said is we're at a point where I don't think  
15 it matters so much what the answer is but just that there is  
16 an answer.

17 And to make a point that I've made before as well,  
18 it's not fair on the guys who are playing by the rules.  
19 There are some, and from my own industry, the online capital  
20 formation industry, there are electronic platforms who are  
21 not playing by the rules. And then I've got clients saying,  
22 well, they get away with it and nobody has arrested them.  
23 And to the extent -- and I'm always explaining, well, the SEC  
24 doesn't have handcuffs, because they are a civil agency, they  
25 don't have the right to do that.

1 took them down.

2 MS. KASSAN: Yeah, exactly.

3 MS. MOTT: When I think about this, you know, how  
4 we're defining the difference is between someone who provides  
5 names versus someone who sells the transaction, right? A  
6 broker-dealer sells the transaction, a finder simply  
7 introduces --

8 MS. HANKS: It depends which side of the  
9 interpretation you fall on. I mean, there are some folks who  
10 would say anybody who brings together buyers and sellers of  
11 securities and takes money for doing that is going to be a  
12 broker-dealer, even if the compensation is not derived --  
13 calculated on the amount of securities sold. There are some  
14 people who say so long as it's not a transaction-based  
15 compensation, then per se it's not a broker-dealer issue.  
16 But I don't think anyone has ever agreed that. So you get a  
17 wide range of interpretations at both the federal and state  
18 level.

19 MS. MOTT: But how much is the issuer responsible  
20 for ensuring that the information is, you know, is provided  
21 and that, you know, they're accredited, that kind of thing.  
22 I mean, that really comes down on the issuer at that point,  
23 after that point, right?

24 MS. HANKS: The issuer has got a whole bunch of  
25 things to worry about, including if I raise money by using a

1 non-registered broker-dealer who should have been registered,  
2 that transaction could be rescinded. And so you've got a put  
3 hanging over your head forever.

4 MR. REARDON: -- in securities law -- Division's  
5 position also is that if a lawyer participates with an  
6 unregistered broker, the lawyer is violating securities laws,  
7 too. So the effect is they're separating the businessperson  
8 from his or her lawyer.

9 MS. HANKS: So anyone in favor of more certainty,  
10 even if it's wrong? Or -- because we keep making the  
11 recommendations and it would be nice if we could sort of move  
12 this ahead in some way.

13 MS. MOTT: So here I'm struggling with this, and  
14 not because I don't think we should move ahead with it. I'm  
15 struggling with this because I think about the situations in  
16 which someone gets introduced or hears about the opportunity  
17 to invest in something and, I mean, it's going to happen,  
18 and, you know, it's -- when I think about the private  
19 investor market, there's a good deal of it that is, how can I  
20 say, formalized? But there's still a lot of unformalized  
21 capital out there. So I think we should put -- I think this  
22 puts some structure around that unformalized capital. That's  
23 why I like it.

24 MS. HANKS: Anyone else want to weigh in on this?

25 MS. SHIMKAT: It's really hard sitting next to

1 what the markets are out there and what entrepreneurs and  
2 small businesses are actually defining as the new way of  
3 doing business and how they need to achieve that capital and  
4 get business done? And I think that kind of leads us into  
5 our debate later this afternoon.

6 But I want to see -- there needs to be movement  
7 somewhere.

8 MS. HANKS: Which direction would you like the  
9 movement to be?

10 MS. SHIMKAT: So that it works better for our  
11 companies.

12 (Laughter.)

13 MS. HANKS: A vote in favor of workability.

14 Annemarie, since you've got a background in the  
15 broker industry.

16 MS. TIERNEY: I don't know that I'm qualified to  
17 comment on what my esteemed colleague said, but I probably  
18 agree with her.

19 (Laughter.)

20 MS. HANKS: One of the questions is whether we  
21 would -- whether and to what extent we want to reissue the  
22 comments that we made in September, with respect to getting  
23 some -- some movement, reducing ambiguity in broker-dealer  
24 regulation.

25 I think the one thing we can all get behind is

1 Patrick sometimes.

2 MR. REARDON: I noticed they moved me closer to the  
3 door.

4 (Laughter.)

5 MS. SHIMKAT: But overall, and I think -- I feel  
6 like we have opened Pandora's box, and we have had some  
7 really animated debates regarding a lot of the issues that  
8 have come out. And even when I am going back to the Midwest  
9 and talking to people, it's like, well, you have to do this,  
10 this is what the rules are. Actually, I shouldn't have said  
11 the Midwest.

12 But we need to make sure that there's something,  
13 that something moves forward, that we move that needle off  
14 zero. We have to take an action and it needs to be though  
15 collaborative. You can't have a mom versus dad. Well,  
16 here's how I'm going to interpret this, because this works  
17 better for us. Here's how I'm going to interpret this.  
18 Versus, well, what's the worst that could happen? It only  
19 hurts if you get caught.

20 We need to make sure that, you know, are we pulling  
21 the protectionism in too far and making so much of it not  
22 being able to work together to achieve our goal? And at the  
23 same time, I think we've really shifted on what is our actual  
24 goal. Is it fully regulatory and here's what we want to do  
25 so that things fit into our funnel? Or are we looking at

1 reducing ambiguity. But the question then is, in what  
2 direction does the reduction in ambiguity go? One of the  
3 things that I've said is even having the wrong answer, at  
4 least it's an answer and it gives us some certainty. What  
5 are your feelings on that?

6 MS. TIERNEY: Well, we've talked about this as a  
7 committee. Patrick is very passionate about this subject.

8 MS. HANKS: He reiterated his passion.

9 MS. TIERNEY: I heard it.

10 (Laughter.)

11 MS. TIERNEY: It's very worthwhile listening to.  
12 I think the fact is that I was -- and you were  
13 talking about Mr. Luparello as I left the room.

14 I was disappointed in his answer to the committee,  
15 if we're talking about that. I think that we know that  
16 there's bad practices in the market, we know that there are  
17 people who don't understand the rules, we know there are  
18 platforms out there that are not registered and following the  
19 rules in a way that makes sense to me. So I think I would  
20 definitely like to see the SEC take more specific action in  
21 the context of finders and platforms involved in primary and  
22 secondary transactions that may not be registered broker-  
23 dealers.

24 You know, you've got some no-action letters out  
25 there from Trading and Markets to certain platforms that are

1 helpful but potentially not being followed by the rest of the  
2 market. So maybe, you know, more obvious disclosure efforts  
3 -- sorry, more obvious enforcement efforts, to the extent,  
4 you know, necessary.

5 I know Patrick feels like there's not enough  
6 enforcement, obvious enforcement in this space. I really do  
7 worry about companies hiring people to help them find capital  
8 and then not having that done in a way that's consistent with  
9 the securities laws. That's not good for the investors, not  
10 good for the companies and it's not good for the market.

11 MS. YAMANAKA: I agree with you, Sara, that having  
12 nothing sends the message that if you have no enforcement, to  
13 Patrick's perspective, or looking the other way, it sends the  
14 message that it's really not an important regulation and it's  
15 really not relevant. So I am of the point that if we have  
16 something out there, we probably should -- should be -- you  
17 can't selectively apply, right? You can't selectively  
18 enforce. Because if you do, that takes us down a whole other  
19 rabbit hole. So let's get off the bucket.

20 MS. HANKS: And any thoughts on what -- what this  
21 initiative would look like? Do we still -- do you still  
22 agree with some of the things set out in the 2015 letter?

23 MS. YAMANAKA: Well, personally, no, there are  
24 things in it. But I'm willing to say let's -- let's just do  
25 something. I think we all don't agree with everything all

1 the time. And so it's just -- I don't really understand why  
2 this is happening, to be honest. And so I just want to  
3 register out there the fact that if we don't do something,  
4 that sends a message out there to people to take the risk and  
5 to take the risk. And so therefore by, again, nonaction, we  
6 are creating an environment -- we are creating the  
7 environment. And if we are okay with that -- I know we're  
8 not happy about that, but if we are -- if we accept the  
9 consequences of nonaction, then we need to be prepared down  
10 the line for when we do have to pull it back and what that's  
11 going to look like --

12 MS. HANKS: So if I -- it's kind of difficult to  
13 summarize, because it's clear that not everybody agrees with  
14 the exact specifications in the 2015. But if we were to say  
15 that we would like greater certainty, and that certainty  
16 could take a number of different shapes, including compliance  
17 and disclosure type initiatives, answers to Q&As. I think,  
18 not to put words into the mouths of the T&M guys, but I think  
19 there's always been this -- well, there's a slippery slope  
20 here and if we let this happen, then what happens next?

21 But Q&A type interpretations of who is a broker and  
22 who isn't might be tremendously helpful, even if it doesn't  
23 go as far as a no-action letter. That seems like a very  
24 innocent sort of thing to encourage. And also to encourage  
25 that the Staff also talk to the states.

1 Because one of the things that we are seeing, and  
2 we see this in the Reg A field, we see, for example, Texas,  
3 Florida, Arizona, North Dakota have completely different  
4 interpretations of the issuer-dealer requirements. And so  
5 some kind of coordination at that level as well would be  
6 tremendously helpful.

7 MR. NELSON: It sounds like we're kind of talking  
8 about a speed limit issue, aren't we? Like what's the speed  
9 limit in your city? Or on a highway in your state?

10 MS. HANKS: I have no idea.

11 MR. NELSON: Like 65? Do they give you five miles  
12 an hour, do they give you 10 miles an hour or 15?

13 MS. TIERNEY: My cousin is a state trooper.

14 MR. NELSON: Um-humm.

15 MS. TIERNEY: So I get a little bit extra.

16 (Laughter.)

17 MS. HANKS: The rules do not apply to Annemarie.

18 MS. TIERNEY: I think it's six, because just for  
19 the margin of error.

20 MR. NELSON: And so what is the actual rule and  
21 what is the actual speed limit and what actually gets  
22 enforced are sometimes diverse and sometimes I actually think  
23 you're getting your answer, Patrick.

24 I love you, but I think what I'm hearing is that  
25 the SEC is saying, well, this is the speed limit, but we

1 might give you five, we might give you 10 over, but at the  
2 same point in time don't be a jerk about it, otherwise we  
3 might, you know, come down and pull you over and give you a  
4 ticket.

5 MS. HANKS: I'm not sure we actually do have a  
6 speed limit, even with the Annemarie rider. And I think  
7 that's the problem.

8 MR. REARDON: And that doesn't apply in private  
9 litigation.

10 MS. HANKS: And I think that is a really good  
11 point. In private litigation, this is what's hanging over  
12 the heads of small companies, you do a deal, it was put  
13 together by the dude at the golf club who knows some guys,  
14 and then it turns out that that was a really bad investment.  
15 And so what happens is a plaintiff's lawyer gets hold of it  
16 and goes, okay, we are going to get your money back because  
17 that was a broker-dealer and he wasn't registered. And  
18 that's what hangs over the heads of small companies all the  
19 time.

20 MS. MOTT: Sara, I mean, what I was looking at is  
21 the document that Greg sent in e-mail, because he couldn't be  
22 here.

23 MS. HANKS: That's the ABA one?

24 MS. MOTT: Yeah. So, I mean, what we're doing is  
25 we're classifying people to be intermediaries by making an

1 introduction. And if they disclose a form that they're  
2 acting as an intermediary, that they are not selling, and  
3 that the issuer says, you know, I understand this, that this  
4 person is not selling and that these people that I'm being  
5 introduced to are accredited investors, I will not take  
6 anyone but accredited investors, what's the problem? Because  
7 they're not selling.

8 They're acting as -- and if we define an  
9 intermediary as someone who does not sell, does not provide  
10 the PPM, does not provide -- you know, then that person, all  
11 they're doing is an introduction.

12 MS. HANKS: Well, which is what -- but we can't  
13 define the law. And the guys who do interpret the  
14 regulations are the guys we need the guidance from. I mean,  
15 that's one of the things that we were encouraging, was this  
16 sort of limited purpose introductory --

17 MS. MOTT: I mean, that's what I'm thinking is just  
18 what we've done here, to me, works fine. Because we're just  
19 -- we're just putting structure -- so let's define it. Let's  
20 have a form. Let's just --

21 MS. HANKS: Anybody against a recommendation that  
22 that be one of the courses that we would like to see from  
23 Trading and Markets?

24 MR. REARDON: I intend to abstain from any further  
25 action from a regulatory standpoint on this.

1 MS. HANKS: Even if it's good action.

2 MR. REARDON: Sixteen years of good action.

3 MS. HANKS: Anyone else want to weigh in on the  
4 form that Catherine -- that's the one that was circulated,  
5 forwarded from Greg Yadley. That would, at least, be  
6 something.

7 MR. AGUILAR: I would like to get the SEC's opinion  
8 on what that -- that letter -- what they would do if a case  
9 came in front of them and somebody had the exemption letter  
10 that was referred to in the document?

11 MS. RUTKOWSKY: I'm sorry, I'm not sure we've seen  
12 that. But I think that there is a vehicle for requesting no  
13 action or an exemptive order. If you wanted some regulatory  
14 certainty, some clarity. So there are established processes,  
15 if this is something you'd like to pursue.

16 MS. HANKS: This is the -- I think it's from the  
17 ABA recommendations that you're looking at there. But it's,  
18 right at the moment, I mean, I think the answer is this is --  
19 that's just a privately produced piece of paper and then if  
20 you took that to the SEC and said, if we did this, would it  
21 be okay, then I think the appropriate action would be to  
22 request a no-action position. Which are issued on a case-by-  
23 case basis and only apply to the people they are issued to,  
24 and we would like it to go a little further than that.

25 Anyone else on the brokers?

1 MS. KASSAN: I'm wondering what the reaction was  
2 when, you know, to the recommendations that were made by the  
3 ABA. What was the response?

4 MS. RUTKOWSKY: I think, this is going back, but it  
5 contemplated a limited purpose registration scheme without  
6 FINRA participation. And the question is then, who -- who  
7 monitors? Who examines?

8 We, right now, are taking on all of the investment  
9 adviser industry. So we're a little short on resources.

10 So it's a question of you're bringing folks in,  
11 you're putting additional regulatory burdens on the SEC and  
12 we don't really have a lot of resources.

13 You know, quite apart from the merits, what you  
14 might think on a particular point. I think that was  
15 something that Steve had told the folks from the ABA last  
16 summer.

17 MS. KASSAN: Maybe again, I'll analogize again to  
18 Title III of the JOBS Act. There's this new type of entity  
19 that is not a full broker-dealer but is regulated by FINRA.  
20 You know, maybe that could be a solution that, you know, we  
21 have this limited type of registration that's not a full  
22 broker-dealer but is a finder and does become a member of  
23 FINRA but with much more limited regulation. I would support  
24 that.

25 MS. HANKS: A limited purpose broker-dealer, in

1 effect.

2 MS. KASSAN: Right, similar to the, you know, crowd  
3 funding portals.

4 MS. HANKS: And you would, of course, need  
5 regulations to create that, both at the SEC and FINRA. And  
6 also you'd need -- I mean, one of the things we should point  
7 out is some of those Title III crowd funding platforms -- at  
8 least one has bitten the dust for regulatory reasons already.

9 So there is a regulatory burden on keeping an eye  
10 on those folks.

11 MR. AGUILAR: Yeah, I'm not one to create more  
12 regulation, but I think that I agree with Jenny that I think  
13 that would be a good solution. But there is also the -- the  
14 idea of when somebody doesn't do it, I mean, are they being  
15 -- are there consequences for that? It sounds like there's  
16 quite a few transactions that are considered securities  
17 transactions that are not being monitored and regulation  
18 isn't imposed on those.

19 MS. HANKS: Does anyone else have any other  
20 questions or comments on the issue?

21 I just want to say thank you guys for coming by and  
22 I know this is the typical Washington parlor game of lining  
23 people up and yelling at them. And we want to say thank you  
24 very much for coming back and hearing us and hopefully we  
25 don't take it personally, but we do appreciate what you're

1 doing.  
2 But, you hear us. I mean, we want some certainty  
3 here.

4 Thank you, everybody. We are now going to adjourn  
5 until 1:45.

6 (Whereupon, at 12:45 p.m., a luncheon recess was  
7 taken.)

8 A F T E R N O O N S E S S I O N

9 MS. HANKS: Thanks and welcome back, everybody.  
10 Sorry for the delay to those of you on the webinar; we had a  
11 bit of a technical problem.

12 So we are now going to talk about why more  
13 companies are staying private, or try and answer that  
14 question. There was an interesting article in the January 6  
15 Wall Street Journal focused on the lower number of U.S. IPOs  
16 over the last decade, and calling the -- referring to a  
17 gusher of private capital.

18 We all know plenty of small companies that would  
19 love to benefit from this gusher of small capital and who are  
20 not seeing it probably. But it's absolutely true that the  
21 decrease in the number of companies going public is no news  
22 to any of us.

23 The article talked about several possible theories  
24 as to why the private markets have proven more attractive in  
25 recent years for companies that traditionally would have been

1 candidates for an IPO. I'm pretty sure everybody here has  
2 got their own thoughts on the topic and we'll be discussing  
3 those. But it's definitely a topic we want to discuss in  
4 depth and further and see what the trends are that are  
5 influencing companies' decisions to stay private.

6 We're going to hear from three separate presenters,  
7 each of whom has extremely relevant experience in this area.  
8 I don't know if this is the order we're going in, but it's  
9 the order I've got. So first is James Hutchinson or Jamie, a  
10 partner in the private equity group of the law firm Goodwin  
11 Procter, as well as a member of Goodwin's technology and  
12 emerging companies, FinTech and impact and responsible  
13 investing practice. Jamie has extensive experience advising  
14 funds and their portfolio companies in a wide variety of  
15 transactions. He's been a key contributor to his firm's  
16 online resources for startups, emerging companies and the  
17 entrepreneurial community.

18 Next, we have Glen Giovannetti of the global life  
19 sciences leader at accounting firm Ernst and Young. He has  
20 close to 30 years' experience with Ernst and Young, the  
21 majority serving clients in the biotech and medical device  
22 industries. He has extensive experience -- sorry. He  
23 published a blog in response to the Wall Street Journal  
24 article I mentioned earlier, which we all have, so look  
25 forward to hearing his thoughts on the topic.

1 And finally, we welcome Yanev Suissa, founder of  
2 SineWave Ventures. Yanev was formerly with the large VC firm  
3 New Enterprise Associates, where he focused on early stage  
4 investments in tech and energy companies. He also helped  
5 form the Department of Energy's loan guarantee program, where  
6 he was engaged in the underwriting of billions of dollars of  
7 debt for issuance to companies within the energy technology  
8 industry.

9 And please take it from here. Jamie, are you  
10 first?

11 MR. HUTCHINSON: Glen is going to lead off for us.

12 MS. HANKS: All right. Glen, thank you.

13 MR. GIOVANNETTI: Well, thank you. And thanks to  
14 the entire committee for the invitation. It's great to be  
15 here. We're hopeful we can at least catalyze some good  
16 discussion. We were talking earlier, I mean, I'm not sure  
17 there is a definitive answer on this, but we will put forth  
18 some ideas. And thank you for promoting the blog.

19 That was a bit of a coincidence. You know, I read  
20 that same article heading out to the JP Morgan Health Care  
21 Conference every year in San Francisco, kind of kicks off the  
22 year for life science companies. And sat there and said, you  
23 know, really, 30 percent fewer public companies? That can't  
24 be the case in biotech.

25 And I think what we'll explore here today is that,

1 you know, biotech is obviously only one small part of the  
2 entire economy and it may be the exception that proves the  
3 rule for certain -- you know, certain unique attributes of  
4 that particular sector. And in fact, what I was pointing out  
5 in the blog was that the number of publicly listed biotech  
6 companies is up 40 percent over the same period of time. So,  
7 you know, the trend is actually reversed. But we'll explore  
8 the broader issues and then if there's some relevance around  
9 biotech, I'll introduce that.

10 I thought what I'd do is start just with some  
11 bigger picture context setting and run through just a number  
12 of data charts to hopefully help inform and put some  
13 structure around it and then we'll dive into some of the real  
14 specific issues around the -- around this question of, you  
15 know, why are more staying private. And we've had a chance  
16 to talk a little bit ahead of this session. So a little bit  
17 where I leave off, hopefully Jamie will pick up. And, of  
18 course, stop us at any point. We don't need to make this  
19 presentation; we're happy to entertain questions.

20 So what's here, and may be a little bit hard to see  
21 at a distance, there were a couple academic studies that  
22 spurred some of this media coverage. This particular one, I  
23 think, was actually quoted in a Bloomberg story about six  
24 months before the Wall Street Journal picked up the story  
25 there in early January. And, you know, commenting on the

1 fact that we've seen this significant decrease in the number  
2 of publicly traded companies and looking at why. So what  
3 we've done here is just summarized some of the data from that  
4 study itself just in 10-year blocks. So their data went  
5 through 2012, so it's a little bit dated.

6 But you can kind of see some of the trend here of,  
7 you know, the rise in public companies up until 1995 and then  
8 a decrease since then. And just pictorially, the green bars  
9 here are the number of IPOs, the gray bars are the number of  
10 M&A transactions where companies effectively delisted via,  
11 you know a transaction. And the red are delistings for  
12 cause, right, which you see were pretty significant, you  
13 know, leading up to -- in the late '90s, leading up to, you  
14 know, sort of the dot com frenzy of, you know, quite a few  
15 IPOs, and even in the decade after. And they've diminished a  
16 bit. So, you know, we can argue whether it's positive or  
17 negative, but I think the number of companies going public  
18 today are less likely to be delisted. They're a little bit  
19 more substantial, they've been private a little longer, they  
20 probably have a little more capital. Right? So, you know, I  
21 think it's fair to say maybe they're more sustainable than  
22 say the average company that was listing in the late -- late  
23 '90s.

24 The next slide is just to make the point -- I've  
25 got a couple of slides on this, but quickly we want to look

1 at this from the standpoint of, you know, is this a U.S.  
2 phenomenon, a global phenomenon. You know, what's happening  
3 here where we have a delisting or not a delisting, I'm sorry,  
4 but a, you know, a decrease in the number of listed  
5 companies.

6 You know, this slide is not very interesting  
7 because the data doesn't change very much. But basically  
8 what it says is 90 percent plus, in fact 94 percent last  
9 year, of IPOs happen on domestic exchanges; only 6 percent  
10 are cross-border. And then if you say, well, does the U.S.  
11 have a particular problem? Because certainly listings are  
12 growing at quite a rapid rate in many exchanges around the  
13 world, does the U.S. have a problem? Well, when companies  
14 choose to list cross-border, they come here, is what the  
15 takeaway here is. The yellow bar is the number of, you know,  
16 foreign private issuers coming to the U.S. And you can see  
17 the other markets, how they compare. So it suggests that we  
18 don't have some unique problem where our companies are  
19 finding their way to go public in other places, and that's  
20 sort of capped off on this slide, which shows that in 2016,  
21 only two U.S. companies chose to list exclusively overseas.

22 So there may have -- there may be others -- there's  
23 quite a few others that probably went to dual list. But they  
24 also listed -- had a primary listing here in the U.S. And,  
25 you know, a handful a year say, there's another market for

1 me, you know, I'm not going to choose to list here in the  
2 U.S.

3 So then turning more to what's going on with  
4 private companies, this is data from VentureSource. And I  
5 direct you to the yellow, the yellow line there, and the gray  
6 line towards the bottom. Those represent seed and first  
7 round. So by translation, I guess, company formations over  
8 the last many years. And the numbers you can't read there on  
9 the right are, you know, running around the last several  
10 years 1,500 to 1,800 venture-backed companies created. So  
11 that's sort of the inflow of likely IPO candidates. It's not  
12 exclusively what would go public because, you know, family-  
13 owned businesses, non-venture backed companies can make their  
14 way to the public market. But this is a pretty big  
15 indication of the funnel.

16 And we see since, you know, we kind of cratered  
17 after the dot com frenzy back at the beginning of the 2000s,  
18 with a little hiccup there around the financial crisis,  
19 there's been a relatively steady climb up. So it's not  
20 necessarily that the funnel is not there for companies that,  
21 you know, would otherwise choose to seek an IPO.

22 The IPOs haven't increased at the same pace. And  
23 that's a large part of the reason we're having this  
24 conversation, and we will get into the larger -- some of the  
25 larger dynamics of why that is. But you can see IPOs prior

1 to 2000 were running at 400 or 500 a year. Since the  
2 financial crisis, you know, we're in the 200 to 300,  
3 depending on -- I'm sorry, since sort of the dot com highs  
4 and the recovery there, you know, in the 200 to 300 IPOs a  
5 year. Last year was quite a bit lower than that. And so  
6 there's been a different bar set relative to the number of  
7 IPOs. And what we're experiencing is companies are staying  
8 private longer.

9 Now the company that gets through, is represented  
10 by these numbers and gets public, probably is a little bit  
11 more substantial in terms of its time to grow as a public  
12 company, perhaps a little better financed. And hence we see  
13 fewer of the delistings.

14 This is the same data. I won't go over it, other  
15 than it excludes the foreign private issuers. This is just  
16 purely U.S. companies going public on U.S. exchanges.

17 And then, you know, the other way companies  
18 disappear is they get bought, of course. And this data is  
19 from Deal Logic, and it's acquisitions of all private  
20 companies, venture backed, not venture backed, by strategic  
21 investors, by PE or financial investors. It's kind of an  
22 all-in number. So it may be not right on point relative to  
23 the population of companies that may go public. But it gives  
24 you an indication that, you know, we're in a robust M&A  
25 environment and have been for, you know, quite some time. As

1 industries are consolidating, and we see that at the top end  
2 with, you know, the Fortune 500 in terms of the amount of  
3 revenue and assets in the economy they control. There's also  
4 a trend of greater externalization for larger companies  
5 looking for innovation and being willing to buy it.

6 So there's an awful lot of deal activity that, you  
7 know, these are companies that otherwise may have  
8 matriculated to the public market that are acquired while  
9 private.

10 Another cut at the data, much smaller numbers.  
11 These are the same -- same data set but deals over \$100  
12 million. So this is the group of companies that, you know,  
13 might have been IPO ready, if you want to think about it that  
14 way relative to their market cap. You know, whether that's  
15 100 or up to \$300-, \$400 million takeout price. So, you  
16 know, if you're looking at a couple hundred in a year on the  
17 IPO side, there's double that number of private companies  
18 that otherwise may have considered an IPO that are -- that  
19 are selling in M&A transactions.

20 This is just for your information, the number of  
21 publicly traded companies that are coming out. This isn't  
22 really germane to the private company story. This is  
23 existing public companies that are being acquired. You can  
24 see that, while pretty steady, it's actually quite a bit  
25 lower. More of that acquisition activity happened much

1 more biotech focused. When we get over on the right side,  
2 you know, many companies are staying private because there's  
3 this gusher of private capital, to use Sara's comment from  
4 the article. There is an unprecedented amount of private  
5 capital out there. It's not finding its way everywhere.

6 The kinds of private capital that is going into  
7 some of the large technology companies in, you know,  
8 multibillion dollar rounds, if we go back to the biotech  
9 example for a minute, very few if any investors are going to  
10 write that kind of a check for a biotech company and wait  
11 five years and turn over a card and see if they get a drug or  
12 not, right? It just doesn't fit -- the financing model  
13 doesn't fit the business model. And that's one of the  
14 reasons we see biotech companies go public. They not only  
15 need the capital, they need a wider shareholder base, right?  
16 And that's what a publicly traded stock provides them.

17 So on the why stay private, you know, the biggest  
18 issue is because they can. There's lots of capital out  
19 there, right? And if you can avail yourself to that capital  
20 and it's at a reasonable valuation that's not such a large  
21 haircut from what a public market might give you, you can  
22 still grow your business, it's not as dilutive as it may have  
23 been at one point in time. And certainly with, you know, the  
24 new pools of capital, the amount of capital, the pools it's  
25 coming from and the valuations, I think we've seen that to a

1 earlier in the decade and even into the late 1990s.

2 So that kind of leads us to the question today of,  
3 you know, why are companies staying more private or staying  
4 private longer. And, you know, not to be flip, but the kind  
5 of short answer we've come up with is because we can, and  
6 we'll talk about what's behind all of that.

7 But if you look on the left-hand side, you know,  
8 why would I go public, you know, that list there is the  
9 common reasons, you know, that companies would pursue a  
10 public offering. And number one, that their business model  
11 really requires it, right? That they have a highly capital  
12 intensive business model and they need to access capital to  
13 grow their business. And public markets, typically,  
14 historically, have provided a lower cost of capital. We can  
15 argue whether that's still the case with all the private  
16 money out there. They need public currency to do  
17 acquisitions, they're looking for liquidity for their  
18 founders, for their investors.

19 Importantly, when we talk about tech and biotech  
20 companies, for their employees. Although Jamie will have  
21 some stuff to say about that, because he's been part of  
22 creating alternatives for private companies in that respect.  
23 And they -- and/or they just want brand identity, you know,  
24 that comes from being a public company.

25 I would say there's one here in particular that's

1 large degree. And then it sort of insulates you from what's  
2 the rest of the list there, right?

3 So obviously as a public company, a lot more  
4 infrastructure needed for disclosure and regulatory  
5 compliance. Some perception, and this was brought up in the  
6 Wall Street Journal article about, you know, disclosure  
7 leading to loss of competitive advantage, especially for  
8 technology companies trying to build something new. Just the  
9 general lack of operating flexibility or lower operating  
10 flexibility when you're public and you have investors that  
11 are much more focused on short-term quarterly profits and  
12 your business model might be one of, you know, long-term  
13 growth and world domination in a particular category. Right?  
14 Just that -- that dichotomy.

15 And then a variety of other -- you know, just the  
16 risks of being a public company. Subject to activists and  
17 short sellers and shareholder lawsuits and the like.

18 So, you know, we really have, you know, factors for  
19 and against. But the answer that we will set up here, and I  
20 will pass the baton here to Jamie, is because they can.

21 MR. HUTCHINSON: So again, I'm Jamie Hutchinson.  
22 I'm a partner in Goodwin's private equity and tech practice  
23 units. We do a lot of work representing emerging stage  
24 companies and the folks that invest in them. And we've  
25 actually kind of had a front row seat over about the past

1 decade to what we kind of call the large cap growth equity.  
2 So a lot of the very big rounds into the high-profile tech  
3 companies, sort of the unicorn set. And a lot of those  
4 transactions come with some interesting dynamics, including  
5 secondary pieces. And so the press has written a little bit  
6 about private IPOs, which I think is -- is not a good -- you  
7 know, it's probably a misnomer. But there's certainly a  
8 different type of transaction, much larger, that has  
9 secondary liquidity. And we've sort of had a front row seat  
10 to that. So I think we should be able to give some ideas of  
11 why this is happening.

12 So and certainly during this presentation, we're  
13 going to jump in, and if anybody has questions and want to  
14 jump in and drill down on stuff, you should do that. Could  
15 make it more interesting than hearing me.

16 MS. TIERNEY: You should know we're not shy.

17 MR. HUTCHINSON: Yeah, I've seen that over the  
18 years, Annemarie.

19 MS. TIERNEY: We're not shy.

20 MR. HUTCHINSON: So, you know, here's a summary of  
21 some of the reasons. There's large amounts of private  
22 capital and it's really on a global level. It's not, you  
23 know, just the U.S. anymore. Employees don't demand a  
24 company go public. There are alternatives to liquidity now  
25 that there weren't in the past. Early investors don't need

1 an IPO or maybe even want an IPO. The idea of a clean exit  
2 is something that can be particularly appealing to closed-end  
3 funds that have a life, a life span. Certain securities laws  
4 have become more flexible, especially the 500 shareholder  
5 rule moving to 2,000 shareholders of record.

6 There is a new generation of entrepreneurs that  
7 have a different set of priorities. And, you know, this is  
8 perhaps the case now maybe in a different way than  
9 historically. We've had direct interaction with a lot of  
10 these folks and they think of the world differently. And  
11 maybe it's a millennial thing. But they're -- I think we're  
12 all seeing in the market, particularly the companies that are  
13 going public, the focus is on things like control maybe than  
14 immediate sort of wealth creation, changing the world,  
15 winning the space, things like that.

16 There's negative -- there's this negative press  
17 phenomenon that can occur with public companies. And we will  
18 drill down onto that as a little bit.

19 So cash as the new acquisition currency. It's  
20 shocking, but debt is cheap and a lot of companies, both  
21 public and private, are able to tap very deep pools of debt  
22 financing to do M&A where, in the past, it might have been  
23 best done with a public company security. M&A equals  
24 innovation, strategies are serial acquirers and they do that  
25 to continue to innovate, and they are affected by not only

1 the cash they have on their balance sheet but their ability  
2 to tap into cheap debt.

3 The high costs of being a public company are  
4 perhaps keeping folks from moving towards an IPO. And then  
5 there's sort of another set of pitfalls that we'll touch on.

6 So, you know, first the large amounts of private  
7 capital. So the capital is coming from different places than  
8 maybe was historically the case. VC funds themselves, many  
9 have gotten bigger and their investment mandates have  
10 expanded. Where, you know, maybe in the '80s and '90s, even  
11 the early 2000s, VCs were really doing early stage sort of  
12 startup type investing. Now their mandates are really across  
13 the spectrum, from early stage to late stage.

14 The traditional private equity funds, you know,  
15 buyout funds, the Carlyles, the KKR's, they did not  
16 historically focus on minority deals, deals that they didn't  
17 have control. And that has changed substantially. Firms  
18 like Silver Lake investing in Zynga and Alibaba, taking  
19 minority positions, TPG. And these are all, you know,  
20 publicly available. TPG in Airbnb and Uber. KKR just  
21 announced a growth equity fund. So these are -- these are  
22 really traditional buyout shops that are moving into growth  
23 equity and have deep pools of capital.

24 Corporate venture capital, Google Ventures, Dell  
25 Ventures, they are out there and investing heavily. That's

1 sort of a new and different source of capital over the past  
2 decade.

3 Hedge funds. Some people refer to them as  
4 crossover funds. Historically, hedge funds would invest in  
5 public securities. They were open-ended funds and they were  
6 structured in a way that having the liquidity of public  
7 securities kind of meshed with their structures. But that is  
8 no longer the case. A lot of the big hedge funds, Tiger  
9 Global, for example, have been extraordinarily successful and  
10 extraordinarily active investing all over the world into  
11 private companies.

12 The sovereign wealth funds. They have over the  
13 past sort of five to 10 years -- well, historically, they  
14 would invest as LPs in the big venture and private equity  
15 funds. And they sort of have come around, based on their  
16 expertise maybe doing that to build their own infrastructure.  
17 They build their own investment teams and they're able to  
18 make direct investments. GIC, Temasek, the Saudi fund that  
19 recently invested in Uber, the Abu Dhabi fund that's invested  
20 in Spotify, you know, there's a long list of the sovereign  
21 wealth funds no longer being passive investors in private  
22 equity and venture but investing directly. And they have  
23 very deep pools and they are super patient investors, so it's  
24 added things to the market.

25 Mutual fund complexes. So one of the things in the

1 Wall Street Journal article, it mentioned how the average  
2 investor doesn't sort of get access to these -- these fast-  
3 growing sort of unicorn companies. And, you know, as I was  
4 reading that, I was thinking, well, that's actually not true.  
5 I suspect, you know, a lot of people in this room have  
6 401(k)s in mutual funds and through the public filings, and  
7 you've seen it in the press, the big mutual fund complexes  
8 are one of the most active investors in private companies  
9 these days. And they, too, are very large pools of capital  
10 and they're very patient. It's a different model. They  
11 don't have an end to their fund life.

12 And we'll talk a bit more about that, because  
13 that's been a really dramatic shift that's sort of changed  
14 things, particularly with shareholder liquidity.

15 And then family offices. Just like the sovereign  
16 wealth funds, they've built infrastructure to direct invest.  
17 Gates, the Omidyar Network, the founder of eBay, folks like  
18 that are now out there making direct investments.

19 MR. SUISSA: Could I -- since you've gone through  
20 this, I might jump in. I would also note that these are not  
21 all smart investors in the venture space. And what I mean by  
22 that is not that they're not smart people, but these business  
23 models that they have historically been in are not the same  
24 business model as venture. Right? We are not typical  
25 finance. I don't do ratios on a daily basis. Right? We're

1 building teams, building strategies, building technologies,  
2 innovating, often being a personal counselor, quite frankly,  
3 and a recruiter.

4 And you have all these guys moving in and they all  
5 have different motivations. So for the big banks and funds  
6 and the more financial folks, you have a phenomenon since the  
7 recession, where people -- whether it's true or not, people  
8 believe that the public markets are not a place to make money  
9 or not a place to make money safely. And you do have this  
10 phenomenon of it's hard to get in, so there must be something  
11 special about this that this small group of people have  
12 access to these set of special deals that you need to be in.

13 And there is that definite like you-need-to-be-in-  
14 it mentality, right? If you're not in Facebook, you're not a  
15 relevant investor in the technology space, regardless of  
16 whether you think Facebook is a good company or not. Right?  
17 And so similar for every other -- a lot other of the big tech  
18 companies. So that's where the banks come from.

19 For the sovereign wealth funds, we've seen a  
20 phenomenon where technology and innovation, as you guys know,  
21 has been promoted much more in the press as a way to -- and  
22 venture, for that matter -- as a way to grow jobs, right, and  
23 learn new skills and build businesses and build economies.  
24 And a lot of the sovereign wealth funds are doing this not  
25 just to make money but because they believe that having

1 access to the understanding of these tech companies will then  
2 give them the ability to bring that technology to their  
3 country. This is particularly relevant among the Middle East  
4 sovereign funds, where they say, we're going to invest in  
5 this because we want you to build an office here and train  
6 our people to do this.

7 So I think -- and then families are similar.  
8 There's also this phenomenon of I don't want to pay managers  
9 fees; I just want to go at it directly, because I think I'm  
10 just as smart. Right? So I'm going to go at all these  
11 things that I really know nothing about and keep going. And  
12 I do think that's a dangerous phenomenon more generally,  
13 maybe not relevant to the going public point that we're  
14 talking about today. But you are seeing this change, I  
15 think. So all the really smart ones came in early, they  
16 realized, because they're smart, that they didn't know what  
17 they're doing, and they've pulled back significantly. And  
18 then you have the second tier of just as smart, maybe not as  
19 smart people, coming in and it will continue to kind of move  
20 that direction until people realize it really is a different  
21 game and unless they're really focused on it and understand  
22 it, they're really just playing with fire.

23 So I think that's part of this dynamic. It's not  
24 -- it's a reaction to, hey, we as financial institutions are  
25 not making money right now, and everyone is asking us, like

1 why aren't you making money? Why aren't you in this? So we  
2 need to do something.

3 MR. HUTCHINSON: And to your point on sort of the  
4 not wanting to pay fees, we see these things that we call  
5 rifle shot funds. So it's like a managed account almost  
6 where big investors will aggregate money, it might be led by  
7 a brand name VC, but they'll set up a side -- it looks just  
8 like a venture fund, feels like a venture funds, it's got a  
9 GP, it's got LPs, but invests in a single asset, a rifle shot  
10 into one company. And, you know, Goldman kind of kicked that  
11 off in some respects when it did a big common round into  
12 Facebook and brought in a bunch of their investors in a  
13 special purpose vehicle. So we're seeing that phenomenon,  
14 too, with some of this new money that doesn't want to pay  
15 fees but wants to co-invest alongside of some of the more  
16 traditional investors.

17 MR. SUISSA: And in that case wants dibs on the  
18 IPO.

19 MR. HUTCHINSON: Right.

20 MR. GIOVANNETTI: Just one maybe question or  
21 comment to add to what Yanev was saying, because I agree  
22 with. One thing to keep in mind is where do we think we are  
23 largely in this wave of private capital? So if we're on the  
24 second wave and, you know, many of these unicorns will make  
25 it out and the value will go up, but some won't, right? So

1 where does that sort of ebb and flow occur? And if you go  
2 back to the one slide I showed about venture-backed company  
3 formations, there's a bolus of companies that are now three  
4 to four years into their venture stage development. And so  
5 one of the dynamics on the pure IPO count could be, hey, we  
6 see a little bit less of this gusher of private money and  
7 we've got a whole load of IPO-ready companies.

8 So, you know, these things bend, right? They ebb  
9 and flow with capital availability.

10 MR. NELSON: So can you guys talk -- you guys keep  
11 on talking about this gusher of private capital into small  
12 businesses or this gusher of private capital into emerging  
13 businesses. What's the average check size that Tiger Global  
14 writes to a company?

15 MR. HUTCHINSON: I suspect it's not less than 100  
16 million.

17 MR. NELSON: What would be the small check size  
18 that a mutual fund would write to a company?

19 MR. HUTCHINSON: I suspect it's not less than 100  
20 -- maybe 50 million.

21 MR. NELSON: I would just caution putting all of  
22 those companies in the same bag and saying that all of this  
23 money just is going into -- the market is awash with capital.  
24 Because there's well over 100,000 small businesses in this  
25 country and you're talking about dozens if not hundreds of

1 people who wanted to be entrepreneurs because they got fired.  
2 My friends got fired from their jobs in the law firms and the  
3 banks and the consulting firms. And okay, great, we're young  
4 and risky and there's all this stuff, we'll start a company  
5 and it's exciting and it's cool and we'll do that. And  
6 unfortunately, that phenomenon has been permitted to continue  
7 because of this larger phenomenon we're talking about where  
8 this money is pouring into companies that wouldn't.

9 I think if you -- and this maybe comes from my  
10 background or where I invest from, but if you really look at  
11 -- if you had to go through -- and everyone has their own  
12 opinion. If you had to go through and say which one of these  
13 companies that are getting funding, period, actually should  
14 be, the answer is probably very high that they shouldn't be.

15 And so I do think there's that phenomenon going on as well.

16 MR. NELSON: What would you decide a company that  
17 should get funding?

18 MR. SUISSA: Well, so when you invest in a company,  
19 right, you're looking for a particular return --

20 MR. NELSON: What would your return be as a VC?  
21 When you invest in a company, what return multiple are you  
22 thinking of in your head? I'm thinking it's about a 2 to 3X.

23 MR. SUISSA: So VCs, I mean, it's everyone has  
24 their own model. It depends if you're angel, whatever. But  
25 I would say most VCs when they answer this question, because

1 deals. So the amount -- the check size in terms of growth  
2 stage private equity -- so the check size is huge, the number  
3 of deal size is smaller.

4 I mean, we were just talking in the earlier session  
5 -- you weren't here. But, you know, venture is about \$50  
6 billion a year right now, angel is about \$25 billion a year  
7 right now, and so that's \$75 billion a year right now. The  
8 lottery is a \$65 billion a year business. So I would -- I  
9 just I guess I take issue with that. Because I speak with  
10 thousands of entrepreneurs who are capital starved.

11 MR. SUISSA: Well, can I make two quick comments to  
12 that? So I will tell you there are VCs competing with  
13 certain one of these names -- names that you would have no  
14 idea were doing seed deals. And that is -- and when an  
15 entrepreneur has to choose between a VC who knows how to get  
16 their ownership and someone who doesn't because they're just  
17 taking dibs on something or just spreading money or just  
18 trying to please investors who think they should be in the  
19 private markets, it's a different game, right?

20 And I will also say there are -- so I think a  
21 phenomenon that happened with the recession, and I don't know  
22 which companies you know and this is going to sound horribly  
23 arrogant. But there are a lot of companies that shouldn't be  
24 companies out there. Like so when the recession happened,  
25 you saw a huge surge in the word entrepreneurship, let alone

1 they have to have an answer even if it's not true, often say,  
2 you know, we won't invest in anything if we can't feel that  
3 we're almost guaranteed a 3X and yet have the potential for  
4 like a 50X or more.

5 MR. NELSON: And so how many startups would you  
6 actually talk to before you actually come across one of those  
7 deals?

8 MR. SUISSA: I think most -- you know, it depends  
9 on the firm and where you're looking but most of the big VCs  
10 will probably look at at least 200 companies and maybe invest  
11 in one of those.

12 MR. NELSON: So it's 0.5 percent of the companies  
13 that you look at actually get funding that you think you have  
14 a reasonable chance of getting a 50X return on?

15 MR. SUISSA: Okay.

16 MR. NELSON: So for every 200 companies, for every  
17 200 CEOs or entrepreneurs that are out there that are  
18 actually interested in capitalizing their company, about 0.5  
19 percent of them actually do.

20 MR. SUISSA: Right, but when I say the one out of  
21 the 200, I mean the 199 shouldn't have the capital, or they  
22 should form a different form of capital.

23 So, you know, I'm coming at this from venture  
24 money. There's other money out there that might be looking  
25 for a different kind of motive, right, or return profile.

1 MS. MOTT: May I shift gears here for a minute  
2 since you jumped in?  
3 MR. NELSON: Sorry.  
4 MS. MOTT: So when you think about the rate of  
5 innovation, when you look at the rate of innovation in maybe  
6 10- or 20-year segments, you know, how much of the capital  
7 that's pouring in is more a reflection of the opportunity  
8 because of the greater rate of innovation? Is that a -- is  
9 that something to be considered or am I off base?  
10 MR. GIOVANNETTI: More investable opportunities,  
11 more investable opportunities, is what you're --  
12 MS. MOTT: Because of the rate of innovation.  
13 MR. GIOVANNETTI: Yeah.  
14 MS. MOTT: You know, it's not -- I keep thinking,  
15 you know, I started my firm 15 years ago and I think about,  
16 you know, the companies we had to invest in, quality  
17 companies we had to invest in, here in the United States but  
18 I'm seeing it all over the world now. It's very different.  
19 I mean, I went to the Netherlands and I walked away  
20 looking at some companies I thought were very, you know,  
21 great opportunities. Well, Spotify is a good example of  
22 that, too. You know, so it's not just -- so I'm not talking  
23 about -- the rate of innovation that I've seen in the past 15  
24 years is much more robust than I think it was 15, 20 years  
25 ago. Other than the dot com.

1 MR. SUISSA: I do agree with that. I absolutely  
2 agree with that. And I think, you know, I know we've kind of  
3 degenerated a little bit into like where is all the money  
4 coming from. But I do think that that's the reason that it  
5 is -- if we go back to the bigger topic, right, that there  
6 are more opportunities and they are growing and they're out  
7 there. But they're still not -- regardless of whether  
8 they're getting financing or not, they're still not turning  
9 to the public markets.  
10 MR. GIOVANNETTI: One last comment and we'll turn  
11 it back over. Different in my space, where it's a lot of  
12 capital intensity. A lot of the innovative companies have a  
13 really asset light kind of model with -- especially you're in  
14 software and you can avail yourself to cloud and, you know,  
15 computing power that's so cheap, your demand for capital is,  
16 you know, a small percentage of what it was, you know, 10, 15  
17 years ago.  
18 MR. SUISSA: Great point.  
19 MR. HUTCHINSON: Yet I think part of the focus on  
20 what we were talking about here is why are companies, you  
21 know, staying private. And so I think it's right, a lot of  
22 younger companies aren't getting the financing they might  
23 want and the money isn't moving down, it's pouring into sort  
24 of the biggest ones and it's keeping those biggest ones, that  
25 otherwise would have gone public, private longer. And so

1 that's kind of the -- at least the lens we're looking at  
2 this. But I take the point that it's not being spread across  
3 equally.  
4 MR. GIOVANNETTI: Small part.  
5 MR. NELSON: So it's wealth concentration.  
6 MR. HUTCHINSON: Yeah. And that's what's allowing  
7 some of these most successful tech companies to push out an  
8 IPO where, before, these huge pools of capital just weren't  
9 there and so, you know, the Googles and Microsoft, you know,  
10 was, I don't know, four or five years old and its market cap  
11 was \$400- or \$500 million when it went public.  
12 Where, you know, let's go to this slide, which is  
13 actually pretty interesting. It's a little hard to see --  
14 super hard to see. But the --  
15 MR. SUISSA: Just believe what we tell you.  
16 (Laughter.)  
17 MR. HUTCHINSON: The blue is how long they're  
18 private. The little orange dot is when they go public. And  
19 the black dot is when they hit 10 billion. And what you're  
20 seeing is, just looking at it, they are hitting 10 billion  
21 before they're going public. It goes from 1980 to 2015.  
22 But it's interesting. So all those companies up  
23 top were private for a shorter period of time, went public  
24 when they were smaller, and they rode the public markets up  
25 to a much bigger valuation.

1 And so what we're seeing now is just the opposite.  
2 Companies are staying private a lot longer. They're actually  
3 hitting these big valuations even before they go public. And  
4 one of the -- I think one of the primary reasons that's  
5 happening is really the mutual fund investors. And they too  
6 have backed off recently. But for a while there, that's how  
7 they made their money. They invested in all those orange  
8 dots when they went public. They didn't used to invest in  
9 private companies the same way, but they still got the same  
10 value creation, because they were in at that inflection point  
11 and then the company went public and they got to rise that  
12 value.  
13 Now, they have to get in when it's private or they  
14 miss out. And that's their whole business model, is to sort  
15 of, you know, ride the growth. So we've seen what otherwise  
16 would have been an IPO in terms of the size of the round and  
17 in terms of the liquidity being offered to the employees  
18 happening when it's a private company driven by mutual funds,  
19 sovereign wealth funds and the like.  
20 MR. SUISSA: And along with that point, and maybe  
21 this ties to what Jonathan and Catherine were mentioning  
22 earlier, valuations -- because there is a lot of money for  
23 these companies we are talking about, valuations get pushed  
24 up very high before they should be. In almost every case,  
25 before they should be. And it's because there is competition

1 and you can take money from whoever you want.  
 2 There is one company that's likely to go public  
 3 this year that in the past two rounds said, we're raising  
 4 money in two days and you have no access to any information,  
 5 period. Put your money down. And they raised several  
 6 hundreds of millions of dollars in two days. So it's just  
 7 the dynamic that's happening.

8 MR. HUTCHINSON: Yeah, I mean, T. Rowe Price in  
 9 Twitter, an \$800 million round shortly before they went  
 10 public, Fidelity in Facebook, Morgan Stanley Funds in Airbnb.

11 MR. SUISSA: Uber.

12 MR. HUTCHINSON: Yeah, Uber. I mean, these are the  
 13 type of companies getting these big -- doing these big  
 14 rounds.

15 And then what's happening with them is sort of a  
 16 secondary component, which is kind of a traditional IPO  
 17 thing, right? You have selling shareholders, the employees  
 18 then are able then to exercise options and get liquidity.

19 And what we've seen, and these are just some  
 20 snippets, you know, Yelp did a pretty small primary round and  
 21 then did a \$100 million buyback from employees. Alibaba,  
 22 before it went public, probably did the largest private  
 23 tender offer that -- ever, and certainly that we're aware of,  
 24 to, you know, thousands of employees, led by Silver Lake and  
 25 DST Global, you know, well north of a billion dollars.

1 And Mark Zuckerberg and Facebook were really  
 2 innovators in many respects, because they were losing the  
 3 talent war. They were four or five years old. People were  
 4 working for less than market rates in terms of salary. They  
 5 saw their friends, engineers at Google and Apple, able after  
 6 a couple years to exercise options and make money. And, you  
 7 know, Zuckerberg and that management team said, we've got to  
 8 fix this. We're not going to be able to attract the best  
 9 talent. How do we do it? And so back in 2009, when  
 10 everybody thought it was, you know, crazy, some investors put  
 11 in a lot of money in a primary at a really high valuation,  
 12 and put in a lot of money in a private tender offer to the  
 13 employee base that allowed for the exercise of options and  
 14 for employees to get a little bit of liquidity. You know, a  
 15 little bit. A million bucks, right? Which is a lot of money  
 16 to a 25-year-old engineer. But just a small fraction of what  
 17 their value they had on paper.

18 And you see the -- so then we saw -- it went from  
 19 kind of the wild west of secondary trading that people kind  
 20 of read about with Facebook, employees selling shares to  
 21 their dentist and things like that, not a lot of control, to  
 22 very controlled private liquidity programs that were done  
 23 purposefully and methodically to allow employees to get the  
 24 type of liquidity they might otherwise -- and early  
 25 investors, the type of liquidity they might have otherwise

1 gotten in an IPO.

2 So founder liquidity is no longer taboo. We're  
 3 seeing it as early as Series B rounds these days. And new  
 4 technologies, outfits like NASDAQ Private Markets, are able  
 5 to allow these transactions to happen the way that -- you  
 6 know, better, faster, cheaper. And so that they have become  
 7 sort of routine. They are periodic private liquidity  
 8 programs for these big tech unicorns that allow them to act  
 9 like a public company in terms of giving their employees that  
 10 equity incentive that actually can turn into money.

11 MR. SUISSA: And I will also say that applies to  
 12 the investors, too. So with VCs, we now have other  
 13 opportunities for getting out in the private markets at these  
 14 high valuations. And there are some of these companies where  
 15 the early VCs are already completely out. Right? I mean,  
 16 people don't realize that, but we are able to get out without  
 17 it being a signaling mechanism, which matters.

18 And because remember, even with these new big  
 19 growth rounds, they're not joining the board or advising the  
 20 CEO. It's still the early VCs who are doing that. And so  
 21 unless we feel the compulsion, it's hard to have the  
 22 entrepreneur feel the same compulsion.

23 MR. HUTCHINSON: So, you know, it's an excellent  
 24 point. We're seeing early stage VCs sell to the growth  
 25 equity investors, sell to the mutual funds and the sovereign

1 wealth funds. Where, you know, 10, 15 years ago, it would  
 2 have been really a bad signal for an early stage investor to  
 3 get liquidity before the company was sold or went public.  
 4 And now it's just sort of become a little more routine. And  
 5 there are pockets of capital that will -- the institutional  
 6 investors will be able to get liquidity from one another.

7 And, Julie, move us along if we're --

8 MR. REARDON: Can I ask a question? In 1980, I  
 9 worked on an initial public offering for a contract drilling  
 10 company in Houston. I don't mind telling you the name, it  
 11 was Drillers, Inc. -- I don't even know exactly what  
 12 iteration they're in. It was a \$20 million IPO. And now  
 13 that's -- that's worth -- I just calculated here, roughly \$58  
 14 million would be the equivalent of doing an IPO.

15 Now, is that size IPO -- because frankly, I don't  
 16 think our charge here is for the company that does an IPO at  
 17 a billion dollar valuation. We're much smaller than that.  
 18 We're worried about the guy with two dry cleaners. You know,  
 19 is the \$58 million IPO just currently off the table? You  
 20 would never do that now?

21 MR. HUTCHINSON: I think my answer is it absolutely  
 22 wouldn't happen.

23 MR. REARDON: Wouldn't happen?

24 MR. HUTCHINSON: Would not happen.

25 MR. NELSON: Why?

1 MR. HUTCHINSON: Because the market has changed.  
 2 Historically, there were investment banks that would do that  
 3 sort of deal and then cover it, have coverage on the back  
 4 side so that company would actually build and get market  
 5 attention. So those were sort of like the Alex Browns of the  
 6 world. They're gone. Hambrecht and Quist, they're gone.  
 7 Robertson Stephens, they're gone. It was the four horsemen,  
 8 they called them, and they were these sort of super-regional  
 9 investment banks that would take a company like that, also a  
 10 company like Microsoft, you know, which was kind of a smaller  
 11 business, public. And that doesn't really exist anymore.

12 I don't know if you're seeing it --

13 MR. SUISSA: No, it doesn't. Not going to happen,  
 14 I agree.

15 MR. NELSON: Why don't those investment banks exist  
 16 anymore? I'm just wondering.

17 MR. GIOVANNETTI: They got bought up around the  
 18 late '90s, going into -- so JP Morgan bought Hambrecht and  
 19 Quist. They all got bought.

20 MR. HUTCHINSON: Deutsche Bank bought Alex Brown.

21 MR. GIOVANNETTI: To try to get into this, you  
 22 know, innovative high-growth space.

23 But, you know, other things changed, too. So there  
 24 is, you know, the profitability of the whole analyst market  
 25 in banks, so that's one of the reasons analyst coverage is

1 goes to Jonathan's point. You know, partially me coming from  
 2 the tech world, I think of things. And everything that is  
 3 happening in my world is in California. Right? But there  
 4 are lots of companies growing in other parts of the company  
 5 that a VC wouldn't step foot in and this money is not going  
 6 to go to, no matter how well they're doing, right? And so --  
 7 and that probably goes to your broader point.

8 MR. NELSON: No, I mean, I'm in California and I  
 9 have a 55-company portfolio and in aggregate they're worth  
 10 about 600 million bucks. They've raised about \$100 million.  
 11 But 40 percent of my portfolio have women founders. And 4  
 12 percent of venture-funded startups have women executives.  
 13 And half of my portfolio is Hispanic founders, which is less  
 14 than 1 percent; 10 percent of my portfolio have black  
 15 founders, which is less than 1 percent.

16 And so --

17 MR. SUISSA: And those percentages are probably 500  
 18 percent of the percent of the other VCs, quite frankly.

19 MR. NELSON: Yeah, no. I mean, I've worked with  
 20 the White House on, you know, diversity sort of stuff. And  
 21 we have a blind selection process. So we just remove  
 22 people's names and pictures and that sort of stuff. And I  
 23 speak Spanish and so that's part of the Hispanic thing.

24 But I just -- it's hard for me -- what I see is  
 25 there is a broad bottom. You know, people can get to

1 hard to get and build your -- and we know that, I'm sure  
 2 you're all aware, there is this -- going on around  
 3 decimalization. Right? So it's a lower -- lower cap, less  
 4 liquid stock, it's harder for a bank to make a trading  
 5 profit. So does that deal look as interesting anymore?

6 Even if H&Q still existed, that would be a problem.  
 7 You know, that deal probably isn't as profitable anymore.  
 8 Even investment banking fees, there is good competition in  
 9 investment banking. The IPO is a 7 percent fee. But you see  
 10 a lot of follow-on offerings that get squeezed down to, you  
 11 know, 3 or 4 percent, because there's enough competition.  
 12 Now, that's really happening with the ones everyone wants  
 13 into. But generally, that whole banking model is less  
 14 profitable. So that is a challenge.

15 And then you have investors who have a lot of  
 16 capitals to put to work. And so it's a 25 or now if it's 50  
 17 with inflation, you know, and you're going to get a 10  
 18 percent allocation of that, you know, do you want to write a  
 19 \$5 million check? Some may. But, you know, a lot of the  
 20 mutual funds are like, I need to put 40- to 50 million to  
 21 work at a time, because I just have so much capital. If I'm  
 22 going to spend all that time to listen to the banker pitch,  
 23 understand the company, get excited about it, I can't just  
 24 put \$4- or \$5 million to work, I've got to put more to work.

25 MR. SUISSA: It's an interesting problem. And this

1 accelerators. They might be able to get to \$1- or \$2  
 2 million. And there's this huge scrunch. And then if I need  
 3 a \$100 million check, that's actually a lot easier to come  
 4 by.

5 MR. SUISSA: Correct. That's right.

6 MR. HUTCHINSON: Seven to 10 million is tough  
 7 money.

8 MR. NELSON: And so, you know, which is why we're  
 9 talking about secondary liquidity options, why that's an  
 10 issue, and which is why Catherine was talking about angel  
 11 investor fatigue, because there's no liquidity for these  
 12 investors. And it just -- it feels broken for those small,  
 13 sub-\$100 million businesses.

14 MS. YAMANAKA: I think you're right, Jonathan. And  
 15 I'm not worried about you guys. You're going to make out.  
 16 The top always makes out. You keep doing what you're doing,  
 17 and do it some more.

18 Unfortunately or fortunately, I think what we're  
 19 here for is to figure out, you know, the 99.9995 percent that  
 20 don't fit into this model. So I think your information  
 21 actually is very interesting. It helps me understand why  
 22 that perception. And, you know, the gushers of capital. And  
 23 when we saw it, we're like, where are these gushers? Other  
 24 than, you know, up there in the Silicon Valley.

25 MS. HANKS: Only gushing in the valley.

1 MS. YAMANAKA: Yeah, very narrow part, right?  
 2 Within one day's drive, all those stats, whatever.  
 3 So I think our challenge is to identify what you  
 4 guys are doing really well, why you're doing it, and how can  
 5 actually we roll it out to where a greater portion -- in  
 6 fact, greater numbers, maybe not in dollars, but the greater  
 7 numbers of people are going to participate in this, grow  
 8 jobs, grow businesses, grow capital. It's going to help out,  
 9 maybe not to the extent that your, you know, demographics  
 10 work out. But is there something that we could take, apply  
 11 and learn, or is this just like going to the moon versus  
 12 going to the grocery store? Does it not apply at all.  
 13 MR. HUTCHINSON: I think it's a little off topic  
 14 from this, but certainly when there is a tremendous amount of  
 15 competition for very few deals, venture capitalists at their  
 16 heart are entrepreneurs themselves, and very smart, and  
 17 they'll seek opportunities that not everyone else is chasing  
 18 because it's too hard or too expensive. So Steve Case in  
 19 Revolution talking about looking into jurisdictions that  
 20 aren't Silicon Valley.  
 21 And I think just anecdotally, we're seeing more of  
 22 that. Things like companies in New Orleans, in Louisiana,  
 23 that you know, I've never done a deal there. And all of a  
 24 sudden in the past couple months, we're starting to see  
 25 things. You know, North Carolina has historically had a

1 solid base, and we're seeing more activity there.  
 2 So I think, because of this phenomenon and the  
 3 hyper competition for the best deals, you could see smart  
 4 money saying, I don't want to overpay. There are smart  
 5 people in other places in this country, let's go see if we  
 6 can find -- unearth some of that. But you might have a  
 7 different perspective.  
 8 MR. SUISSA: No, I agree with that. And so our  
 9 fund, SineWave, because I came from some of the bigger funds  
 10 like NEA, we only invest with those funds, actually, for  
 11 financing risk, which is at the heart of what a lot of you  
 12 are talking about. And I will say that the really top tier  
 13 funds are not -- they'll pretend they are and the press will  
 14 say that and they would deny it to the nth degree, but they  
 15 are not doing a lot of deals right now, at all. And I know  
 16 that, because I'm looking to invest with them. I invest  
 17 alongside them. I monitor and I work with them as partners.  
 18 And they're just not doing a lot of deals right now. But  
 19 we're more than happy to watch all the others bump up our  
 20 existing deals. Right?  
 21 So that is an important phenomenon, and you see  
 22 some firms who used to be investing all the time taking on  
 23 different industries. All of a sudden, VCs like insurance.  
 24 Like no one ever paid attention to insurance before. All of  
 25 a sudden, they like --

1 MR. GIOVANNETTI: FinTech.  
 2 MR. SUISSA: Yeah, FinTech. So there's trends,  
 3 right, and it changes and people will follow where the  
 4 opportunities are.  
 5 MR. REARDON: Could I ask another question? Julie  
 6 or Sebastian, in the law that passed last year at the end of  
 7 the year, creating the advocate for small business, there was  
 8 a definition of small business that was \$100 million assets.  
 9 Is that what it was?  
 10 MR. GOMEZ: So, Patrick, I think you're referring  
 11 to the fact that when the bill created the committee portion  
 12 of the bill that this committee codified, it uses the same  
 13 definition that this committee has of looking for private and  
 14 public companies up to 250 million.  
 15 MR. REARDON: 250 million, okay. I'm a lawyer; I'm  
 16 not good with numbers.  
 17 All right, I've got a company that's worth \$250  
 18 million or it's going to be worth \$250 million, but it's not  
 19 a whiz-bang industry. It's not, you know, blood testing or  
 20 anything in Silicon Valley. It may be a smokestack industry,  
 21 it may be in Texas, it may be conventional oil and gas.  
 22 Where do I go to finance that? What's the answer there?  
 23 Putting aside all the glitzy, glamor stuff that is going  
 24 public at a billion dollars and is producing two to three  
 25 times return on money, I mean, just the -- in Iowa or Texas

1 or wherever you're from, the flyover zone, we've got  
 2 companies out there that need money, they employ people, they  
 3 pay taxes, they make a decent profit. Where do we go to get  
 4 money for those companies?  
 5 MR. HUTCHINSON: So I think it's hard to finance  
 6 them from an equity finance perspective. I think that they  
 7 will be able to tap into debt markets. But the reality is,  
 8 it's harder to finance it than it is to sell it. There is a  
 9 huge part of the private equity industry on the buyout side  
 10 that's focused on the middle market. And a \$250 million  
 11 company that's making money in a traditional industry, there  
 12 will be a line 20 deep to buy that company by private equity  
 13 sponsors.  
 14 But if you want to sell 10 percent of it and try to  
 15 build it, that's a harder one. Because the buyout shops will  
 16 take control all day long. And they'll actually -- it's  
 17 almost universal in deals right now where the management team  
 18 will probably be asked to, quote, roll over. So sell 80  
 19 percent of the company or 75 percent of the company and keep  
 20 a minority position from the original founder.  
 21 But it is hard for those sorts of traditional  
 22 businesses to find equity financing. My opinion.  
 23 MR. SUISSA: So this may be a little bit of a  
 24 tangent, but I think all of this including the bigger topic  
 25 comes down to marketing. And the reason -- I think the

1 number one reason if you ask me why should a company go  
2 public, I don't think any of the ones -- we dismissed a lot  
3 of the ones as not being relevant anymore. The only one that  
4 I still think resonates is the legitimacy point. Right?  
5 Being able to be, I am a public company, I am real.  
6 Everything else can be done elsewhere.

7 But when that marketing thing turns against you,  
8 right, like when companies go public and they're already  
9 criticized in the first quarter for not producing -- the  
10 number one thing when our companies go public is they're not  
11 profitable. It's because they're throwing all their money  
12 into growth, right? That's what they're supposed to do.  
13 Like we don't look for them to break even, we look for them  
14 to grow and grow and grow. And it ends up killing them.

15 Like, or you have a model -- and I'm not arguing  
16 about any particular company's value, but you have a model  
17 like Groupon who says, look, the way we do our business is  
18 different than the way you think about things, so we're going  
19 to approach this a little bit differently, right? And that  
20 may be good or bad or legal or not legal, or whatever the  
21 drama was. But that was a problem for them, right? And they  
22 pulled -- it really hurt them, in a big way.

23 Similarly, with these companies, right, the ones  
24 that you're talking about, Patrick, it's a marketing thing.  
25 Right, if I view you as this little company in the middle of

1 wanted to get it to be a \$250 million company and they don't  
2 have any molecular chemists working for them or anything like  
3 that. It's something that's, you know, it's one of those  
4 ugly businesses that just makes money, okay? So what do I do  
5 to finance it to get it to -- maybe it has the potential to  
6 go to a quarter of a billion in assets. I mean, venture  
7 capital comes to mind, angels come to mind.

8 I mean, angels are local. Venture capital, you  
9 know, we do have some financing sources in Texas. Are those  
10 the choices? I mean, industry partners. I assume that you  
11 can do joint ventures or something like that, even if the  
12 company doesn't want to buy you, they may do a JV or  
13 something like that. Are those the options that are  
14 available if we can't do a public offering?

15 I'm just trying to figure out. And I realize I'm  
16 outside of your fairway. I'm a little smaller. But help me  
17 here understand what the financing options are, if I'm not in  
18 a whiz-bang, sizzling business but it's just one of those  
19 ugly old --

20 MR. GIOVANNETTI: And debt is not an option?

21 MR. REARDON: Well, I mean, you can only take debt  
22 so far. I mean, at some point, somebody is going to wise up  
23 and say, I'm not going to get my money back.

24 MR. GIOVANNETTI: Well, it depends on how much cash  
25 flow is coming into a business, and stabilizes, right?

1 -- why is so much in the valley? Right? It's in the valley  
2 and people think you need to come to the valley because you  
3 need that stamp in order to attract capital and you need that  
4 stamp in order to attract talent. And everybody thinks they  
5 need to go there in order to work at a great tech firm. So  
6 everything starts to congeal in one place, right?

7 And if you market -- and so people are really  
8 interested in growth, and that's why venture is really hot.  
9 But I'll tell you, people are pulling back from that right  
10 now, right? People are interested in stable returns right  
11 now.

12 And so there is an opportunity in some of these  
13 other places, where there are stable businesses in  
14 traditionally stable industries that have stable returns and  
15 give you an alternative to -- just give you an opportunity.  
16 A lot of them don't even think there are alternatives.

17 And I don't know what that means. Right? But I do  
18 think it's about how you spin it, how you market it and how  
19 the people who need to hear that marketing hear it. Right?  
20 So how do you publicize that to the folks who aren't in  
21 Dallas or aren't in New Orleans, like Jamie mentioned.

22 MR. REARDON: Okay, now, let's say I've got this  
23 company that I did the public offering for in 1980. And  
24 let's use \$60 million as a round number. This company is a  
25 private company, it's got a \$60 million value on it. If I

1 MR. REARDON: Right. But suppose it's all going  
2 back into growth. I mean, maybe if you're building  
3 smokestack, there's collateral being created there that the  
4 bank gets excited about. But, you know, we know about banks  
5 and we have banks.

6 MR. HUTCHINSON: I mean, I think the quickest way  
7 to 250 million, and we see it all the time, is through a --  
8 sell control to a private equity fund and they invest in you,  
9 so you sell 60, 75 percent of it to, you know, middle market  
10 buyout fund in Boston or Chicago and they will then invest  
11 into that company to do more acquisitions, to consolidate  
12 smaller players. And that's sort of the path of least  
13 resistance.

14 But the quid pro quo is the founder is giving up  
15 control.

16 MR. REARDON: Right.

17 MR. HUTCHINSON: But they've gotten some liquidity  
18 once. And we've seen it work really well for founders and  
19 families to give up that control, turn over, you know, that  
20 control to institutional investors, professional boards, go  
21 out and do a couple of acquisitions, and the next thing you  
22 know you have increased the value to 250 million. And that  
23 second bite at the apple for that rollover piece can be  
24 meaningful.

25 MR. REARDON: Right.

1 MR. HUTCHINSON: That's the path of least  
2 resistance. But, you know, there are joint ventures and  
3 taking debt and trying to find a family office.

4 We've seen sort of a real expansion of what we call  
5 fundless sponsors. You know, individuals that are out of the  
6 big private equity shops that don't have committed pools of  
7 capital but know how to do deals. They will find a company  
8 like that and say, look, I will bring in some private equity  
9 partners and help you build the business.

10 We're seeing a lot of transactions and those are  
11 particularly -- a \$50 million tee shirt company in Atlanta,  
12 you know, a health care services company in Cleveland. I  
13 mean, those are the sort of things where you're seeing  
14 private -- middle market private equity really play a role.

15 MR. REARDON: I'm sorry, I'll pass on my next  
16 question. I'll let Jonathan speak.

17 MR. NELSON: If you guys were going to design a  
18 system -- okay, we have a magic wand and we're going to  
19 design a system for investors to be able to raise \$10-, \$20-,  
20 \$50 million, or for companies to be able to raise from \$1-  
21 to, I don't know, \$100 million and then achieve liquidity on  
22 the back end, what would that do or what would you tweak  
23 about the current system?

24 MR. HUTCHINSON: That's a hard one.

25 MR. SUISSA: Depends who you are. Right? So as a

1 is because, you know, the less options you have, the more  
2 you've got to go with me, the better it is for me. Right?  
3 So that's, you know, a caveat.

4 MR. NELSON: So is that basically more efficient  
5 markets?

6 MR. SUISSA: To a degree. It's also why you see  
7 the development of -- so my firm is a great example of this,  
8 as is kind of the phenomenon that Andreessen Horowitz has set  
9 the VC world to which is, you know, the value-added investor.  
10 Right? Which was kind of a fake term, you know, a decade ago  
11 and is now a real term. If you have a choice, then the model  
12 needs to change, right? We need to find other ways to help  
13 our companies and add value or you can't get in. And so I  
14 think that's a similar element, too. So the more  
15 information, the more opportunity, the more I have to do  
16 more, which by the way is in all the incentives of what you  
17 guys are trying to accomplish, right?

18 MS. MOTT: So I would like to switch back, please,  
19 to liquidity. One of the things we have been discussing is  
20 we want to try to understand the impact on the fact that  
21 investors invest and hold things longer. Therefore, there is  
22 less money coming back into the market. So I see that as,  
23 okay, so typically there would be a liquidity event and that  
24 money, the profits, would be plowed right back into the --  
25 into the economy in some other new startups or maybe they

1 VC, I have different incentives than an entrepreneur, who has  
2 different incentives, et cetera, et cetera. So I'll be  
3 against my interests and talk as an entrepreneur, right?

4 And so you already see things developing of this  
5 nature, right? Like Kickstarter is a very basic example of  
6 an alternative way to raise money that takes us out of the  
7 equation. Sometimes, I think it's a dumb choice to go on  
8 Kickstarter and sometimes it's a smart choice. Right? And  
9 similarly, Angel List is another great example of that.

10 You also have several of these kind of family  
11 office networks or middle tier institutional networks,  
12 probably ones that are relevant to what Patrick's doing,  
13 actually, creating these kinds of groups that deals can post  
14 on the platform, when anyone sees it, people can comment.  
15 Kind of like an Angel List, but for all stages of things,  
16 including for funds, right?

17 And I do think that it's about the information.  
18 Right? So it's about if entrepreneurs -- there's a lot of  
19 people to finance these things and a lot of people looking  
20 for the money. So it's about making the connection between  
21 the two. Right? And so I do see the proliferations allowing  
22 that.

23 So the answer is, the more information, the more  
24 you can connect the parties, the better.

25 For me -- the reason I say it's different for a VC

1 took it and bought another house somewhere. So again, it's  
2 fueling the economy.

3 So what we're trying to understand is what can we  
4 do for or how can we understand this? Is this a blip? You  
5 know, at some point in time, and I agree with you, there's a  
6 lot of not-smart money out there. And at some point, will  
7 they experience investor fatigue and then just get out of the  
8 market and then things settle down a little bit?

9 So we're trying to work through this other piece  
10 that we've talked about is I think there's -- and I'm anxious  
11 to hear from the SEC how the tick pilot is going. So, you  
12 know, at one time there was a lower tier public market. It  
13 doesn't exist anymore. And does that seem like it's  
14 something like we should be exploring or considering so that  
15 again we can create this -- I'm calling it velocity of money,  
16 but that's probably an incorrect term. That's a Treasury  
17 term and I'm probably using it wrong.

18 So what are your thoughts about, you know,  
19 liquidity, how that impacts IRR, how it impacts, you know,  
20 the flow of money into the economy long term, even though  
21 there's a like -- to me, I look at it and I say, supply,  
22 demand. Supply is pretty big right now, so that's impacting  
23 what we're seeing, is supply.

24 So what are your thoughts on liquidity options? So  
25 I'm sort of throwing a whole bunch of questions --

1 MR. SUISSA: I'll just say one thing and then let  
2 these guys chime in, because I think they know more about it.

3 I don't think there's a lack of liquidity at all.  
4 I just think it's in different places than you think it is.  
5 So -- and that's kind of the point of the conversation.  
6 Right? There's other ways to get out, there's other ways to  
7 move money, there's other ways to exit at all different  
8 stages. And that's actually why less companies are going  
9 public, in my opinion, because it is not the only option for  
10 liquidity.

11 MR. HUTCHINSON: There is more liquidity now than  
12 ever.

13 MR. SUISSA: Yeah, I agree.

14 MR. HUTCHINSON: And, you know, things like 4(a)(7)  
15 to make it a little clearer that, yes, there's a way to do  
16 it. But, you know, in 2000 and before the 2007, you would  
17 really never see founders and employees getting liquidity  
18 until the venture investors got liquidity. And now we see --

19 MS. MOTT: Sooner.

20 MR. HUTCHINSON: Sooner. Like in a Series B round  
21 is sort of the first place we see it, which is pretty early.

22 You know, the company still has a long ways to go but we're  
23 seeing founders and some early employees being able to get  
24 liquidity. And then seeing programmatic, frequent, you know,  
25 once a quarter or twice a year type of liquidity for the

1 larger private companies. That didn't exist. And, you know,  
2 things -- technologies that allow that to occur easier, you  
3 know, are sort of all contributing to this additional  
4 liquidity that we have now.

5 And those people are buying houses. And, you know,  
6 I think the real estate prices in Silicon Valley reflect a  
7 lot more liquidity.

8 MR. SUISSA: It is not without conflict, either.  
9 People are concerned about it still because, you know, it  
10 incentives, right? So the reason it's happening is because  
11 of the talent crunch, right? People need to be able to keep  
12 their talent. But then it's also when you're giving talent a  
13 way out of being locked into the incentive structure, it  
14 creates a problem. So people are still trying to figure it  
15 out.

16 I don't think any of the companies have figured it  
17 out, you know, to a tee yet.

18 MR. GIOVANNETTI: They could have gone public.

19 MS. MOTT: I was going to say that also for life  
20 science biotech? I mean, my sense of what they're doing  
21 with their capital really has to be in clinical development.

22 MR. GIOVANNETTI: A hundred percent.

23 MS. MOTT: I mean, clinical trials. So that would  
24 be different, would you agree?

25 MR. GIOVANNETTI: Yeah, and they still adopt much

1 more of a traditional model. I mean, it might not be  
2 founding, three years to an IPO, it might be five, eight,  
3 depending on, you know, where the market is. Because they  
4 don't really have a choice because, you know, even to this  
5 point you have to get your employees liquidity, you only have  
6 to get them there because there's masses sources of private  
7 capital that can keep you private and you get to keep control  
8 and there's a benefit for that, right? If that didn't exist,  
9 you would do an IPO because you still need capital.

10 MR. SUISSA: That's a good point.

11 MR. GIOVANNETTI: All of these phenomena are about  
12 the larger market forces that are at work. To the extent  
13 that many of those don't apply in biotech, we see more of a  
14 traditional model. And so we don't see founders getting out  
15 until after the lockups on an IPO, much the way tech was 15  
16 years ago. It really hasn't changed, you know.

17 I do think, just to the -- you brought up the tick  
18 size. That is interesting to watch and we will see what the  
19 results are of that as well. Whether that will create float  
20 for some of these smaller cap stocks and keep banks and  
21 analysts in the game so you don't -- you know, you might have  
22 a different calculus in going public. It's not going to  
23 change the calculus of I've got private capital, I don't need  
24 to go public. But, you know, if you're a company that  
25 otherwise is or that market dries up, I still don't think

1 it's going to overcome -- anything like that is going to  
2 overcome the fact that a lot of public investors even want to  
3 put big chunks of capital to work and it's got to have enough  
4 of a float to make that work for them, right? That's just  
5 where a lot of the capital -- the pools that it's invested  
6 from, you know, that's a phenomenon that's going to be  
7 difficult to overcome. But, you know, this could be helpful.

8 MS. HANKS: Can I raise a question that's going to  
9 tie into something that we talked about this morning, which  
10 was liquidity in the Regulation A space? When you talk about  
11 companies as early as the Series B round, what size of  
12 company are we talking about there? Because I have a feeling  
13 that the companies we were talking about this morning are  
14 very much smaller than the guys who are now getting liquidity  
15 as early as Series B.

16 MR. HUTCHINSON: So maybe, you know, a \$12- to \$15  
17 million premoney value, maybe up to 20 million. And they're  
18 raising, you know, sort of \$5- to \$10 million.

19 MR. SUISSA: Is that for Series B?

20 MR. HUTCHINSON: Yeah, on the small side.

21 MR. SUISSA: Oh, okay. I mean, that's like what  
22 the A is now, because the valuations have gone up.

23 Typical -- I mean, traditionally a Series B company  
24 was a company, you know, had maybe 5 million in revenue, 5 to  
25 10 in revenue kind of thing, like early revenue. Around the

1 like, you know, 30s, 40s, 50s in valuation. You know, 10X  
2 would be high, right, of that revenue multiple.

3 Now, like a typical -- an A can get that high.  
4 More like the 20s, 30s. But things have just been pushed up.

5 But traditionally, Jamie is correct, that's the  
6 right size.

7 MR. HUTCHINSON: Fenwick does a really nice study  
8 every quarter, showing sort of where the value from the A and  
9 the B is. And I was actually just looking at theirs. So I  
10 think things -- it definitely is creeping higher for every  
11 round.

12 MR. SUISSA: And size wise, too. Bs used to be  
13 like \$15 million infusion and now they can be up to like 40  
14 million, 50 million.

15 MR. GIOVANNETTI: I know biotech is nitchy, but the  
16 other thing that really has changed is I can't remember the  
17 last time I helped an entrepreneur with a business plan and  
18 pitched it to a VC. VCs create their own companies, they  
19 figure out where the science is, they go find the management  
20 team, they license it, and it's very much a build your own.  
21 So they're not looking at 200 deals, like the way it is in  
22 tech, where you can start something with low capital; you're  
23 going to need a lot of capital to begin with.

24 And in the '90s, when it was Hambrecht and Quist  
25 and Robertson Stephens, you know, I did a lot of IPOs where

1 was 25 and then you did a 30 down the road, you know, that's  
2 not a bad income stream, right, for a smaller bank. And you  
3 got some trading out of it. And you might get an M&A deal  
4 out of one of them. So, you know, it's not -- they got  
5 pretty good multiples at the time when tech was first really  
6 taking off.

7 MR. SUISSA: This might be a switch a little bit,  
8 but I've been thinking about, Jonathan, about your firm and  
9 the numbers and how to -- and also the question of how do we  
10 fix some of these things. A mentor of mine, Steve Koltai,  
11 who writes a lot on entrepreneurship has this whole list of  
12 things that are required for a successful entrepreneurship  
13 ecosystem. And one of the ones I always remember is  
14 celebrating the wins. And I think that's key. Right?

15 So when you go invest in the middle of the country  
16 -- it happened with New York. So when New York became a big  
17 venture ecosystem, people threw tons of money in and tons of  
18 money in, and then it all stopped. Because everyone is like,  
19 where are the IPOs? Where are the exits? It's like a nice  
20 idea for a few years and we'll all jump on the band wagon,  
21 because by nature human beings are lemmings, including  
22 investors. And we'll all do it and we'll all go after it.  
23 But until you see the wins, no one is going to do it. And  
24 when you do see the wins, if no one knows about it, that  
25 might be good for you as an investor because you have dibs on

1 the funds raised were 20 million, 25 million, 15 -- I can  
2 remember a 15 million.

3 We won't even really look seriously about getting  
4 involved with a company in Series A in life sciences if it  
5 hasn't raised 20 or 25, because it's a couple of years of  
6 burn. You know, if they've only raised five, it's like, by  
7 the time we get involved, they may not be here, right. So  
8 the scale is completely different. But it also comes from  
9 the fact that investors have learned, saying it's too risky,  
10 in a way, to go to the entrepreneur, so to speak. They want  
11 to -- they're already walking the halls in the labs to figure  
12 out who the potential entrepreneur is and recruiting them  
13 out. So it's a very different dynamic.

14 MR. NELSON: Can you talk a little bit more about  
15 what it was like when you had those smaller investment banks  
16 raising smaller rounds for more companies? Like what were  
17 their economics like? What were their economics like?

18 MR. GIOVANNETTI: They were doing 7 percent, you  
19 know, on the IPO, same. They were -- they were probably  
20 making a little -- and I'm not a banking expert. They were  
21 probably making a little more on the trades after. And at  
22 least in life sciences and a lot in tech, you would count on  
23 two or three pretty fast follow-ons at that same 7, 8  
24 percent. So you could see -- you know, even though it was a  
25 small dollar to begin with, maybe it was 15, your secondary

1 those great opportunities, but it doesn't encourage more  
2 money to come in.

3 So there is something about, you know, identifying  
4 the wins, identifying the success stories, and being able to  
5 make them more clear. So in your business, with the  
6 different minorities and women and gender and running things,  
7 you know, show the wins.

8 We had that at NEA with Care.com, when Sheila took  
9 her company public. So the more you -- the more you  
10 publicize, the more people see that it actually works and,  
11 you know, affects their bottom line, the more they're  
12 interested.

13 MS. HANKS: We've only got a few minutes left. I  
14 just wanted to make sure, is there anything from the  
15 panelists that you think we've missed? Any insights or  
16 slides?

17 I'm pleased that the conversation has gone exactly  
18 the way that we need it to go, but are we missing anything  
19 from your point of view?

20 MR. HUTCHINSON: I think maybe just, you know, one  
21 of the points about why companies aren't going public is  
22 there is a lot of M&A still, and you're seeing it in the big  
23 strategics. And could you see more of it if the repatriation  
24 of cash under the new administration is allowed in a tax  
25 efficient way? You can't underestimate the effect that that

1 has on a lot of companies. Just they get big enough and then  
2 Google or Oracle or Cisco comes in and makes a compelling  
3 offer and they sell before they would even get the chance to  
4 go public.

5 And just recently we're seeing, you know, these  
6 dual track -- where a company will file to go public and  
7 right before they go, a big strategic will snap them up.  
8 Cisco did that with AppDynamics, Stone Canyon did it with  
9 Mauser. And those are just in the past couple months.

10 So I think that is -- we touched on it, but that's  
11 an important issue why companies are staying private longer  
12 or just not even ever getting the chance to go public,  
13 because there are deep pools of capital. The big strategics  
14 have a lot of equity cash. Debt is cheap and they're able to  
15 pay, you know, top dollar to take these companies sort of out  
16 of play.

17 MR. GIOVANNETTI: And you're showing the big guys  
18 in tech, but this is happening in other sectors. You know,  
19 talk about banking and insurance, they're monitoring the  
20 FinTech startups. We started keeping a database of like  
21 5,000 FinTech companies because the banks want to know,  
22 should we buy them, are they innovators, are they  
23 competition, who's-going-to-eat-our-lunch kind of thing.  
24 It's happening in consumer products.

25 A lot of companies have set up their own internal

1 innovation arms, realized that it's hard to create an  
2 innovative culture yourself, and so they're much more looking  
3 externally, saying do I partner it or do I buy it in.

4 And, you know, it's not always tech but it's often  
5 got a tech feel to it. But the acquirer is not always a tech  
6 company. So there are many that I would put in that serial  
7 acquirer category.

8 MR. HUTCHINSON: And it's not even a public  
9 company. I mean, we're just starting maybe to see the tip of  
10 the iceberg as, you know, Uber and DD and Airbnb, for  
11 example, have recently announced acquisitions, have been able  
12 to borrow a bunch of money. You know, could we see that sort  
13 of strategic expand outside of the historically large public  
14 companies that did that sort of M&A.

15 And the last issue, it's still expensive to be  
16 public. And, you know, to Jonathan's point, maybe around why  
17 we're not seeing some of these smaller public companies is,  
18 you know, the compliance makes it -- makes it expensive.  
19 It's real money. I mean, it's millions of dollars to go  
20 public and it's millions of dollars to stay public. And it  
21 has to sort of be economically -- make economic sense to do  
22 that and make that investment. Those are probably the  
23 biggest ones we didn't touch on.

24 MR. SUISSA: I had a subjective one that I think is  
25 worth mentioning. So the mentality aspect of things is

1 really important. So, you know, entrepreneurs, Jamie  
2 mentioned this early, they believe in their company, they  
3 want to grow it, they're long term, they don't care about  
4 this stuff and they don't want to hear you telling them that  
5 they're not -- you know, that their, you know, passion is not  
6 real or not working because you don't understand it. Right?  
7 And so I think that's what kind of pulls them away.

8 But the VCs are really important, too. So VCs,  
9 when they invest in something or they have a bad experience,  
10 they wear their scars forever. They just don't forget. It's  
11 amazing. We'll have a meeting. Well, do you remember 15  
12 years ago when we did this thing? It's like, there were no  
13 phones, or whatever, Apple didn't exist or whatever, right?

14 (Laughter.)

15 MR. SUISSA: And they don't forget. And when they  
16 do take the leap back in, which they ultimately do, often, if  
17 they get hurt again, it almost kills the opportunity set.  
18 And I would say VCs have been significantly -- I would say  
19 they feel scars, whether they will admit it or not, from the  
20 most recent IPOs or the past IPOs. Some recent examples, we  
21 already gave examples of. And all of them have had it with  
22 something, because we're all in different deals but all in a  
23 lot of the same deals, too.

24 This year is a very crucial year, because there are  
25 a lot of tech companies going public this year, or that are

1 expected to. And the good news for the bigger point is,  
2 there does get a point in which we say, all right, this is  
3 ridiculous, you need to go public. Like there is a point at  
4 which everyone is like, this just needs to happen.

5 I don't have any insider knowledge, but I would bet  
6 Uber is feeling that, I would bet Airbnb is feeling that.  
7 Right? So there are these -- there is a point at which it  
8 has to happen.

9 But if it doesn't go well, it will, especially  
10 given all the new opportunities and options and alternative  
11 routes, it will kill it. So, fingers crossed. And if there  
12 is a way to mediate that, that would be a great thing.

13 MS. HANKS: All right, thank you. Any follow-up  
14 questions, wind-up questions from our panelists?

15 MR. NELSON: Just my personal stuff is on my  
16 sleeve, of course. But I'm actively looking at taking  
17 companies, like doing a Reg A offering and then seeing if the  
18 compliance is actually about the same as taking a company  
19 public on the London AIM exchange. For them, \$5 million a  
20 year, growing 30 percent year over year is actually a nice  
21 IPO. Or even looking at the Australian Stock Exchange and,  
22 you know, being public but actively traded on a foreign  
23 exchange.

24 MS. TIERNEY: I think just one thing, to go back to  
25 some of the themes that you guys have touched on, there was a

1 market for small IPOs that does not exist anymore. These  
2 companies do not belong in the public markets at, you know,  
3 even like sub-billion dollar market cap companies, they  
4 struggle. You're not going to get research written about  
5 your company, you're not going to have a bank getting you to  
6 your next deal. The cost of being public, it says 2.5 up  
7 there. I've talked about being the general counsel of a  
8 public company, Brian has as well. Those are real costs.

9 So, you know, it's great to say we want companies  
10 to go public, and we do. There are definitely wonderful  
11 reasons and valid reasons for a company to go public. But  
12 until we've sorted out some of the things like tick size  
13 instead of decimalization, right, that does provide more  
14 spread for research and other sort of things that came with,  
15 you know, penny increment trading before that change.

16 But there are enough market forces right now that I  
17 think our goal should also be to do what we talked about  
18 earlier today, is try to find a way to help create off-  
19 public-exchange liquidity for these companies that are very  
20 successful, they're just not, you know, tech unicorns. So I  
21 think that has to be part of what we focus on, because those  
22 companies are private, they're getting funding, they can get  
23 debt, whatever. They're not the ones we're seeing in the  
24 news. But they probably also shouldn't be in a highly  
25 illiquid public market listing.

1 could be.

2 Based on our prior discussions, we have come up  
3 with a draft recommendations. You should all have both --  
4 have received soft and now you've got hard copies of the  
5 recommendation. And so I think you have also seen the  
6 suggestions that Greg Yadley sent around to make changes to  
7 that wording. And the changes that Greg had suggested were  
8 to change the recommendation. The recommendation is at the  
9 bottom of the page.

10 And his -- of course now I've lost his statement.

11 He says instead of saying while generally the  
12 definition of diversity should be up to each issuer, issuers  
13 should include disclosure regarding race, gender and  
14 ethnicity of each member/nominee as self-identified by the  
15 individual. That's in our current draft.

16 The alternative language being suggested is, while  
17 generally the definition of diversity should be up to each  
18 issuer, issuers should include disclosure whether race,  
19 gender and ethnicity of each member/nominee, as self-  
20 identified by the individual, are considered.

21 Anybody got any opinions as to -- yeah.

22 So we're looking at the sentence that begins, while  
23 generally. And it -- the alternative that Greg is suggesting  
24 is, while generally the definition of diversity should be up  
25 to each issuer, issuers should include disclosure whether

1 MS. HANKS: Anybody else?

2 Well, thank you very much indeed. That was really  
3 useful. Thank you.

4 MR. SUISSA: Thanks for having us.  
5 (Applause.)

6 MS. HANKS: Julie, can we get the slides sent  
7 round?

8 MS. DAVIS: They're on the web, but I'll --

9 MS. HANKS: Thank you.

10 Okay, guys. We're going to move on to the final  
11 piece of today's program, which is board diversity.

12 We've now had a couple of discussions on the  
13 recommendations, spent a good portion of our time on October  
14 5, as well as the conference call on December 7.

15 As you will recall, currently Regulation SK and  
16 Item 407(c)(2)(vi) requires companies to disclose in their  
17 proxy statements whether a nominating committee considers  
18 diversity in identifying nominees for the company's board of  
19 directors. The rule also requires that if the company has a  
20 policy with respect to the consideration of diversity in  
21 identifying director nominees, how that policy is implemented  
22 and how its effectiveness is assessed.

23 As we have discussed, the disclosure requirement is  
24 soft, diversity is not defined, which means the regulation  
25 hasn't been as helpful in generating useful information as it

1 race, gender and ethnicity of each member/nominee, as self-  
2 identified by the individual, are considered.

3 There's a slightly different spin on the -- no, the  
4 race, gender and ethnicity of each member would be still  
5 self-identified. That is still included.

6 MS. MOTT: He just changed the word -- he just  
7 changed the word "regarding" to "whether."

8 MS. HANKS: "Are considered." Yeah.

9 MS. YAMANAKA: So it kind of changes --

10 MS. HANKS: It's did you think about this, did you  
11 consider it. That's the big change between the two.

12 MS. SCHIMPP: From my standpoint, it just strikes  
13 me as less useful information. The answer is, yes/no, and it  
14 doesn't give you any granularity on gender, racial, ethnic,  
15 you know, representation. Which is really what the value add  
16 of this kind of report could be.

17 MS. HANKS: The original is more what have you got  
18 on your board.

19 MS. SCHIMPP: Right.

20 MS. HANKS: And then the new one was, did you think  
21 about who you've got on your board. And apologies to Greg if  
22 he's listening in; I'm totally misphrasing that.

23 MS. MOTT: Yeah, but we discussed that. And --

24 MS. HANKS: We have discussed these words a lot.

25 MS. MOTT: I know. I mean, okay, so we did discuss

1 it and my preference was for the detail. I like the original  
2 language that we have.

3 MS. HANKS: Any opposing? All right.

4 So I think the sense of the panel is that we would  
5 leave the language as it is currently drafted. Okay.

6 And what about the last sentence? Greg is asking  
7 -- this is the sentence. While disclosure should be the  
8 default, issuers should have the option to opt out. Do we  
9 keep that sentence?

10 MR. NELSON: Yes.

11 MS. YAMANAKA: The way I'm reading it is that we're  
12 saying if you don't want to answer, you don't have to.  
13 Right? Whereas, if you leave it -- if you put it in or leave  
14 it out, they're going to be obligated to answer.

15 MS. HANKS: I'm not sure if you're going to be  
16 obligating -- I suppose you would, yeah. Yes, you're right.

17 MS. YAMANAKA: If that's the case --

18 MS. HANKS: You want -- if you want them to  
19 disclose --

20 MS. YAMANAKA: To Michele's point, if we think the  
21 information is relevant, then -- because my opinion is the  
22 people who don't want to answer are going to be the ones who  
23 opt out. Right? So why do we want to put compliance in for  
24 people who -- but that's just --

25 MS. HANKS: Any objections to that? And so what

1 the proposal is right now is that we keep the language as  
2 disclosed -- as set out in this draft. We need to take a  
3 vote on that now?

4 MS. KASSAN: I thought we were saying that we  
5 wanted to remove the last sentence? I thought --

6 MS. HANKS: The suggestion was to remove it. But I  
7 think --

8 MS. KASSAN: I thought Laura was agreeing with  
9 that. And I think I do, too, actually.

10 MS. HANKS: You agree to remove it?

11 MS. YAMANAKA: The way I read it -- okay, let me go  
12 back again -- is if we leave it in, they can opt out of it.  
13 So do we want them to be able to opt out or not report? And  
14 if the answer is yes, then we leave it in. If we really want  
15 this information --

16 MS. HANKS: You want to force the information --

17 MS. YAMANAKA: You want to force the information, I  
18 would remove the sentence.

19 MS. SCHIMPP: It's not quite relevant here, but on  
20 a program at SBA where we run where we have an opt out  
21 portion, we're finding that a lot of women-owned businesses  
22 opt out because they don't want to be -- they feel like  
23 they'll be disadvantaged by being identified.

24 MS. HANKS: Interesting.

25 MS. SCHIMPP: The opt out can be used in ways that

1 one doesn't intend. And if the information is useful,  
2 eliminating the opt out, I would endorse eliminating it.

3 MS. HANKS: Lisa?

4 MS. SHIMKAT: We had had a lot of discussion  
5 surrounding that. And I am more in favor of leaving it  
6 there. And that's why we put the language in, for the  
7 default to be to answer and put this out there. Because the  
8 other argument as well is -- was giving everyone the  
9 opportunity to self-identify, which gave us more flexibility  
10 there. And the default being this and then the opt out is a  
11 decision on the back end.

12 So my -- my preference is to leave it in as is.

13 MS. HANKS: Any other thoughts?

14 MS. KASSAN: I mean, it does provide the option for  
15 them to define diversity however they want. So that kind of  
16 allows some flexibility there, if they really don't want to  
17 talk about ethnicity, gender and race. So I think I feel  
18 comfortable taking it out.

19 MR. AGUILAR: Yeah, I think if we look back at the  
20 fifth sentence, whether it will fail to generate the  
21 information that's useful, if we leave that sentence in, I  
22 think the same result -- we're going to get the same result  
23 as we're currently getting. So I would -- I would agree that  
24 we should take that sentence out.

25 MS. HANKS: Can we have a proposal to take this

1 language and take the last sentence out?

2 PARTICIPANT: So moved.

3 Okay, and a second?

4 MR. AGUILAR: Second.

5 MS. HANKS: All in favor?

6 I don't want to force a premature vote.

7 MR. NELSON: I'd like it to be kept in.

8 MS. HANKS: And Catherine?

9 MS. MOTT: I just don't know. I'm sorry, I'm not  
10 sure. Because I'm trying to think through the implications  
11 of leaving it in or taking it out, based on the wording that  
12 already exists there. So maybe our attorney can help us.

13 I mean --

14 MR. REARDON: They are members of the bar.

15 MS. MOTT: I'm sorry to hold things up.

16 MS. HANKS: The first part does read "require  
17 issuers to describe."

18 MR. REARDON: Catherine, I mean, I don't know what  
19 the -- I don't know what the right solution is here. I'm  
20 trying to defer to you all, and I've talked enough on other  
21 things.

22 But I mean, it's a sticky wicket however you do it.  
23 I mean, it's -- I mean, I think just go with your gut because  
24 it is -- I mean, I think -- the only thought I had was is our  
25 system or the SEC's system, it's not mine, is one of

1 disclosure. I don't think we mandate, unless there is a  
2 special statutory admonition about diversity and disclosure  
3 of it, is there -- I mean, we're not mandating you to have a  
4 board that's diverse; we're just saying you disclose it. And  
5 so, I mean, I think it seems to me to be within the powers of  
6 the SEC to say you need to disclose that.

7 And so then it becomes a matter of policy and what  
8 we all think is in the best interests. Corporate America  
9 knows that diversity is a hot button and rightly so, I think  
10 some people would say. And I agree with that to an extent.  
11 And Jonathan and I talked about it at the last meeting, that,  
12 you know, there are any number of views on this. And I'm  
13 trying to be sensitive and not step on any toes.

14 So I think it doesn't matter. At the end of the  
15 day, the Commission is going to give it a lot more thought  
16 and they'll come to probably a more considered decision than  
17 I'm capable of doing.

18 MS. HANKS: This is, of course, only a  
19 recommendation and it's not the actual wording of whatever we  
20 think the Commission should adopt.

21 Would it change anybody's mind if the final  
22 sentence said something along the lines of, while disclosure  
23 should be the default, issuers should have the option to opt  
24 out if they explain why? Make any difference?

25 MR. REARDON: Then you get into the what is an

1 originally?

2 MS. KASSAN: It's for potential investors.

3 MS. HANKS: I mean, I think the summary of the  
4 discussions in the two previous discussions are like after  
5 considering that, I mean, those are I think our objectives  
6 and the aim at which the recommendation looks to underscore.

7 MS. SHIMKAT: And I will support whichever way we  
8 go. And since there is full self-disclosure and we're not  
9 going through and redefining each of the categories, you  
10 know, the data could be skewed either way. That's why I was  
11 more in favor of the opt out side of it. Because you are  
12 going to do other due diligence, you are going to do other  
13 items that are going to be important, as well. This is  
14 really, really important. I'm just worried that we won't  
15 have as consistent data as we think we would have.

16 MS. HANKS: I don't think you're always going to  
17 get a lot of data from this. Not that you can put into  
18 charts, I think.

19 MS. YAMANAKA: And I think that's the case. I think  
20 that we're always going to have -- my own children, right,  
21 they go, mom, which box should I check? And frankly, I hope  
22 we get to the point where, you know, the box is always  
23 checked at the bottom or whatever it is. But for today, for  
24 now, we've had multiple discussions about this and I think  
25 we've all identified and come to the conclusion statistically

1 adequate explanation. I mean, this is such -- I have -- this  
2 young lawyer -- you heard me mention the young lawyer who  
3 went to Washington and Lee and I've known since he was a  
4 freshman in college. Well, I talked to him recently and he  
5 said, well -- and it was about this very issue. And I said,  
6 Chad, you know, I mean -- and we were talking about it. And  
7 I think I mentioned on one of the calls that I knew a woman  
8 who was -- had European ancestry but she had grown up in  
9 Zimbabwe and moved to Fort Worth and I met her and she said,  
10 well, I'm African American. Yet she's the color I am. I  
11 mean, this whole thing is rather imprecise. And my friend  
12 Chad, whose parents are -- his father is African American,  
13 his mother is white. He says, I check both boxes.

14 So there's no precision here. And, I mean, you do  
15 the best you can and we go from there. We have the similar  
16 situation with our former President who -- his father was not  
17 African American, he was African. His mother was white. He  
18 self-identifies as African American. I mean, it's too  
19 complicated for me.

20 MS. HANKS: So we will leave the box checking for  
21 the people who write the rules.

22 Lisa?

23 MS. SHIMKAT: Yes. What is our overall intent with  
24 the disclosure? Is it data that we're going to utilize? Is  
25 it data for decisionmaking? What did we determine from that

1 from studies, et cetera, that it is a business benefit to  
2 include diversity. And which is why maybe investors would  
3 like to know, in regards to disclosure that Patrick is  
4 speaking about, this is just another piece of information to  
5 disclose.

6 Is it going to be perfect? No, absolutely not.  
7 But it's going to give an essence of perhaps a picture, other  
8 people do all their other due diligence. And so it gives  
9 them a first place to start, you know, or end, as the case  
10 may be, depending on where they're at.

11 So that's why I really think it's important that  
12 we, instead of letting people, organizations, whatever,  
13 maintain the status quo, because that's what we're talking  
14 about, that we take out that -- that option.

15 MS. KASSAN: I think it's also really useful for  
16 fund managers and wealth advisers who are investing in public  
17 equities, because their clients are asking for, you know, I  
18 want to invest in companies that have diverse boards, I want  
19 to invest in companies that have women in leadership, for  
20 example. So I just can't imagine any down side.

21 If a company really doesn't want to talk about race  
22 and gender, they can say we have people from the following 10  
23 states, or we have people from the following three age  
24 groups. You know, it's totally up to them to define  
25 diversity. I just don't see any problem with it.

1 MR. NELSON: I'll say take it out.

2 MS. HANKS: Okay, so before we get to that bit,  
3 does anyone have any objections to any of the rest of the  
4 language? Are we okay?

5 MS. TIERNEY: So I have the same concern that I had  
6 when we discussed this last time which is it says, you know,  
7 provide information regarding each member nominee as self-  
8 identified by the individual. But what happens if an  
9 individual chooses not to self-identify? Right? So I don't  
10 love the idea of opt out. If we're going to think that this  
11 is important, I think we should make it important. Opt out  
12 means they'll opt out and nobody will understand why some  
13 companies have it and some companies don't have it.

14 But I do think we need to have some mechanism for a  
15 company to, you know, acknowledge that some of their members  
16 were not willing to self-identify. Otherwise, you'll have 10  
17 board members with information on five and no information on  
18 the other five, because those people chose not to self-  
19 identify. But it's going to raise an SEC comment, I would  
20 think.

21 MS. HANKS: Presumably, the rule when written would  
22 say, in the event the individual declines to provide that  
23 information, put N/A in the box.

24 MS. TIERNEY: Okay. That's just my concern.

25 MS. HANKS: I'm just going to punt that and say

1 I'll bet the guys at the SEC who are good at writing these  
2 rules will manage to work that one out.

3 N/A. Box one, box two, N/A, all good alternatives.

4 So can we move to the -- the proposal is the  
5 language as drafted without the last sentence. So again, you  
6 repropose?

7 MS. TIERNEY: I repropose.

8 MS. HANKS: You re-second? Okay.

9 And then all in favor?

10 (A chorus of ayes.)

11 MS. HANKS: Anyone against?

12 We're good. We have language. Thank you.

13 MR. REARDON: I gave out a comparison that we don't  
14 need to talk about. But if you have any comments -- I mean,  
15 it's maybe not helpful after the discussion today. But if  
16 anybody wants to send me any comments to it, it's just  
17 something I did. In dealing with businesspeople, I found  
18 that tabular presentations side by side are useful and help  
19 people grasp the issues. So I did that just because I felt  
20 like it helped me, just drafting it helped me crystalize some  
21 of the thoughts.

22 But anyway, we'll all see the typo on the first  
23 page, and I'll correct that. But Julie, if you're interested  
24 in posting it on the website, I will get you the digital  
25 file.

1 MS. HANKS: And thanks for doing that. It's a  
2 useful resource.

3 Before we completely wind up, I will work with the  
4 Staff to put together the recommendations from the  
5 discussions this morning. Interestingly, I thought the  
6 overall view was -- if I had had to predict anything, I would  
7 have said, preempt everything. But there's a much more  
8 subtle and reasoned and nuanced opinion that wants to take  
9 the states' thoughts into account in both of the proposals  
10 that we discussed, and we will be reflecting that and we will  
11 be getting drafts out on those. So thank you very much for  
12 those discussions.

13 And just one thing before we leave. Any thoughts  
14 on what goes onto the agenda for next time? I know Catherine  
15 had --

16 MS. MOTT: I'm very curious. I know I brought this  
17 up last time, too. But whenever the tick pilot is completed,  
18 really I'd like to see the data and hear the remarks from the  
19 SEC on that.

20 MR. NELSON: I would love to hear aggregate data  
21 statistics on fraud. Just because if we're protecting --  
22 trying to protect unaccredited investors, it would actually  
23 be helpful to say, okay, these are the instances when things  
24 have gone south.

25 I would also love to talk about getting data -- I'm

1 a data nerd -- on how much capital small businesses think  
2 that they need, and what are ways that we could actually  
3 suggest to get that data. Because all of our opinions are  
4 anecdotal; I don't think we actually have any hard data on  
5 this at all. If it's possible.

6 MS. YAMANAKA: And to that point, elaborate on your  
7 point, Jonathan. I think it was really interesting because  
8 clearly we have different communities, right. The gushers or  
9 the gushers, that's great. But I'd like to have a better  
10 sense of, you know, is it 90 percent and how many "gabillion"  
11 is that for 200 companies, versus the companies, I think  
12 Patrick, you're talking about the ones that I see, that need  
13 capitalization above leverage, okay, but below IPO or access  
14 to that type of capital.

15 So if there is any data out there, what is that?  
16 You know, what does it look like.

17 MS. KASSAN: Yeah. And, you know, there are so  
18 many companies that completely count themselves out of even  
19 thinking about being able to raise capital. Because it's so  
20 complicated, they hear about these laws and they hear, oh, I  
21 can only talk to wealthy people and I don't know any wealthy  
22 people. So even if we were to get data on how many companies  
23 are trying to raise capital unsuccessfully, that would leave  
24 out a huge number that just don't even think that it's  
25 possible for them.

1 MS. YAMANAKA: If we could just get the tip of the  
 2 iceberg. But I don't know -- I know that's really hard.  
 3 MS. HANKS: I'm not sure where we would look for  
 4 that iceberg. Any thoughts on where the iceberg might be,  
 5 gratefully received.  
 6 MR. NELSON: Quickbooks. Intuit.  
 7 MS. HANKS: Interesting.  
 8 MR. GOMEZ: Also keep in mind that in some  
 9 exemptions, you can't use general solicitation. To the  
 10 extent that you have companies self-identifying themselves as  
 11 publicly looking to raise capital, query whether that puts  
 12 them already in a category of an exemption that would need to  
 13 permit general solicitation. So I think part of the  
 14 challenge is how do you get data on the aggregate without  
 15 actually going to the particulars of a specific company such  
 16 that a particular company doesn't have to publicly indicate  
 17 to the world that they are looking for capital.  
 18 MS. HANKS: That would be kind of ironic. Hey,  
 19 companies, who would like to self-identify as violating  
 20 Section 5?  
 21 (Laughter.)  
 22 MS. HANKS: We maybe shouldn't do that bit.  
 23 MR. NELSON: I also think there is a census --  
 24 there is a census committee, they do like an annual census of  
 25 businesses, and this is where they get the jobs numbers from

1 before we wind up?  
 2 All right, thank you very much.  
 3 Thank you everybody in Internet Land. Thanks.  
 4 (Whereupon, at 3:44 p.m., the above-entitled matter  
 5 was concluded.)  
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1 and this is where they get that sort of stuff. If we could,  
 2 in that census, while the census is actually going out and  
 3 getting them that data, just say, hey, zero to 10, how much  
 4 would you like to have more money to grow your business, or  
 5 something along those lines.  
 6 MS. YAMANAKA: I do know there are surveys that are  
 7 out there, because I fill them out, because I get them all  
 8 the time. And I don't think we're going to get a precision  
 9 in data. It's not like we're going to get a census or  
 10 whatever. But just something to -- so that when, you know,  
 11 people like Jonathan and Patrick, when they're throwing out  
 12 numbers, there's something that -- and I don't have to say  
 13 "gabillion," right? We have more precision in the amount of  
 14 numbers. Because again, intuitively, through anecdotal,  
 15 qualitative experience and people in my world, they fall into  
 16 more of the industries, the number of businesses that Patrick  
 17 is. So if we could just get a -- or spoke about.  
 18 If we could just get kind of a data field, it would  
 19 be really great, just to put something on the ground.  
 20 MS. HANKS: Continuing quest.  
 21 MS. SCHIMPP: We use Pepperdine capital markets  
 22 survey, find it useful for at least the lower, middle market  
 23 comparisons.  
 24 MS. HANKS: That would be good, if we could.  
 25 All right, anything else? Am I missing anything

1 PROOFREADER'S CERTIFICATE  
 2  
 3 In the Matter of: EQUITY MARKET STRUCTURE ADVISORY  
 4 COMMITTEE MEETING, SMALL AND EMERGING COMPANIES  
 5 File Number: OS-0215  
 6 Date: Wednesday, February 15, 2017  
 7 Location: Washington, D.C.  
 8  
 9 This is to certify that I, Christine Boyce,  
 10 (the undersigned) do hereby swear and affirm that the  
 11 attached proceedings before the U.S. Securities and  
 12 Exchange Commission were held according to the record,  
 13 and that this is the original, complete, true and  
 14 accurate transcript, which has been compared with the  
 15 reporting or recording accomplished at the hearing.  
 16  
 17  
 18 \_\_\_\_\_  
 19 (Proofreader's Name) (Date)  
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