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1 UNITED STATES SECURITIES AND EXCHANGE COMMISSION

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6 SEC ADVISORY COMMITTEE ON SMALL AND EMERGING COMPANIES

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OPEN MEETING

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Tuesday, September 17, 2013

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9:30 a.m.

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U.S. Securities and Exchange Commission

18

100 F Street, N.E., Washington, D.C.

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Station Place 1 Multipurpose Room

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ADVISORY COMMITTEE MEMBERS PRESENT:

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Stephen M. Graham, Co-Chair

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M. Christine Jacobs, Co-Chair

7

A. Heath Abshire

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John J. Borer III

9

Dan Chace

10

Milton Chang

11

Leroy Dennis

12

Shannon L. Greene

13

Richard L. Leza

14

Kathleen A. McGowan

15

Catherine V. Mott

16

Pravina Raghavan

17

Tim Walsh

18

Gregory Yadley

19

PANELISTS:

20

Alex F. Cohen

21

Marianne Hudson

22

Jeffrey M. Solomon

23

Joel H. Trotter

24

David Verrill

25

0003 SEC Staff:

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Mary Jo White, SEC Chair

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Luis Aguilar, SEC Commissioner

3 Keith Higgins, Director of the SEC Division of Corporation
 Finance
 4 Jonathan A. Ingram, Acting Chief Counsel, SEC Division of
 Corporation Finance
 5 Johanna V. Losert, Special Counsel, SEC Office of Small
 Business Policy
 6 Mauri Osheroff, Associate Director, SEC Division of
 Corporation Finance
 7 Karen Wiedemann, Attorney Fellow, SEC Office of Small
 Business Policy
 8 Ted Yu, Senior Counsel to the SEC Director of the Division of
 Corporation Finance

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P R O C E E D I N G S

OPENING REMARKS

1 MR. GRAHAM: Okay. Let's get started. Ted, do
2 we have a quorum?

3 MR. YU: Yes, we do.

4 MR. GRAHAM: Okay. One administrative note.
5 Could you make sure that you keep your cellphones away
6 from the mic because it does cause feedback. Well,
7 welcome to all the committee members. It's good to see
8 you again. Once again, thank you for your time and
9 effort. Thank you for your time and effort over the past
10 two years. It's been time I think well spent and time
11 that has gone by quickly. We also want to thank the SEC
12 staff for all of their help.

13 Before we get started, I'd like to introduce
14 our newest committee member Pravina Raghavan. Is Pravina
15 here? Were you just waiting to be called?

16 CHAIR WHITE: It's called responding to a cue,
17 right?

18 MR. GRAHAM: Yes.

19 CHAIR WHITE: Welcome also.

20 MR. GRAHAM: Yes. Pravina has been appointed
21 by Chair White to serve as the committee's SBA observer.

22 And she is the Acting Associate Administrator in the
23 SBA, with over 15 years of experience in providing

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1 advisory services to businesses in all phases of their
2 growth. And before joining the SBA, Pravina was a vice
3 president with MTV and BET networks and was a small
4 business owner of a strategic advisory firm that assisted
5 companies with their growth plans. Pravina, we're very
6 happy to have you with us. Thank you.

7 As you know, this committee was created by the
8 SEC in 2011 for a two-year term which expires October
9 4. October 4 is just around the corner, and we understand
10 that the Commission is considering the possibility of
11 renewing the committee for another term. But in this
12 connection Chris and I took the opportunity to speak
13 individually to nearly all of you to talk about the past
14 and the future. And we'd like to share two comments and
15 observations that resulted from this conversation. So at
16 this time I'd like to turn it over to Chris.

17 MS. JACOBS: Thank you. The purpose of these
18 one-on-one calls was an end-of-term sort of report card,
19 and to provide Stephen and I feedback about the process,
20 about what we accomplished over the two years and to hear
21 your thoughts and your experiences. Our calls each
22 lasted less than 15 minutes unless members needed more
23 time. Two members did, Catherine Mott and John Borer.
24 We granted them the extra time. They brought issues
25 before the Committee, which we are going to hear about

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1 today.

2 The comments that we heard from these calls
3 with committee members fell into sort of four buckets of
4 comments. The first bucket was sort of a self-report
5 card, more reflective comments, maybe personal comments
6 about the experience of being on the committee. You felt
7 it was a privilege to serve, felt it was a great
8 experience, learned a lot. A couple of quotes, "We did
9 things and we did a good job." "We did a lot with our
10 seven recommendations that we put in over the two years."
11 And lastly, that it was an honor to be asked to help.

12 The second bucket was agency or SEC specific
13 comments. One member in particular found the agency to
14 be sincere and had an admiration for their current
15 challenges. Others felt that it was good to see that the
16 SEC was genuinely interested in our issues. There had
17 been sort of an unfortunate turnover of talent top down,
18 and there was worry that perhaps we would have lost
19 momentum along the way. Some of you were a tad skeptical
20 about the overall commitment to change and to address
21 some of our issues.

22 But generally, except for one of our members
23 who said we should go slower and be more thoughtful, 100
24 percent of the balance of our committee overall felt some
25 frustration at seeing movement on our recommendations,

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1 saying things like, "We wish that the SEC could do
2 something with our suggestions." "We sure hope the SEC
3 moves on our issues, and this is all taking too long."

4 The third bucket was about Stephen's and my co-
5 chair responsibilities. It was noted that there was no
6 idle chatter, productive, that we kept the meetings going
7 and that we invited disparate views. The last bucket of
8 comments from you at the committee was about the SEC
9 staff that we deal with day in and day out. To a member,
10 you said, "Thank you to the SEC staff for a job well
11 done. Felt that you all had done a great job on
12 speakers." One hundred percent of the committee was
13 supportive of the staff that we have encountered over the
14 past two years. And lastly the quote that we like the
15 most was that "the staff had been impressive and
16 dedicated." And with that I will end the comments from
17 the one-on-one meetings.

18 MR. GRAHAM: Thank you, Chris. Well, we
19 certainly hope that the committee's term will be renewed,
20 as we believe that it's important to have a meaningful
21 way through which the needs of the smaller public
22 companies and emerging private companies can be discussed
23 and presented to the SEC for its consideration. We have
24 managed to accomplish a great deal over the past two years in
25 terms of making recommendations and raising awareness.

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1 Seven of those recommendations -- we did make
2 seven recommendations. And among them, of course, the

3 recommendation dealing with general solicitation, the
4 recommendation dealing with raising the Reg A+ limits and
5 also the recommendation dealing with raising the
6 thresholds that would trigger public reporting on the
7 part of private companies.

8 Now we know that these ideas found their way
9 into the JOBS Act, but that doesn't in any way lessen
10 their importance or lessen the importance of your work in
11 advancing these issues before something is actually done.

12 In addition, we've made a recommendation regarding
13 scaled disclosure, which we think is a fairly important
14 one. And we'd like to see some action on that. Also
15 conflict minerals, you know expressing at least the
16 Committee's view of the need to focus on capital
17 formation and investor protection and not politics.

18 And lastly, tick size, which perhaps is a piece
19 of the puzzle or a part of the answer to reinvigorating
20 the markets for the smaller public companies. But
21 there's still much work to be done. Perhaps there's no
22 better example of that than the agenda that we have set
23 for today which is quite full. We will start the morning
24 with a presentation by the SEC staff on three recent rule
25 makings that will be very important for smaller

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1 businesses: the elimination of the general solicitation
2 ban; the Bad Actor disqualification provisions; and the
3 proposed new Regulation D and Form D requirements.

4 We'll then have a presentation by the Angel
5 Capital Association and its views on these rule makings.

6 And then in the afternoon we'll discuss the impact of
7 the JOBS Act, which was enacted, as you know, nearly a
8 year and a half ago and also new ideas for facilitating
9 capital formation. We'll start with a presentation by
10 Joel Trotter, now of Latham and Jeffrey Solomon of Cowen
11 and Company. And we'll also hear from John Borer who
12 will present some ideas for easing the capital
13 information process by expanding availability of Form S-3
14 to smaller public companies. Chris, I'll turn it over to
15 you.

16 MS. JACOBS: Thank you. We'd like to welcome
17 Chair White this morning. She was recently appointed in
18 April of 2013 by President Obama to serve as the 31st
19 chair of the SEC. She arrived at the SEC with decades of
20 experience as a federal prosecutor and securities lawyer.

21 Prior to serving as the chair of the SEC, Chair White
22 was the U.S. Attorney for the Southern District of New
23 York, the only woman to hold that position in the 200-
24 year plus history of the office.

25 And while her background in federal prosecution

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1 and securities fraud is deep and storied, she is now
2 facing challenges that broaden that range and expand her
3 reach and her legacy. She understands capital formation.

4 And when Stephen and I had the good fortune of meeting

5 Chair White for the first time, she made it clear that
6 she understood our challenges, that she had followed our
7 work and wanted to make a difference in our world of
8 small and emerging companies. So with that, I welcome
9 Chair White.

10 CHAIR WHITE: Thank you very much, Chris. I
11 appreciate it very much. And I also was very interested
12 in listening to your report. I think there are some to-
13 dos in there for me that I heard as well from both you
14 and Steve. It's good to be back with the Committee today.

15 I think when I was here last time back in May, I hadn't
16 been here all that long. I feel like I'm fully settled
17 in at this point. I do continue, though, to really
18 marvel at the scope and importance of the SEC's mission.

19 And I was very glad to hear of your sort of hundred
20 percent endorsement of the spectacular SEC staff which I
21 -- you know, I completely share.

22 I mean as you know, this agency shoulders
23 significant responsibility on behalf of investors in our
24 markets and we are really blessed with the staff that we
25 have. So I appreciate that endorsement from you folks as

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1 well. I also want to reiterate just how important this
2 Committee is and how important your recommendations are.

3 They help us tremendously in our efforts. I'm going
4 to talk a little more about that as I go through this.

5 So let me personally thank all of you for the
6 dedication you've shown to this Committee and the
7 contributions that you have made to helping us do our job
8 more effectively. The Committee's co-chairs, Steve
9 Graham and Chris Jacobs, deserve a special thank you,
10 which I extend for your leadership over the past two
11 years. I'd also like to single out but there are many
12 more as well.

13 But I thank SEC staff, Mauri Osheroff, and I
14 think I pronounced that right. I can pronounce no names,
15 as you know. Ted Yu and Johanna Losert, in particular,
16 for their work supporting the activities of this
17 Committee. And I'll thank Jonathan Ingram, who I know is
18 going to lead the presentation today, too because he's
19 right beside me.

20 As members of the Advisory Committee on Small
21 and Emerging Companies, you are in a unique position,
22 truly unique position, to help us with insight into the
23 challenges that these companies face in the capital
24 markets. And you've performed an absolutely invaluable
25 role. That is why -- and I guess I'm actually the

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1 deliverer of the news to the Committee. I'm very pleased
2 to say that the Commission has renewed this Committee for
3 another two years. No surprise at all, but I just want
4 to confirm that to the Committee.

5 And I look forward to continuing the dialogue
6 and receiving your insights and suggestions on how we can

7 continue to support, enhance our support of small and
8 emerging companies. As I mentioned at the last meeting,
9 I really welcome policy and debates and am committed to a
10 rulemaking process that insures, within the parameters
11 obviously, our overall mission that the SEC makes a
12 positive contribution to the success of small businesses.

13 We have as an agency an extraordinary amount of
14 work to do. But one of my very top priorities, like I
15 said this last time as well, is completing the
16 congressionally mandated rulemakings that we have on our
17 plate, including the JOBS Act mandates which are intended
18 to help small businesses in raising capital. And I think
19 to reiterate what I think Steve said, you know, you also
20 -- your contributions to that JOBS Act effort really
21 can't be overstated as well, I think. So just to pass
22 that along.

23 As you know, in July the Commission adopted
24 rules as mandated by Title II of the JOBS Act to lift the
25 ban on general solicitation in Rule 506 securities

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1 offerings. And we, as Steve mentioned, adopted rules to
2 disqualify securities offerings involving certain felons
3 and other bad actors from relying on Rule 506. These
4 adopted rules will be effective next week, and I'm very
5 interested to see how they will be used.

6 In connection with their effectiveness, the
7 staff will be closely monitoring and collecting data on
8 this new market to see how it in fact operates, observing
9 the practices issuers and market participants are using
10 and assessing whether and to what extent the changes in
11 the private offering market may lead to additional fraud
12 or not. And, as you know, at the same time these rules
13 were adopted, the Commission also proposed rules intended
14 to enhance its ability to evaluate the development of
15 this new market and to address concerns that may arise
16 once the ban is lifted.

17 And I know your agenda as you've mentioned,
18 obviously has a detail about a discussion and
19 presentations on both the adopted rules as well as the
20 rule proposal. The comment period for the proposal ends
21 next week, and I encourage you to comment on the
22 proposal, obviously very interested in that. I know you
23 also have a keen interest in the remaining JOBS Act
24 rulemakings. So you should know we're continuing to work
25 very diligently to get those rules done in a way that

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1 facilitates capital raising activities and addresses
2 investor protection concerns.

3 Again, I strongly encourage you to provide
4 feedback on all of our rule proposals, as the insights
5 and suggestions you provide really will help us to adopt
6 better rules. So I couldn't be more encouraging of that
7 and that effort. The JOBS Act, as you know, also
8 directed the Commission to conduct a study and to report

9 to Congress on decimalization, in particular the study
10 which was sent to Congress last year. It was to look at
11 how decimalization affected the number of IPOs and the
12 trading of small and mid-cap company securities.

13 And following your last meeting in February
14 where you approved recommendations regarding
15 decimalization, the Commission held, I think it was four
16 days later if I remember -- although I wasn't here yet
17 but I did follow it -- held a roundtable to discuss this
18 particular topic. Across the panels I think it's fair to
19 say that there was significant support for the Commission
20 to implement a pilot that would widen ticks for small and
21 medium capitalization companies, though some during the
22 roundtable expressed concern about the potential costs of
23 the wider ticks.

24 The Commission is now considering whether to
25 pursue such a pilot and its appropriate parameters as a

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1 means to gather data to help inform decisions in this
2 area. I realize that a pilot differs from the more- what I
3 would call- definitive approach advocated by the Committee
4 in its recommendations. But I just wanted to have you
5 rest assured that this is something that continues to
6 have our very close attention -- this entire area
7 frankly, but including my personal attention and
8 interest.

9 Of course we also as an agency remain focused
10 on a range of other important priorities from enforcing
11 our laws and examining firms to reviewing filings and
12 engaging in a lot of complex rulemaking. In doing all of
13 this we always keep in mind our tripartite mission, our
14 overall mission to protect investors, to maintain fair,
15 orderly and efficient markets and obviously to facilitate
16 capital formation.

17 And we're always open, indeed anxious, to
18 receiving ideas for how we can better serve the needs of
19 all investors and small and emerging companies in
20 particular. So I'll stop with that. You have a very
21 full agenda, but I want to just say thank you again for
22 all that you do and for all of your assistance. I look
23 forward to receiving your report on your meeting today
24 and to our continuing dialogues in the future. Thank you
25 for having me and thank you for being here.

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1 MR. GRAHAM: Thank you, Mary Jo. I would like
2 to introduce Keith Higgins. Keith is the new director of
3 the Division of Corporation Finance. Keith was appointed
4 by Chair White a couple of months ago. He joins the SEC
5 after practicing for many years at Ropes & Gray. Keith,
6 I'd like you to make a few remarks and then introduce
7 the staff at the table. Keith.

8 MR HIGGINS: Thank you, Steve, and thank you,
9 Chris. Welcome, good morning. And thank you, Chair
10 White. We appreciate the support that you've shown for

11 the Committee and its work. I'd like to welcome
12 everybody here and thank all of you for taking the time
13 to be with us here today. The very busy agenda that we
14 have ahead of us -- gee everybody is leaving. You sort
15 of know what the pecking order is here at the Commission
16 but that's all right. I won't take it personally.

17 We do have a busy agenda, so I want to be
18 brief. As Stephen mentioned, I'm still a relative
19 newcomer at the Commission, having been here for just a
20 little over two months. And this is the first time I've
21 had the pleasure of joining the Committee in its work.
22 However, both from my private practice experience as well
23 as the short time that I have been here at the
24 Commission, I've been able to observe the work of the
25 Committee and the importance of the Commission and the

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1 staff to have a group of individuals broad ranging across
2 a lot of different disciplines, industries, types of
3 interest, to be able to provide thoughtful advice and
4 recommendations, to the Commission and to the staff, about
5 ways in which we can address the interests and priorities
6 of smaller companies and emerging companies.

7 When the Committee was created back in 2011,
8 then Chairman Schapiro charged it with providing the
9 Commission with ideas on how to facilitate capital
10 formation in a way consistent with investor protection,
11 as the Chair mentioned. Stephen went over the
12 recommendations and many recommendations. It's amazing
13 what the committee has done in its brief two-year tenure:

14 The ban on general solicitation or eliminating it, the
15 modification that triggers for reporting, the development
16 of a new offering exemption modeled on Reg A, creation of
17 a separate U.S equity market to facilitate trading by
18 accredited investors.

19 Ideas for revising small reporting company
20 disclosures, scaling it back perhaps in ways that would
21 make it more or less burdensome for smaller companies and
22 allowing, as the Chair mentioned, smaller exchange listed
23 companies to take advantage of an increased trading tick
24 for their securities.

25 Obviously, as Stephen mentioned, many of these

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1 have found their way into the law. The JOBS Act picked
2 up quite a number of them, and I can tell you we've got
3 teams working right now on the JOBS Act rulemaking. And
4 as the Chair had mentioned, the two -- the crowdfunding
5 and Reg A+ proposals are on the front burner. So you
6 should expect to see something I think in the relatively
7 near future on those.

8 For me the real value of the Committee's work
9 is not, you know, the breadth of the recommendations but
10 the thoughtfulness with which you bring your ideas to the
11 Commission and to the staff to allow us to get a
12 perspective of how you see things that we can be doing

13 better to help small and emerging companies achieve the
14 goals of facilitating capital formation. So I'm
15 delighted, as the Chair mentioned, the Commission has
16 decided to approve the renewal of the Committee for
17 another two years, and so I look forward during my tenure
18 to working with you.

19 With that and before we start out I'd like to
20 introduce the other SEC staff members who are up here
21 with me. To my left are Johanna Losert, in the Office of
22 Small Business Policy, and Ted Yu who is one of my Senior
23 Special Counsels. To my right are Jonathan Ingram, who is
24 our Acting Chief Counsel, Karen Wiedemann, who is an
25 Attorney-Fellow in the Office of Small Business Policy,

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1 and Mauri Osheroff, who is the Director who oversees the
2 office.

3 Since your last meeting Gerry Laporte, who I'm
4 sure all of you knew, who had for many years been the
5 Chief of the Office of Small Business Policy, retired.
6 And we are in the process of filling his position. I
7 actually believe very strongly that the Office of Small
8 Business Policy is going to be a very interesting place
9 to be over the next several years. There's a lot on the
10 Commission's agenda between the Reg A+ the crowd-
11 funding, the general solicitation activities that are
12 going to require implementation, thoughtful
13 interpretations. And really I think it will be a place
14 where there'll be a lot of activity and it will be an
15 opportunity for someone who's looking for an exciting
16 challenge and has an interest in helping small and
17 emerging companies to take on a responsibility.

18 We are posting for the position. It will be
19 available on the website. I would urge you if you know
20 anybody who's looking for a gig in Washington -- I did it
21 after 30 years of private practice. I can tell you
22 firsthand it's been amazing so far. It's been a great
23 opportunity to be involved in trying to shape policy. I
24 mean I've spent a lot of time advising companies how to
25 comply with rules without thinking a lot about what those

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1 rules ought to be, although I obviously occasionally did.

2 This I think is an opportunity for someone who
3 really wants to do something and wants to have an impact
4 to come in. So we'll be interested in getting
5 applications from folks who want to make a difference.
6 And so I urge you to if you have any recommendations, let
7 us know. We'd be delighted to hear them. So with that,
8 I'd like to turn it back to Chris and Steve to start
9 today's meeting.

10 MR. GRAHAM: We will just turn it right back to
11 the table and let you guys proceed.

12 MR. INGRAM: Okay. Thank you.

13 MS. WIEDEMANN: Good morning.

14 MR. INGRAM: And thank you, Keith. Good

15 morning members of the Committee. This morning Karen and I are
16 going to discuss the three rulemakings that Chair White
17 mentioned just a bit ago, each of the rulemakings
18 related to Rule 506, and Regulation D and Form D. I want
19 to start today by discussing the amendments to Rule 506
20 that will permit issuers relying on the exemption to use
21 general solicitation. Karen is going to discuss amendments
22 to Rule 506 that will prohibit certain bad actors from
23 relying on the exemption.

24 Finally, I'll conclude by discussing the
25 proposed rules that the Commission issued that, if adopted,

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1 could enhance the Commission's ability to analyze the new
2 Rule 506 market that is expected to develop.

3 MS. WIEDEMANN: And you know this but I'll say
4 it, we're here as a resource for you. So while we've
5 planned a presentation with some time for Q&A, obviously
6 if you have questions as we go, please don't be shy. You
7 know, this will work out better for everyone I think if
8 we can make it more interactive. So if an issue comes up
9 as we're going, please just dive in and we'll try to
10 address it.

11 MR. INGRAM: I was just going to -- the views
12 that we express today are our own and don't necessarily
13 reflect the views of other staff members or the
14 Commission. I know that many of you --

15 MR. HIGGINS: That's retroactive back to the
16 Chair.

17 MR. INGRAM: Yes. That is
18 retroactive, yes. I know that many of you are well
19 versed in Regulation D and in Form D, but I thought it
20 would be worthwhile to spend a couple of minutes
21 describing the relevant rule and form at issue.
22 Regulation D was adopted by the Commission in 1982 and
23 consists of three exempted rules, Rule 504, Rule 505, and
24 Rule 506. Each of the exemptions have conditions that
25 must be satisfied in order for the issuer to rely upon

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1 them, such as limitations on the amount of capital that
2 can be raised and the types of purchasers that can
3 participate in an offering.

4 Rule 506 is by far the most popular of the
5 exemptions under Regulation D, comprising 90 to 95
6 percent of all Regulation D offerings. In 2012, almost
7 \$900 billion was reported as being raised in Rule 506
8 offerings. This compares to \$1.2 trillion raised in
9 registered offerings. I'm going to quickly run through
10 the five conditions or elements of current Rule 506 which
11 I will refer to as Rule 506(b).

12 First, there is no dollar limit on an offering
13 amount in a Rule 506(c) offering. Second, purchasers in
14 a Rule 506(b) offering must be limited to accredited
15 investors, a concept that I'll discuss in just a bit and
16 up to 35 non-accredited investors who are sophisticated

17 persons. Rule 506 defines sophisticated persons as those
18 having such knowledge and experience in financial matters
19 that they can evaluate the merits and risks of the
20 transaction.

21 Third, in a Rule 506 offering certain
22 information must be delivered to non-accredited investors
23 before any sales in the securities. In contrast, there
24 are no requirements to deliver information to accredited
25 investors before a sale. Fourth, the use of general

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1 solicitation in a Rule 506(b) offering is prohibited.
2 Finally, securities sold in a Rule 506(b) offering
3 are restricted securities for purposes of resale.

4 Generally speaking, this means that if
5 securities are sold by a non-reporting company, they do
6 not become freely transferable for a period of one year.

7 A key factor in the popularity in Rule 506 is that
8 securities required in a Rule 506 offering have "covered
9 security" status under Section 18 of the Securities Act.
10 In a nutshell, states cannot require registration or
11 qualification of a transaction in covered securities.
12 This means that many issuers will choose to rely on Rule
13 506 rather than other Regulation D exemptions in order to
14 avoid state law registration issues.

15 Now I'd like to go over two key concepts under
16 Regulation D, the definitions of accredited investor and
17 general solicitation. The first key concept under
18 Regulation D is accredited investor status. In general,
19 accredited investors are institutional investors and
20 wealthy individuals that are presumed to be able to fend
21 for themselves. Natural persons can qualify as
22 accredited investors on the basis of income or net worth.

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24 For income, an accredited investor is a person
25 who earned more than \$200,000 or \$300,000 together with a

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1 spouse in each of the prior two years and usually expects
2 the same for the current year. For net worth, an
3 accredited investor is a person who has a net worth over
4 \$1 million excluding the value of that person's primary
5 residence. In addition, there's a long list of entities
6 that qualify as accredited investors under the
7 definition.

8 One thing to note about the definition of
9 accredited investor is the "reasonable belief" standard in
10 the definition. This means that a purchaser is deemed to
11 be an accredited investor if the issuer has a reasonable
12 belief that that is the case, even if it turns out that
13 the purchaser does not in fact meet the thresholds in a
14 definition. The second key concept in Regulation D is
15 general solicitation. While the term general
16 solicitation is not defined in Regulation D, Rule 502(c) of
17 Regulation D provides examples of general solicitation,
18 which include newspaper and magazine ads, communications

19 over television and radio, and seminars where the
20 attendees have been invited through general solicitation.
21 In addition, the staff has issued interpretative
22 letters in which we've indicated that there is deemed not
23 to be a general solicitation in various circumstances
24 where an issuer or a broker-dealer has a pre-existing
25 substantive relationship with the offerees. So that's a

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1 brief summary of Regulation D and Rule 506 as it exists
2 today, which takes us to the recent amendment to Rule 506
3 that was adopted by the Commission on July 10th and as
4 the chair indicated, will become effective on September
5 23rd.

6 Section 201(a) of the JOBS Act directs the
7 Commission to amend Rule 506 to permit general
8 solicitation in Rule 506 offerings provided that sales
9 are made only to accredited investors and issuers take
10 reasonable steps to verify accredited investor status
11 using such methods as determined by the Commission. The
12 Commission issued the proposing release to implement
13 Section 201(a) in August of 2012 and voted to adopt the
14 rule and amendments as proposed with one modification in
15 July of 2013.

16 There are at least four important things to
17 note about Rule 506(c). First, general solicitation is
18 permitted under Rule 506(c) with no restrictions on the
19 content or manner of the general solicitations. This
20 means that issuers may include general solicitation
21 materials on their publicly-accessible websites.
22 However, general solicitations under Rule 506(c) are
23 still subject to the antifraud provisions of the federal
24 securities laws.

25 Second, purchasers in Rule 506(c) offerings

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1 must be limited to accredited investors, but there is no
2 limit on the number of purchasers who are accredited
3 investors. Third, as I will discuss further, issuers
4 must take reasonable steps to verify the accredited
5 investor status of purchasers consistent with the
6 statutory directive in Section 201(a).

7 Finally, Rule 506(b), which I discussed earlier,
8 remains unchanged after adoption of the rule. So for an
9 issuer that does not wish to engage in general
10 solicitation, or does not wish to verify accredited
11 investor status, or wants to sell to non-accredited
12 investors who meet the sophistication requirements of
13 506(b), those options are all still available.

14 As in the case with Rule 506(b) offerings,
15 under Rule 506(c) there is no limit on the dollar amount
16 of the offering. There are no specific information
17 requirements because all purchasers must be accredited
18 investors. The securities are restricted securities for
19 purposes of resale, and the securities have covered
20 securities status under Securities Act Section 18. As

21 for verification, Rule 506(c) sets forth a principles-
22 based method for verification, which is a flexible facts
23 and circumstances test that requires an issuer to make an
24 objective determination as to whether the steps taken to
25 verify accredited investor status are reasonable in the

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1 context of a particular offering.

2 In addition, the Commission added in the
3 adopting release a nonexclusive list of verification
4 methods that issuers may use but are not required to if
5 they want greater certainty that they have satisfied the
6 verification required. For the principles-based method
7 the Commission stated in the adopting release that the
8 factors to consider under this method include the nature
9 of the purchaser and the type of accredited investor that
10 the purchaser claims to be, the amount and type of
11 information that the issuer has about the purchaser, and
12 the nature and the terms of the offering.

13 In addition to the principles-based method, in
14 response to a wide range of commenters, the Commission in
15 the adopting lease also provided a nonexclusive list of
16 methods that issuers may use to satisfy the verification
17 requirement. This nonexclusive list is intended to
18 supplement the principles-based framework, and issuers
19 are not required to use any of these methods.

20 The nonexclusive list only applies to
21 verification of purchasers who are natural persons. This
22 nonexclusive list of verification methods consists of
23 four methods. First, verification based on income, which
24 can be done by reviewing copies of any IRS form that
25 reports income. Second, verification based on net worth,

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1 which can be done by reviewing specific types of
2 documentation dated within the last three months, such as
3 bank statements, brokerage statements and credit reports.

4 Third, written confirmation from a registered
5 broker-dealer, a registered investment advisor, licensed
6 attorney, or certified public accountant as to a person's
7 accredited investor status and finally, certification by
8 persons who had invested in the issuer's 506(b) offering
9 as an accredited investor prior to the effectiveness of
10 the new Rule 506(c) and continued to be investors in the
11 issuer.

12 And finally, a quick note on Form D. Form D is
13 a filing that must be made no later than 15 days after
14 the first sale of securities in a Rule 506 offering, or
15 for that matter, in any Regulation D offering. Since
16 2008, Form D has been required to be filed electronically
17 on EDGAR, so Form Ds are readily accessible on the
18 Commission's website.

19 In connection with the amendments to Rule 506,
20 Form D was amended to add a Rule 506(c) check box, so
21 that issuers will indicate whether they are relying on
22 the Rule 506(c) exemption. In addition, the signature

23 block of Form D was amended to include a certification
24 that the offering is not disqualified from the reliance
25 on Rule 506 pursuant to new Rule 506(d). And speaking of

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1 disqualification, now would be a good time for me to turn
2 over to Karen to discuss the bad actors release.

3 MS. WIEDEMANN: Okay. The Bad Actor Rule is
4 something that we've talked to you about before, but I'll
5 rewind the tape a little bit and give a little bit of
6 background. As John mentioned, there were three
7 rulemakings that came out of the July 10th Commission
8 meeting, the 506(c) rules, bad actor, and a proposal for
9 Reg D and Form D amendments. And for the Chair they were
10 an important package that responded to some of the
11 statutory mandates that the Commission has been given and
12 also attempted to address some of the investor protection
13 concerns and information gathering concerns that we have.

14 Bad actor was part of that package, but it
15 actually has a longer history. It goes back to the Dodd-
16 Frank Act and was a mandate from July 2010 to add bad
17 actor disqualification rules to Rule 506. With the
18 adoption of Rule 506(c), we think that bad actor has
19 probably become even more significant than it was
20 originally envisioned to be. So the rule that was
21 adopted as I said, you've been briefed on it before.

22 The basic idea is that an offering will be
23 disqualified from reliance on Rule 506 if the issuer or
24 any other person that's sort of covered in a covered
25 relationship with the issuer, has some sort of

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1 disqualifying event in its past. And we can talk quickly
2 about what the list of covered people are and what the
3 triggering or disqualifying events consist of.

4 There is also a difference in treatment that we
5 can talk about between a preexisting disqualifying event,
6 so everything that's happened up until September 23rd
7 which is the effective date of the new rule, compared to
8 events that happened afterward. So as I mentioned,
9 offerings will be disqualified if the issuer or any
10 covered person has a disqualifying event.

11 The list of covered persons that issuers will
12 have to think about besides the issuer itself, its
13 predecessor if there are any, any affiliated issuers --
14 there's a group of sort of control persons of the
15 issuer that are in the frame, so directors, executive
16 officers, general partners, managing members. The rule
17 also covers officers of the issuer who are actually
18 participating in the offering. That's a change from the
19 original proposal which would have covered all officers
20 of the issuer.

21 There was a concern that that might reach too
22 broadly with large and complex organizations that may
23 have quite a lot of officers who don't have much to do
24 with the activities under Rule 506. And so the focus for

25 officers is only on those who were actually participating
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1 in the offering. The rule covers 20 percent beneficial
2 owners of the equity securities of the issuer measured on
3 the basis of total voting power. That's also a change
4 from the proposal which would have covered any holder of
5 at least 10 percent of any class of the issuer's equity.

6 Again, the concern was an attempt to avoid
7 possible over-breadth and focus really on the equity
8 holders who were in a meaningful position to influence
9 the policy and direction of the issuer. The rule covers
10 promoters as proposed. There was a new addition for
11 pooled investment fund issuers which constitute about a
12 third of the 506 offerings reported on Form D. For
13 pooled investment funds the rules cover the investment
14 manager, that is the investment advisor of the fund or
15 other investment manager of the fund and the principals
16 of that investment manager, so general partners,
17 directors, managing members and so on.

18 And finally, the rule also covers as proposed
19 anyone who solicited or who is compensated for soliciting
20 investors in the offerings in place of an agent, broker-
21 dealer, that sort of thing, as well as directors,
22 executive officers, general partners and officers who
23 participate in the offering of those compensated
24 solicitors. The triggering events were substantially as
25 proposed with one addition, one fairly significant

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1 addition.

2 So what will trigger disqualification: certain
3 kinds of criminal convictions, basically convictions in
4 connection with the purchase or sale of security, making
5 a false filing with the SEC or arising out of the conduct
6 of certain types of regulated financial intermediaries?
7 And for that rule we'll look back five years in the case
8 of the issuer and its predecessors and affiliated
9 issuers, 10 years in the case of every other covered
10 person.

11 Similarly, you'll be disqualified for any court
12 injunction or restraining order in connection with the
13 same events, that is purchase or sale of security, making
14 a false filing with the SEC arising out of the conduct of
15 certain financial intermediaries. The look back there is
16 five years, so the injunction or restraining order must
17 have been issued within the last five years and must
18 still be in effect at the time of the proposed offering
19 in order to trigger a disqualification.

20 The new provision that was mandated by the
21 Dodd-Frank Act is a set of disqualifying events for
22 orders of state and other federal regulators. So that
23 includes things like state securities regulators, state
24 insurance and banking regulators, as well as federal
25 banking regulators and the National Credit Union

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1 Administration. The Commission also added the CFTC, the
2 Commodity Futures Trading Commission to this list of
3 regulators, you know, taking the view generally that
4 their actions should be considered on par with these
5 other regulators in the financial sector.

6 So disqualification will be triggered if any
7 one of the regulators on that list bars someone from
8 associating with the regulated entity from engaging in
9 the business of securities, insurance or banking or
10 similar businesses. Disqualification will also be
11 triggered for any final order based on fraudulent,
12 manipulative or deceptive conduct. And again, for those
13 we're looking back 10 years, so any such order entered within
14 10 years of the proposed offering would trigger
15 disqualification.

16 There are a couple of different categories of
17 SEC actions that will trigger disqualification. First,
18 disciplinary orders relating to brokers, dealers,
19 municipal securities dealers, investment advisors,
20 investment companies will generally trigger
21 disqualification. In addition, and this was a change
22 from the proposal, a Commission cease and desist order or
23 a subset of them will also trigger disqualification.

24 When our baseline rules, the Regulation A bad
25 actors qualification rules were originally adopted, the

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1 SEC didn't have cease and desist authority. And so those
2 rules never covered C and Ds. Now to take account of the
3 power that the SEC has in this area, certain cease and
4 desist orders will trigger disqualification, namely those
5 that are based on violations of scienter-based antifraud
6 provisions of the federal securities laws, so for
7 example, 10(b) and Rule 10b-5 or violations of Section 5 of
8 the Securities Act which is the basic registration
9 requirement that applies for most offerings.

10 And then to round it out, the last group
11 unchanged from the proposal, any issuer that's had a stop
12 order issued with respect to their registration statement
13 or an order which are in the Reg A exception or any
14 underwriter that's participated in such an offering.
15 Suspension or expulsion from an SRO such as FINRA will --
16 or a ban from association with an SRO will also trigger
17 disqualification and lastly, U.S. Postal Service false
18 representation orders.

19 There is as proposed a reasonable care
20 exception provided in the rules so that if an issuer can
21 show that it didn't know and in the exercise of
22 reasonable care couldn't have known of the existence of
23 the disqualification, that it will not lose the
24 exemption. So that was proposed and broadly supported by
25 the commenters and was included in the Final Rule. And a

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1 key difference from the proposal is the distinction
2 between the treatment of disqualifying events that

3 happened before September 23rd, the effective date, and
4 qualifying events that happened afterward.

5 And remember we're focusing on the actual --
6 not the underlying conduct but rather, you know, the
7 criminal conviction and the court order, the regulatory
8 order. That's the triggering event. So for any of those
9 that occurred before September 23, the consequence for
10 the issuer will be a disclosure requirement. They'll be
11 required to provide purchasers a reasonable time before
12 they purchase a description of the events, so that they
13 have that in hand before they make their investment
14 decision.

15 For events that occur after September 23 -- on
16 or after September 23rd I guess technically,
17 disqualification will arise. And then lastly as in the
18 proposal, there is a provision for waiver included in the
19 rule. And so for good cause shown, the Commission would
20 have the ability to waive disqualification if it should
21 arise. And with that I turn it over to John to talk a
22 little bit about their Reg D, Form D proposal.

23 MR. INGRAM: Thanks, Karen. Well, July 10th
24 was a pretty busy day around here because the Commission
25 wasn't done yet. The final action that they took that

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1 day was to approve the issuance of a proposing release on
2 Regulation D, Form D and Securities Act Rule 156. The
3 proposal is intended to enhance the Commission's ability
4 to assess developments in the private placement market in
5 light of the fact that the prohibition on general
6 solicitation will be lifted.

7 In particular, the proposal would improve the
8 Commission's ability to evaluate the development of
9 market practices in Rule 506 offerings and would address
10 certain concerns raised by investors related to issuers
11 engaging in general solicitation. As the Chair
12 mentioned, there is a 60-day comment period on the
13 proposals and the 60th day is this Friday. So I
14 encourage you if you haven't already to read the
15 proposing release and let us know what you think. I know
16 that we're probably bordering on information overload
17 here as far as our descriptions of the different adopting
18 releases and now the proposing release.

19 So on the proposing release what I'm going to
20 do is -- there were seven main components too. There
21 were some proposals that were set forth in the release
22 and I'm just going to tick through them one by one.
23 First, issuers that intend to engage in general
24 solicitation as part of the Rule 506(c) offering in
25 addition to the current requirements would be required to

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1 file Form D at least 15 calendar days before engaging
2 in general solicitation for the offering. The Commission
3 referred to this as the advance Form D filing
4 requirement.

5 Second, within 30 days of completing any Rule
6 506 offering -- so that would be with or without general
7 solicitation, issuers would be required to update the
8 information contained in Form D and indicate that the
9 offering had ended. This was referred to as the closing
10 Form D amendments.

11 Third, issuers would be required to provide
12 additional information in Form D to enable the Commission
13 to gather information on changes in the Rule 506 market
14 that could occur after the prohibition on general
15 solicitation is lifted. The additional information would
16 include things such as expanded information on the
17 issuer, the types of securities offered, the types of
18 general solicitation used, if any, and the methods used
19 to verify accredited investor status of investors.

20 Fourth, an issuer would be disqualified from
21 using the Rule 506(c) exemption in any new offering if
22 the issuer or its predecessor or affiliates did not
23 comply with the Form D filing requirements in a Rule 506
24 offering within the past five years. As proposed, the
25 disqualification would continue for one year beginning

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1 after all the required Form D filings are made. Issuers
2 would be able to rely on a cure period for a late Form D
3 filing and in certain circumstances could request a
4 waiver from the staff.

5 Fifth, issuers will be required to include
6 certain legends or cautionary statements in any written
7 general solicitation materials used in a Rule 506(c)
8 offering. The legends would be intended to inform
9 potential investors that the offering is limited to
10 accredited investors and that certain potential risks may
11 be associated with these offerings. In addition, if the
12 issuer is a private fund and includes information about
13 past performance in its written general solicitation
14 materials, it would be required to provide additional
15 information and materials to highlight the limitations on
16 the usefulness of this type of information. The issuer
17 would need to highlight the difficulty in comparing this
18 information with past information of other funds.

19 Sixth, issuers will be required to submit
20 written general solicitation materials to the Commission
21 through an intake page on the Commission's website.
22 Materials submitted in this manner would remain
23 confidential, would not be available to the general
24 public. As proposed, this requirement would be
25 temporary, expiring after two years.

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1 Finally, currently a Securities Act rule
2 provides guidance on when information and sales
3 literature by an investment company registered with the
4 Commission could be fraudulent or misleading for purposes
5 of the federal securities laws. Under the proposal, this
6 guidance would be extended to the sales literature of

7 private funds. Finally, the Commission also requested
8 comments on the definition of the accredited investor and
9 manner and content restrictions on the general
10 solicitation of private funds.

11 So that's a rundown of the proposing release.
12 If you liked or didn't like anything that you heard, I
13 strongly encourage you to submit a comment letter to the
14 Commission. If you have already submitted one, you are
15 not precluded from submitting an additional one. If you
16 liked things, we'd love to hear that you did. If you
17 don't like some of the things that I've mentioned, we'd
18 like to hear that as well. And it would be particularly
19 useful in those circumstances if you could provide us
20 with some alternatives that we could consider to those
21 proposals.

22 We're also very interested in gathering
23 information on the costs and benefits that each of these
24 proposals would involve. So to the extent that any of
25 you have information or can compile information with

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1 respect to that that would be very helpful as well. So
2 that concludes our discussions of the three rulemakings
3 from July. And we're happy to try to address any
4 questions that folks may have.

5 MR. GRAHAM: Comments, Catherine?

6 MS. MOTT: I'd like to start with a question.
7 For the -- under general solicitation you list seminars.
8 Are seminars defined as demo days and venture fairs?

9 MR. INGRAM: Well, we don't have a definition
10 of demo days in the rules. And in fact as I mentioned,
11 we don't have a definition of a general solicitation. We
12 do provide examples of what could constitute general
13 solicitation. And it's a difficult question to answer.
14 It's a facts and circumstances determination. I don't
15 think that we could give a bright line answer with
16 respect to that one.

17 MS. MOTT: If I may comment on that please?
18 There are thousands of demo days and venture fairs. And
19 many people are in the audience that are accredited
20 investors and unaccredited investors and media
21 professionals and things like that. This is something
22 that has been happening in the capital formation markets
23 for many, many years. And we have concern that a 506(b)
24 offering that is present at the demo day that it will
25 default to 506(c) by virtue of being now considered

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1 general solicitation. So maybe having some I guess
2 clarifications might be helpful for the entire
3 marketplace.

4 MR. HIGGINS: I understand. What's the
5 situation now?

6 MS. MOTT: The situation now is that venture
7 fairs and demo days people come in and present their
8 companies for, you know, basically what the company does,

9 and what they intend to do, how they intend to grow, and
10 that they're raising capital. And as matter of fact
11 here's how much they're raising.

12 MR. HIGGINS: But I guess my question is -- and
13 I'm sorry. Someone must have concluded it's not
14 currently a general solicitation, right, because if it
15 were that would violate the rule, right?

16 MS. MOTT: Say that again please.

17 MR. HIGGINS: Someone must have concluded that
18 demo days are not general solicitations, right?
19 Currently, because if they were, they wouldn't be
20 permitted under current 506.

21 MS. MOTT: That's correct. What we're
22 concerned about is 506(c) says that it is.

23 MR. ABSHURE: Actually on your first question,
24 no. Every state out there has venture capital days
25 promotions for equity investment. And every one of them

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1 violates the prohibition on general solicitation
2 advertising. But unfortunately because they are most
3 often sponsored by a state government agency or in effect
4 the governor's office, we just watch. I had to be honest
5 with you but, yeah, every one of those technically --
6 every one of those violates existing rules.

7 MR. HIGGINS: Well, I guess only if it's an
8 offer of security. Listen, I think it's a hard -- it is
9 a hard question, right? And, you know, the joke would be
10 we'll get to a definition of general solicitation right
11 after we get -- after one on insider trading. And of
12 course there isn't one. I think it will be hard. And
13 we're open to ideas but I think it will be hard to come
14 up with a definition, a safe harbor for what's a general
15 solicitation and what's not, because it's one of those
16 very gray areas.

17 But we recognize the -- now the rule of course
18 allows -- I mean the good thing about the rule is that
19 you can do it. If it happens to be a general
20 solicitation, that's okay. That doesn't preclude a
21 company from raising -- but of course you've then elected
22 into the only accredited investor bucket as opposed to
23 more flexibility for other types of investors.

24 MS. MOTT: Correct. For the entrepreneur who
25 is raising capital, you know, he or she may default to

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1 that and not know it. And I know the legal community is
2 trying to figure this out, and I know the incubators are
3 trying to figure this out. I mean I received a couple
4 calls from our local incubators, and I can't answer those
5 questions for them yet. So I know that there's some
6 fuzziness around that issue right now.

7 MR. YADLEY: One of the advantages of Rule
8 506(c) -- and I applaud the Commission for doing a great
9 job. It took longer than people thought and but I think
10 the results are pretty good. The most important thing is

11 it focuses on who's purchasing. It doesn't mean this is
12 not an incredibly important issue, and it makes it very
13 difficult for practitioners when the client comes in and
14 says I met all these people at this fair and I didn't
15 know them but boy, they really want to invest. And you
16 get into all this, so that's an advantage.

17 Having gone slowly to adopt 506(c), I also urge
18 the Commission and the staff to go equally deliberately
19 with respect to the rule proposals which are very broad
20 reaching. And I think everyone understands the need for
21 the Commission to have good information to be able to
22 study what's happening. I mean how can you improve
23 capital formation unless you understand what people are
24 doing and why they're doing it? So the goals are
25 laudable but the amount of information that would be

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1 required under the new Form D goes pretty far and
2 probably farther than is needed for the stated purposes.

3 And just to pick up another area from Catherine
4 of uncertainty: an advance filing is more difficult than
5 it sounds because often a company however it's met
6 investors, whatever it's trying to do, 15 days in advance
7 is a long time to make a commitment. And particularly if
8 it turns out that you have defaulted into 506(c) land or
9 made an inadvertent general solicitation, by that point
10 15 days is 15 days in the past and you've now blown the
11 election.

12 And because you've used general solicitation,
13 you can't fall back on Section 482. And I don't think
14 that the Commission intends to inhibit people like that.

15 But it really does decrease your flexibility. So that's
16 something that's important. At the tail end of that the
17 closing filing, it's really not so easy to know when an
18 offering has concluded in many cases. It's also as much
19 as I love, as you did Keith, being a lawyer and being
20 able to advise clients, in a lot of these private deals
21 lawyers are not around to be consulting all the time.

22 So a small company, even a good sized company
23 that's well run, they're not focused on the SEC rules.
24 So they think they're doing everything right but it's too
25 late to make an advance filing. And once the offering

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1 is done, they're back to business. And, you know, they're
2 not necessarily consulting their lawyer.

3 And then just a comment on the content. There
4 are lots of things that, again, I don't think this is the
5 Commission's intent but requests for information just
6 about the fact that somebody is raising money, that's
7 often considered confidential, particularly if it turns
8 out that the offering is not successful and you've now
9 sort of told the world hey, we tried to raise money and
10 we couldn't.

11 I think people that I've spoken with and
12 certainly the American Bar Association Federal

13 Regulations Securities Committee, to name one, is working
14 very diligently to provide comments, including
15 suggestions for how to do it better -- probably will not
16 be there by next week although everybody is trying. So
17 please don't rush into adopting some of these proposals
18 out of pressure from third parties. Thanks.

19 MR. ABSHURE: If I could respond to a couple of
20 Greg's comments there, we'll start with the advance
21 filing. Part of the reason the states supported the
22 advance filing is just so we can answer the questions
23 that are asked of us by investors. We go out and we
24 encourage investors to do their research prior to making
25 an investment, plus we're going to as part of our

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1 investment charge, be scouring the internet looking at
2 offerings and things of that nature. Well, if the Form D
3 doesn't have to be filed until 15 days after the first
4 sale, one, we're not going to be able to answer any of
5 those questions asked by the investors because we're not
6 going to have any information on file. Two,
7 we're not going to be able to tell by looking at an
8 internet advertisement or going to a seminar, or seeing a
9 billboard, whether this is an entity that is actually
10 trying to comply with Form D requirements under 506(c) or
11 is skirting those. Now in terms of confidentiality --

12 MR. YADLEY: If I can just comment on that -- and
13 I'm sure you're not expressing the view that your state
14 or any other state advises investors about what offerings
15 to invest in unless it's a registered offering and your
16 state has a fair, just and equitable standard. Also, as
17 much as I believe in enforcement, with all those the
18 offerings that are made under Rule 506, \$900 billion,
19 there's not enough enforcement people to be doing that.
20 I understand that it's a bad answer to say, you know, do
21 your own due diligence investor, but to get the
22 information 30 days earlier than you would, I'm just not
23 sure how much you're going to get.

24 MR. ABSHURE: Well, I wouldn't disagree with
25 the date, but at the same time if the investor calls me

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1 and says tell me about the officers and directors of this
2 corporation, tell me about the beneficial owners of this
3 corporation, tell me who the placement agents are that
4 are selling this offering, have you had any problems with
5 them, have there been any disciplinary actions, have
6 there been any complaints, what do you know, that's the
7 type of information we give them every day. Now that's
8 not the type of information that I'm going to be able to
9 give them if I don't have that Form D.

10 MR. HIGGINS: I guess I -- it sounds like we
11 have maybe a bit of a three bears' problem you know. The
12 papa bear says the form is too late and mama bear says
13 the form is too early, right? So maybe there's somewhere
14 between 15 days before and 15 days after first sale.

15 MR. ABSHURE: I think it's -- you know in terms
16 of 15 days before I don't need it. We're not going to
17 review it, it's not a qualification filing. We're
18 prohibited from making a qualification filing. It's just
19 that I think the filing date ought to be tied to the date
20 that first time you use public solicitation of general
21 advertisement. As an issuer, you can't go that far until
22 you've made that filing. So you're going to
23 know if you're engaged in general solicitation. You're
24 going to know if you put it on your lips. You're going
25 to know if you're going to a seminar. Well, in that case

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1 I want to make sure that the Form D is on file prior to
2 that time, or at least simultaneously so when I get a
3 call from an investor who's been to that and wants to
4 know who are these people, have you had any problems with
5 them, I at least can answer those questions.

6 If the Form D is one of the documents that
7 investors use to make an informed decision on whether or
8 not to invest, if we tell investors to do their due
9 diligence before they invest, well let's give them the
10 document before they invest. If the Form D is part of
11 that, then it needs to be part of the entire package of
12 information that is out there before they would make a
13 decision to purchase.

14 MR. YADLEY: I can't answer all the questions
15 you've raised, but one thing that I think is key to the
16 discussion is the Form D. Should it be part of the
17 offering materials on which an investor is relying? And
18 historically this was not why Regulation D had the Form
19 D. It was there for information gathering and statistical
20 purposes so it's --

21 MR. ABSHURE: I mine every one that comes in.
22 I pull the beneficial owners, I pull the officers and
23 directors. I pull the broker-dealers, I pull the
24 consultants that are getting compensation. And I put
25 that in our database and I look to see who's selling what

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1 and who are associated with the bad guys, and I think
2 it's at the same time.

3 I mean consider a 506(b) offering where they
4 don't have to give you anything. So if I have an
5 investor call me at that time and he says hey, I've got
6 an offer here to buy X, Y, Z corporation, and what have
7 they given you? Nothing. Well, at least I'm going to be
8 able to go back to the Form D and say here's the officers
9 and directors, here's the beneficiary, here's the guys
10 that are calling the shots, here are the broker-dealers,
11 and here are the issues that I've had with them in the
12 past.

13 The other thing in considering the permit on
14 general solicitation without guidance, gives us a little
15 concern. And I understand that ship has sailed. And
16 part of that is because I don't think that the zealous

17 entrepreneurs understand that once you start general
18 solicitation in advertising, both in the 506 offering and
19 perhaps a crowdfunding offering, you're no longer an
20 entrepreneur that's calling your own shots. You are now
21 arguably the management of a corporation.

22 And I don't think they understand the
23 difference in the various state corporate laws that are
24 going to be applicable to them. And also I don't think
25 they understand the difference between advertising their

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1 product, or say advertising their securities sales and
2 that the securities fraud liability is going to attach to
3 that. With regard to the reasonable steps to verify, I
4 think all of us will agree that that problem is much more
5 acute with dealing in it with an individual than it is
6 with an entity.

7 The states support verification by a third
8 party. To be honest with you, the last thing in the world
9 that states want to see is a third party error, an
10 investor sending their tax returns to the issuer that's
11 trying to sell them an investment. We don't want to see
12 that happen. We would much rather see that verification
13 take place specifically by a broker-dealer, because with
14 the removal of that prohibition on general solicitation
15 advertising that means you can have direct sales from the
16 issuer to the investor.

17 That gets the broker-dealer back into the
18 equation, and then maybe we have a back door suitability
19 analysis. Maybe a little bit of due diligence or at
20 least a broker-dealer looking at that investment and
21 advising their client as far as whether or not it should
22 be appropriate for purchase. And then we're not -- we
23 support the disqualification provisions, but in our
24 experience if somebody is disqualified, they're going to
25 stay in the offering, they're just not going to sign

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1 their name on the Form D. But we still think it ought to
2 be there, because it gives us a little more of a hammer.

3 And the last thing I'll say is we're not
4 extremely happy with the lack of retroactive application.

5 While we agree that if a party has settled a late filing
6 violation, that that probably shouldn't kick them out in
7 terms of a retroactive application but if in January or
8 in July he was convicted of securities fraud, we think
9 that should. That's all.

10 MR. GRAHAM: Thank you, Heath.

11 MS. MOTT: I'm going to speak practically, and
12 I'm going to talk about what happens in the real world.
13 First of all, my angel group has been around for 10
14 years. We've invested in over 40 companies roughly
15 \$23 million. We have never used a broker-dealer. We
16 won't use a broker-dealer for deals, because they're
17 coming to sell us a deal. We're out proactively looking
18 for a good opportunity to invest in. So this idea of a

19 broker-dealer just how it plays in the marketplace, that
20 doesn't bode well for the marketplace.

21 By the way, I've never contacted my state
22 securities association. This is no offense intended, but
23 this is, we do our due diligence. We use the best
24 practices of the National Venture Capital Association, so
25 we behave a lot like venture capitalist. And we do our

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1 due diligence, and not only do we know where the people -
2 - we know the people on the board. We know the people's
3 neighbors that are on the board. I mean these are local
4 deals. We drive by, we look and see that their car is in
5 the parking lot, lights on.

6 I mean we actively coach and mentor. You know
7 these people because they're your neighbors. They are
8 part of your community. So I'm just speaking to what I'm
9 hearing here, and I'm thinking this is not how the
10 marketplace behaves.

11 MR. ABSHURE: Well, I think that what you're
12 speaking of is indicative of what the old private
13 placement marketplace used to be, where you had
14 investors, institutional investors, the
15 organizational investors that had the experience, the
16 expertise to look at a startup entity and realize okay,
17 I'm taking a look at their board of directors. I'm
18 taking a look at their business plan, I'm considering
19 their capital needs, I'm looking at their IT, I'm looking
20 at the competitive -- you know, the competition and
21 everything else.

22 That was historically the private placement
23 market, and things were wonderful. That's changed,
24 that's no longer the private -- with this, that is no
25 longer the private placement market. I'll be honest with

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1 you, you're not the investor I'm concerned about. The
2 investor I'm concerned about is the one that flicks on
3 his computer, and whoever has the slickest website can
4 sell directly to that person. I'm talking mom and pop,
5 grandma and grandpa retail investors.

6 And I think that was always our biggest issue
7 with changing and removing that general solicitation
8 prohibition, was because it moved the historical private
9 placement investor, you guys, which had the experience
10 and the expertise and the ability to absorb a loss. And
11 it moved that speculative illiquid investment over to
12 someone who doesn't have the expertise and who doesn't
13 have the ability to absorb loss.

14 MR. YADLEY: Both of you have touched on
15 something that is -- it's sort of a side issue but it's
16 one that's been fighting for air; that is not everybody
17 has access to the angel group and there are
18 nontraditional broker-dealers who are available for some
19 of these smaller offerings. One of the key
20 recommendations of the last 20 small business forums

21 sponsored by the SEC, as well as a recommendation of the
22 prior advisory committee on small business, was to have a
23 sort of limited type of broker-dealer, someone who would
24 be regulated but who would be able to assist companies
25 raising capital, not necessarily do all the suitability

0055

1 and have all the bells and whistles attached to
2 regulation of a traditional broker.

3 But particularly now because issuers are not
4 going to necessarily be selling only to their neighbors.

5 Frankly, I think there are lots of dangers with general
6 solicitation. Even though I have supported it for years,
7 it's a good thing. The focus ought to be on the
8 purchaser and it is, but having lots of investors in
9 your offering if you're an issuer and having people that
10 you don't know, are both bad things. A smaller number of
11 investors who you get to know you, who can be
12 counted on for your next offering is very important.

13 There are lots of mostly individuals out there
14 who have some knowledge about the company who are not
15 necessarily angels themselves, or if they are, they have
16 limited funds but know people who have funds who can
17 perform a great service for issuers. And I think that
18 this is something the staff has lots of information about
19 this. And I hope you will reconsider a focus on a private
20 placement broker.

21 MR. GRAHAM: Okay. Greg, well you have the
22 last comment for this session. We're going to take a
23 break now. I thank everyone for their thoughts. We are
24 going to break and reconvene at 11:00. And we will be
25 continuing this conversation.

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1 (A brief recess was taken.)

2 MR. GRAHAM: We're going to be continuing with
3 the discussion of the amendments to Regulation D. And we
4 once again thank the staff for giving us more context.
5 And thanks everyone for the discussion that we had in the
6 last session. I'd like to introduce David Verrill and
7 Marianne Hudson of the Angel Capital Association. They
8 will be speaking to us now about some of their views in
9 the amendments to Regulation D and perhaps some of their
10 views of the unintended consequences of the new rules.

11 Marianne is the Executive Director of ACA. And
12 for those of you who don't know, ACA is the professional
13 Alliance of Angel Investors and angel groups in North
14 America with 200 plus member groups representing 10,000
15 accredited investors. And I'm sure you can vouch for each
16 one of those 10,000 accredited investors. Marianne has
17 been involved with entrepreneurial education and
18 mentoring programs designed to insure that all
19 entrepreneurs develop sustainable innovative businesses.

20 David is the Chairman of the ACA. He has spent
21 a decade at MIT raising capital from industry and
22 facilitating technology transfer. And David is also the

23 founder and managing director of Hub Angel Investment
24 Group, an earlier stage investment group in Boston.
25 Marianne and David, thank you for joining us and you have
0057

1 the floor.

2 MR. VERRILL: Thank you very much. It's a
3 pleasure to be here. We've got a PowerPoint presentation
4 going on behind us. We view so many PowerPoint
5 presentations we thought we'd inflict a little bit of
6 pain on you to see what our world is like. I'm going to
7 run through a number of slides just to set the scene of
8 what the Angel Capital Association is and does, what our
9 member groups and members do as well, really how the
10 process works. So it really gets down into the weeds a
11 little bit about the practicality of angel investing and
12 as well as to let you know the scale and the scope of those
13 investments.

14 So the ACA's mission is to fuel the success of
15 angel groups and private investors who actively invest in
16 early stage companies. We very recently expanded our
17 mandate from angel groups to accredited investors,
18 accredited portals and accredited family offices. We are
19 the largest trade group for angels. We have members in
20 every single state in the United States and five
21 provinces that represent approximately 10,000 accredited
22 investors, and, yes, we've certified them several ways
23 which I'll talk about a little bit later. Thank you.

24 We do have a charitable partner in the Angel
25 Resource Institute. Their real focus is on educating
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1 angels and providing research about our \$23 billion
2 industry. And Marianne will go through one of the sets
3 of data that they have put forward. Just to kind of take
4 a step back and give everybody a graphic on what the
5 fundraising life cycle is really like, and if you look at
6 this graphic here, you can see the line represents where
7 a company is with respect to its stage

8 On the far left is just the idea stage, a woman
9 in a garage, an idea and progressing through proof of
10 concept, product design, product development,
11 manufacturing and delivery. Those are roughly the stages
12 of a company's development. And just underneath the line
13 you can see the types of funding, and in the rectangles
14 are descriptions of the likely funding sources for that
15 stage of company.

16 So the founder typically will use credit cards
17 and other savings and methods of getting companies
18 started. He or she then might solicit friends and family
19 who may or may not be accredited investors to pitch in a
20 small amount of money. Usually the securities that are
21 provided at that stage are loosely defined. There's no
22 lawyer typically that's involved in that level of
23 activity. But as individual angels and angel groups
24 start to look at companies in the seed and startup stage,

25 which is really the critical point of getting a company
0059

1 out of the garage and into the marketplace, that's really
2 the role that we play and our members play within the
3 Angel Capital Association.

4 And then outside of that oval you can see seed
5 funds, venture funds and then institutional equity. And
6 loans and bonds are put there to make a point. The banks
7 don't participate in the funding life cycle of early
8 stage companies. There's no collateral for them to take
9 as bond. And so really the banks don't play much of a
10 role until the end of a company's life. Now having said
11 that, there are banks like Silicon Valley Bank, which is a
12 partner of ours, that do provide debt financing as a
13 company is growing, but certainly they need to have
14 revenue in the form of their collateral.

15 Now just to talk about the level of investment,
16 last year angel invested about \$23 billion in about
17 66,000 companies. The VCs invested about \$27 billion in
18 a far less number of companies. But just to give you the
19 relative scale of angel investing, we really just don't
20 get the notice or credit I don't think in the marketplace
21 for (a), the amount of capital that we're putting to work
22 and (b), the stage at which we're doing it. And in
23 comparison to private equity you can see the size of
24 private equity funds is nearly \$350 billion. And for
25 those of you who are interested in the hedge fund world,

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1 that's approaching \$2 trillion.

2 So we're small in terms of the amount of
3 capital, but there are two really strong benefits to what
4 we do. The first is the stage at which we invest. And
5 if you look at the first two columns, the left hand
6 columns on this graphic, those are the seed and early
7 stages of a life's company. And you can see that angels
8 really provide on the order of 90 percent of that
9 financing. And again, these are companies taking in
10 their first real capital from so-called sophisticated
11 investors. And just in those two categories, angels
12 funded nearly 47,000 companies in 2012, and VCs funded
13 less than 2,000.

14 So almost 25 times the number of companies are
15 being funded at their earliest stages by angels versus
16 our colleagues the VCs. And the real output of that can
17 be seen in the creation of jobs. Startups create a
18 tremendous number of jobs. Certainly when you're
19 starting a company you don't have 482 employees, you have
20 2, 3, 4, 5 or 6. But there are many of them and they're
21 a really important contributor to job creation.

22 This graphic is a little bit of an eye chart,
23 but it basically is U.S. Census Bureau data from 1977 to
24 2005, nearly a 30-year period of time. And it tracks the
25 number of small companies and the number of jobs that

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1 they create in that year. And there are two points to
2 note. One, certainly without these jobs there would be
3 unemployment a lot higher than it is today and over this
4 period of time. But secondly, the consistency of the
5 number of jobs created by startups is pretty amazing.

6 And it's even more interesting to note this
7 ends in 2005. Since 2005, the number of angel groups in
8 the United States has nearly doubled. So my suspicion is
9 that the blue lines on this chart continue to increase
10 with regularity. Now we're here today to talk about the
11 JOBS Act and how the SEC has provided some rulemaking to
12 it. We want to make sure that everybody in this room and
13 our friends in the SEC and the audience beyond knows
14 about the landscape that angels work within, the
15 statistics, the trends, how sophisticated we are, the
16 impact on startups and how we help the health of our
17 economy.

18 We're going to talk about the final Rule
19 506(c), reasonable steps to verify accredited investor
20 status, what that means for startups and angels, the rule
21 on Reg D Form D, Rule 156 and the accredited investor
22 definition. And Marianne and I are going to ham and egg
23 it a little bit here. I'm the ham, she's the eggs, so
24 we'll let her take this from here.

25 MS. HUDSON: I have to think about what that

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1 means. Thank you so much for including us on this agenda
2 today. We really appreciate it. And I personally want
3 to thank the staff of the SEC which has been really open
4 and accommodating to hearing us. And I think they really
5 have -- are really trying to do the right things, protect
6 the investors, help capital formation. And I really
7 appreciate what they do. As David said, I think we want
8 to just spend a little bit of time talking about the
9 angel investing area before we talk about the rules. So
10 I'll be going through that in just a little bit.

11 So this might be another way of, you know,
12 talking about the overall financial landscape from one of
13 the slides that David showed. But we've kind of looked
14 at five levels of equity capital right now. And
15 entrepreneurs don't necessarily follow all of these
16 steps, but what we often see is first the entrepreneur is
17 funding themselves with their credit cards, their
18 mortgages, "First National Bank of You."

19 And then they might work with their friends and
20 family to support what they're doing. And as angels, we
21 want to see that the people who know and care about them
22 are going to support them as well, but that might be
23 equity, it might be something else. And then angel
24 investors will follow up that kind of investment. And
25 then sometimes the kinds of things that we're funding

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1 need venture capital for expansion. Sometimes we
2 continue that financing, and the company has the

3 financing that they need. But between those kinds of
4 investment, between the angels who might stay in multiple
5 rounds and/or venture capital, we can then get those
6 companies ready so that they can go become part of the
7 public market, usually through merger and acquisition.

8 This will show you some kind of continuing
9 statistics about angels and again, making the point that
10 in terms of startups and early stage companies, we're
11 funding the majority of those kinds of companies. So in
12 2012, not quite \$23 billion is estimated to have come
13 from angel investors compared to not quite \$27 billion from
14 the important expansion of venture capital with 67,000
15 deals during that time from angel investors and 3700 from
16 venture capital. And it looks like there's something
17 like 268,000 accredited angel investors across the
18 country.

19 Just to give you a sense, you know, a piece of
20 some really successful branding companies. So what you
21 have here is a set of companies that started off with
22 angel investing. A lot of them then were venture backed,
23 but these became kind of the companies that have created
24 the jobs and the innovations that have changed the
25 quality of people's lives across the country. Let me talk a

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1 little bit about who angel investors are. Obviously, they
2 fit the accredited investor definition. And for me they
3 also are the kind who invest in companies that are not
4 their family, kind of hard to separate from their friends
5 because we get to know those people.

6 But what we do see is that a lot of investors,
7 particularly the ones who belong to our angel groups, are
8 former entrepreneurs or who have exited their company and
9 then they're making angel investments -- might be becoming
10 entrepreneurs again. But a lot of them are also
11 corporate leaders and professionals. And again, we see
12 about almost 270,000 of them.

13 From a motivation standpoint, you know, a lot
14 of them are doing it of course to make a return, and they
15 understand the risks that are involved. But this is
16 their chance really to invest part of their investment
17 portfolio in stuff that really matters to them from a
18 non-financial standpoint. So this is a way for them to
19 help entrepreneurs to stay engaged to really help create
20 what I'm going to call cool companies in their
21 communities. It's sort of that's their way of giving
22 back.

23 And they really care about that, whether that's
24 in their community, maybe it's, you know, parts of
25 alumnae of their university or some other sector that

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1 they really care about. So you know, they're doing that
2 to network and learn, they do want to make a return,
3 they'd like to see that they're giving something back to
4 the economy. But of course in the end, they are looking

5 for a return.

6 As David said earlier, we have seen a growth in
7 angel groups, almost a four-fold increase over the last
8 14 years. It started off with less than a hundred angel
9 groups just as the century started, and we now have
10 almost about 400 angel groups across the country. And
11 that's the majority of who we represent. It's the
12 easiest set of folks to be able to describe. But I
13 should note that the vast majority of angel investment
14 doesn't happen from angel groups, it happens from
15 individuals doing their own work in formal sets of
16 organizations who may or may not be sophisticated, and of
17 course those who are now working through some of the
18 accredited web platforms that David spoke about.

19 I'm going to be spending most of my time on
20 statistics, talking about angel groups, because they are
21 the ones that we know the best and have the most data
22 about, but I do want to make that important point about
23 how angel investors work. So if we do look at angel
24 groups, you know, we see that there is something like a
25 potential of 8.7 million accredited investors that have shown

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1 up in multiple reports, including the proposed SEC rules.

2 It looks like there's approaching 270,000 active angels,
3 and about 15,000 of those belong to the angel
4 groups that I'm going to be talking about.

5 They are the experienced kind of groups I think
6 Catherine Mott mentioned before, you know. They have a
7 lot of experience. A lot of them have been making
8 investments or are former entrepreneurs themselves. They
9 like to invest in what they know about and have
10 experience about, so that they can add value to the
11 entrepreneurs, help them grow, connect them to potential
12 funders, potential customers and those kinds of things.

13 And we really spend a lot of time on best
14 practices, so we actually do a lot education through the
15 Angel Capital Association, the Angel Resource Institute,
16 really one of the best practices in being an angel
17 investor. And learn how to find the right deals, how to
18 do due diligence -- I'm going to spend a lot of time on
19 that. What are the right kinds of terms for the deals and
20 really best valuation?

21 And one thing that's really fun about being an
22 angel investor is, since a lot of us are former
23 entrepreneurs, we really understand that for us to do well the
24 entrepreneur needs to do well. So we become kind of an
25 extra advocate and mentor for them. And then, you know,

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1 once we make the investment in the company, we spend a
2 lot of time. We're on the boards of those companies, or
3 we are observers for that. A lot of us then kind of
4 serve as seed level people for some time on the company
5 to help them move forward if they're missing a particular
6 capability.

7 And we also look at developing the kind of
8 relationships that they need for follow-on funding, be
9 that from other angels later on or from venture
10 capital and other types of private equity. And really
11 kind of the biggest movement for us is developing
12 relationships with corporations who might acquire some of
13 our companies and help kind of an early exit.

14 This is kind of a graphic of the overall
15 evaluation process that angel groups use. So what we're
16 seeing is, you know, an angel group is getting somewhere
17 between five and a hundred investment opportunities per
18 month. They are coming to them individually or through
19 their own website that they have to work from. They've
20 set up often a team of members of the group to do an
21 initial screening of the investment to make sure it kind
22 of fits with what that group is good at.

23 Is that what they know about, is it in the
24 community that they want to work in? Does the team have
25 kind of a beginning understanding of really their company

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1 and their background and how they can really grow value?

2 And if it passes that kind of screening, then they
3 will get in front of typically either a monthly or a
4 quarterly investment meeting where that entrepreneur will
5 have a chance in that room of just accredited investors
6 and the staff of that group to put out their presentation
7 and answer a lot of questions from the group.

8 Let the group kind of visit about what they
9 think are the merits or concerns they have about that and
10 then might come back for an additional meeting for those
11 who might be interested in learning a lot more about that
12 company, spending a couple of hours with them to ask
13 questions before they move through a formal due diligence
14 process. And then finally, some small set of those
15 organizations receive an investment with professional
16 terms, working with really some strong legal counsel to
17 make sure we've got those processes together. And then
18 it's really our job to support those companies.

19 It looks like based on the statistics that
20 we've seen that somewhere on the order of about 5 to 10
21 percent of the companies that come to an angel group end
22 up getting financing from the organizations. The others
23 might kind of stay with us for additional mentoring and
24 maybe connection to other angels and investors in a
25 community to work with those companies and perhaps

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1 support them later.

2 And I guess from an angel group standpoint, it
3 looks like the average size investment for the group
4 itself is about a quarter of a million dollars. That
5 might involve somewhere between 10 and 20 individual
6 investors who are supporting that particular company,
7 sometimes investing individually, sometimes forming a
8 single purpose LLC to invest in that company and often

9 then syndicating with others,
10 Then, you know, what's really important for us
11 is to make sure we're supporting the entrepreneur after
12 we make the investment. So I think I've mentioned a few
13 of these things before, but certainly as part of the
14 investment we want the information rights. We want to
15 know, you know, what's going on with the company. And we
16 actually have learned through research that when we
17 really monitor the company and we mentor them, they do
18 better. There's a lot more potential success for their
19 growth.

20 So we have really spent a lot of time, you know, focused
21 on working with them.

22 And there has even been a study by Harvard and
23 MIT that's really underscored the importance of having
24 angels involved in selecting and supporting the
25 entrepreneurs to help them grow that really increases the

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1 chance of success.

2 Finally, what I want to do is show you a couple
3 statistics about what we know about angel group
4 investment. This is through the HALO Report, which is
5 really designed to talk about the trends and what angel
6 group deals look like. It's not meant to describe the
7 size of the market, but just what the deals look like and
8 comparisons between regions and type of sectors. And
9 this is a report done by the Angel Resource Institute,
10 Silicon Valley Bank, and CB Insights which handles deals
11 that were involved.

12 So first, what we know over the last three years
13 is that the median size deal of an angel group round is
14 between half a million and \$625,000 when just the angel
15 groups are involved. So that means typically you have
16 two or three or four angel groups involved within that
17 deal. So this is the amount that the issuer, the
18 entrepreneur has received. Sometimes we do co-invest
19 with venture capitals, so the green line along the top
20 shows what the median sizes are when angels co-invest
21 with venture capital.

22 From a pre-money valuation standpoint for 2012,
23 actually 2011 and what we know for the first half of
24 2013, the pre-money valuation on a median range is two
25 and a half million dollars. But we give you a range

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1 there from really very small and startup to as much as
2 over \$6 million. But we do -- we are seeing that we are
3 seeing quite a range of differentiation between regions
4 and certainly sectors. So certainly a lot of the IT type
5 investments would be smaller.

6 We know that the majority of our investments
7 are really in the Internet, what I call IT and software
8 and healthcare. And when we say healthcare, we mostly
9 mean medical devices. And so, you know, more than two-
10 thirds of our investments are in Internet IT, healthcare

11 and mobile and telecom with a lot more growth coming in
12 clean tech. But then you'll see really quite a variety
13 of investments. And by dollars of investments, you can
14 see a similar distribution there, except you can see that
15 healthcare takes a bigger percentage of our investments,
16 showing that the investment size for the life science
17 investments that we're making are actually considerably
18 larger because that's what those companies need.

19 Finally, the thing I really like about angel
20 investing is that angels are everywhere across the
21 country. This gives you a distribution by number of
22 deals in 2012 in the data set that's in the HALO Report,
23 and it really shows that the investments were really
24 truly across the country and not necessarily just in the
25 traditional venture capital areas that you might see in

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1 say California and Boston, really everywhere.

2 And then the final point is this is showing the
3 returns of angels and angel groups conducted by academics
4 Robert Wiltbank at Willamette University and the Kauffman
5 Foundation. And this shows I believe more than 3200
6 investments by angel group investors mostly between 1995
7 and 2007. And what it really shows is the median size of
8 returns for these deals was 2.6 times the investment in
9 3 1/2 years, which roughly works out to an average IRR of
10 27 percent.

11 But the real point here is that median doesn't
12 mean much, and so we've gotten to learn that, you know,
13 there's a lot of risks involved in angel investment. We
14 knew that already, it was just good to have the
15 statistics behind it. And so we see that more than half
16 of the deals or 32 percent lose some or all of our money
17 and not quite 8 percent have a 10 times or more return on
18 investment. And that's where the majority of the return
19 in that 27 percent IRR comes from.

20 And so we've learned from this kind of work
21 that, angel investors need to make multiple
22 investments to protect their ability to have a return and
23 not have a loss. Through some of this we are not showing
24 the slides. We've also learned things about if we invest
25 in what we know, we increase our potential or chances of

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1 success often for the entrepreneur. And also if we
2 support them with mentoring and monitoring, that also
3 helps them. So with that, I'm going to turn things over
4 to David with that background to talk a little bit about
5 the rules.

6 MR. VERRILL: Thank you. So Jonathan and Karen
7 and colleagues did a great job of describing in detail
8 the different rules. But just to repeat them very
9 briefly, the so-called 506(b) quiet deals, these are the
10 deals that we've been doing all along. And we have been
11 self-certifying by questionnaire whether or not an angel
12 investor is indeed accredited. We do that in order for

13 them to become a member of our group. And then when we
14 make an investment, we yet again confirm accreditation to
15 the issuer that we are indeed accredited.

16 And there have been no other additional
17 verification requirements to date, and the issuer must
18 have reasonable belief that the investor is indeed
19 accredited and otherwise unaccredited. We're going to
20 get into a little bit of the detail here, but I wanted to
21 just sort of put forward where the friction is, where the
22 rub is in process. And, you know, angels like everybody
23 else are creatures of habit. They've been doing
24 something one way for a very long time. They've been
25 relatively successful at it. They don't use

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1 intermediaries. All of the work is done on their own.

2 They are mentors, they are board members. And
3 so they sort of feel as if it's their ecosystem. And
4 they participate in a number of activities in order to
5 contribute to that ecosystem, but also to generate deal
6 flow and understand which of the companies that are
7 presenting in business plan contests. And demo days are
8 the best, because that's part of the screening process.
9 You want to find the best companies, and you want to help
10 those companies be successful both with your time, your
11 energy, your expertise, your connections, and your money.

12 We had our annual conference in San Francisco
13 last year, and the SBIR brought I think it was 10
14 companies that they had funded through one of their
15 programs. It was amazing to see some of those companies,
16 they were some really interesting companies. That event
17 was 99.9 percent accredited investors. There were some
18 vendors there and some sponsors of the ACA who had
19 personnel who were not accredited investors. And it
20 would be a darned shame for that to be so strict of a
21 regulation that we would consider that a public forum and
22 subject to a 506(c) filing.

23 These events are critical sources of deal flow
24 for us. And we want to continue to do that. We don't
25 want to retire our members from participating in these

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1 activities, and I fear that some of them will have that
2 type of a response. The generally solicited offerings
3 state that all purchasers must be accredited investors.
4 The old Rule B allowed up to 35 non-accredited investors,
5 really does not apply to C.

6 And there are a number of questions, for
7 example, if a company had a previous round of financing
8 where it was a B filing and did have non-accredited
9 investors in that particular series of financing, what
10 happens if the next series of financing is generally
11 solicited? And what about friends and family? It could
12 effectively make it difficult for friends and family to
13 participate in these types of rounds.

14 The other point I'd like to make is that the

15 issuers must take additional reasonable steps to verify
16 that all purchasers are accredited. As I mentioned
17 earlier, thus far we've been using a check-the-box self-
18 certification questionnaire. I certainly would like to
19 see that continue. If there are additional questions
20 that we all think could be added to that to add to the
21 veracity of that questionnaire that would be a
22 preference. The suggestions that have been listed and as
23 noted, it's a non-exhaustive list of methods that could
24 be used to take reasonable steps to verify.

25 But, you know, anecdotally I talked with a

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1 dozen or so angels when the initial rulings came out.
2 And, you know, the responses range from, "I'll never be
3 an angel investor again if I have to give my accountants
4 documentation such that he or she will have to prove
5 verification" to "It's no big deal." But I think the
6 preponderance of people just didn't like the additional
7 friction in the marketplace. And I think that adds just
8 another potential of risks of losing very important
9 investors in the angel ecosystem.

10 And I think the issuers are going to need a
11 tremendous amount of education. Entrepreneurs are
12 focused on starting their company, raising money to get
13 that company's products into the market and being
14 successful. What they really can't be asked to do is be
15 held down by regulation and additional activities that
16 take away from really the primary importance. Now I
17 understand that with the advent of crowdfunding a whole
18 new kettle of -- can of worms is being opened up. And we
19 do need regulation to govern that. But I think the
20 business as usual activities that we've been doing really
21 need to be preserved as much as possible.

22 The next slide is again, a little bit of an eye
23 chart, but this points to the safe harbors that the SEC
24 has commented on. And I won't go through each one of
25 them, but I think our initial response and that of the

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1 marketplace was okay, well let's find a safe harbor that
2 will cover us. And I think that approach has waned in
3 terms of how the marketplace ought to respond. I really
4 think that the principles-based approach that's been put
5 forward needs to be the primary method that we hitch our
6 wagons to. But I think we obviously need to define that
7 with far greater detail.

8 And to that point just a couple of bullets, and
9 Jonathan made note of these earlier as well. Whether the
10 steps taken as reasonable is an objective determination
11 in the context of the particular facts and circumstances
12 of each transaction, including the nature of the
13 purchaser, the type of accredited investor the purchaser
14 claims to be, amount and type of information the issuer
15 has about the purchaser, the nature of the offering, the
16 manner in which the purchaser was solicited, terms such

17 as minimum investment amount. The verification standard
18 requires the issuer to establish reasonable belief that the
19 purchaser is accredited.

20 And in some instances when a third party is
21 being asked to provide that additional reasonable belief
22 and verification, there's sort of a 30-day trigger on
23 that and also whether or not that needs to be done or a
24 three month -- was it a three month, three months. And
25 whether or not that would thereafter have to be three

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1 months every single time you make a new investment seems
2 a little bit much.

3 So the ACA has put forward guidance on the
4 principles-based method to our membership. We've shared
5 that letter of guidance with the SEC, and we have some
6 additional materials that we'll be putting forward to them
7 that show in far greater detail, I think, the positioning
8 that we think our membership will and should take.

9 The principles-based methodology certainly is
10 robust. We don't feel that people ought to be stuck in
11 the safe harbor treatment. But there are areas of shaded
12 gray I think that really need to be clarified. For us,
13 we believe that membership in an established angel group
14 called EAG here is a powerful mechanism of meeting the
15 principles-based methodology. We are all accredited
16 investors, we have certified that in order to become a
17 member of our angel group.

18 Almost all of the members of my group are
19 referred by another member. Word of mouth is a really
20 important method for us to sustain our angel groups.
21 Many of the members of my group have made investments
22 before joining an angel group, and the structure of the
23 group offers them a different mechanism of investing that
24 is appealing to them rather than doing it on their own.
25 They can share the expertise and the process that we

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1 bring to the way that our group works.

2 By the way, we are structured as a fund. Most
3 of the angel groups in the U.S. are networks where each
4 individual ultimately makes his or her own investment
5 decision and writes their own check. In my group, all of
6 the members of my group have committed to our fund, and
7 that capital has been committed. And then we will go
8 through the same process that Catherine's group or
9 Marianne's group goes through in order to find, screen,
10 present, perform due diligence, negotiate terms and
11 invest. We simply use a democratic approach for that.

12 But because we're structured as a fund, I think
13 there's a lot more rigor to the process. We're able to
14 preserve some capital from that fund to aggressively
15 follow our capital. Many of these companies need more
16 money than they even think, and multiple rounds of
17 financing are sort of the order of the day. So there are
18 different types of models amongst the angel groups that

19 shouldn't go unsaid. Almost all angel groups have a set
20 of conflict of interest guidelines.

21 Some of them even require their members to sign
22 a document on how they will conduct their business, how
23 they will report conflicts of interest. Ours does and we
24 take that very seriously. And if we have a person in our
25 group who does not behave accordingly to those rules,

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1 they're simply not invited into the next fund. In all
2 cases we're recommending that a deal that our members are
3 involved in

4 -- make sure that the issuer checks with their legal
5 counsel that they believe that membership in an
6 established angel group does indeed meet the principles-
7 based method.

8 We also think that the principles-based method
9 may be appropriate for other active angels and those that
10 might have invested previously, sat on public or private
11 boards. So these are other sort of litmus tests that
12 prove further their accreditation. So we'd like the SEC
13 for clarification, and we hope that they will consider
14 the discussion that we have here.

15 We would like to affirm that the ACA's guidance
16 on an established angel group as a reasonable principles-
17 based method, so that the market can develop practices
18 further and help capital formation more along the lines
19 with which we've been doing it. We don't want to upset
20 that applecart.

21 There are very common questions coming from the
22 entire ecosystem, not just angels and angel groups, about
23 general solicitation. And I think the word that's been
24 put into the rulings was seminars. And obviously we'd
25 like to know if demo days and other types of events are

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1 indeed considered public advertising, or if they're
2 really more an artifact of the process of a company
3 finding mentors, finding opportunities, to network with
4 people and ultimately finding funding.

5 And how do 506 investments work if previous
6 rounds had been filed as Bs, or had unaccredited friends
7 and family type of investors? So I think there's some
8 room for clarification in those guidelines and those
9 rules. And hopefully we'll get there at some point in
10 the near future.

11 MS. HUDSON: Thanks and I think a discussion
12 among this group about those kinds of issues would be
13 particularly helpful. What I'd like to talk about a
14 little bit is -- are the proposed rules on Reg D, Form D
15 and Rule 156. And I completely understand the thought
16 behind this rule to really get data and understand what's
17 going on there. It just may be that startups have some
18 different issues when they're raising capital than other
19 parts of the capital formation chain.

20 So I think many startups and early stage

21 investors do think that a lot of the pieces of that
22 proposed rule could put a lot of startups out of
23 business, because they missed some of the filing
24 requirements and don't have the capital behind it to
25 continue if they trigger a penalty. And to talk about

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1 this a little bit, I guess what I'd really like to do is
2 talk a little bit about who these companies are and how
3 they raise capital and then I'll bring up a couple of
4 ideas.

5 So, you know, a lot of the startups that we're
6 investing in have no revenues at all or really low
7 revenues. They're certainly not profitable at that time.

8 They have very few employees. We're often seeing at the
9 angel group level even, you know, companies that really
10 are just kind of two people and they're looking for
11 capital to grow to five or six initially. They don't
12 have the kinds of resources of some other larger
13 companies that also fit within the 506 space.

14 Many of these entrepreneurs, you know, know a
15 lot about their industry, they've worked in businesses,
16 but this is the first time that they're CEOs -- this is the
17 first time that they're raising capital. And in the
18 past, you know, they've been funded through themselves,
19 their family and friends, bootstrapping and other things
20 like that. So they're less familiar with these rules,
21 and they often really don't have attorneys or, you know,
22 the kinds of attorneys that can really, I think, well,
23 advise them in this process. So in other words, they may
24 not have heard about this process.

25 And how they raise capital right now I think is

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1 also really relevant. So most of them are submitting to
2 us an executive summary and then later a business plan
3 with an ability for us to ask a lot of questions that
4 then moves into much deeper information. If we want to
5 go in to do due diligence with them, we'll get kind of
6 full binders for that. But starting off, it's executive
7 summaries and business plans. It's rarely a PPM and
8 almost never are we having involved a broker-dealer, any
9 other intermediary. It's really based directly on our own
10 relationships.

11 And frankly as an angel investor when I make an
12 investment, I want to make sure that all of my capital
13 goes to the entrepreneur so that they can grow. That's
14 kind of where I'm coming from. So having an intermediary
15 gets in the way of that. It's hard for them, you know,
16 to put some of the advanced information about them in an
17 advance Form D because they may not know the
18 investment terms upfront. A lot of times what happens is
19 that it gets negotiated with a lead investor, in an angel
20 group or a platform or otherwise.

21 So, and then, the lead investor will lead a team
22 to do extensive due diligence which can still change the

23 terms of the deal based on what we learned. They're
24 identifying their potential investors from who they
25 already know, from the angel group, a lot of referrals.

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1 But yes, they are doing a lot of these events and demo
2 days. It's a very important part of how they meet us and
3 we meet them.

4 Another key thing to know is as these startups
5 are getting started, they have one idea of what they want
6 the business model to be or what the product is or how
7 the product is going to be used. And in discussions with
8 sophisticated investors and just kind of thinking
9 themselves, they may change their business model and
10 their idea multiple times. And there's so many great
11 examples of, you know, big companies now that started off
12 with one idea and it turned into something else.

13 So it's going to be difficult for them up front
14 to really talk about their business model. They may
15 really have to, in this proposed setup, file multiple Form
16 Ds to be accurate about what the company is going to be
17 about. And they're going to, you know, currently answer
18 a lot of questions and inquiries in person, by email, be
19 it secure or not, to go through the due diligence
20 process. And right now a lot of them are not wanting to
21 publicly reveal how much they're raising for
22 competitive purposes, competitive protection reasons.

23 So with that background, I think our key
24 concerns right now is that at least for startups and very
25 small businesses, it really is a significant burden to

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1 look at the requirements that are in the proposed rules.

2 As we've mentioned a few times, the pitch events are a
3 long-standing practice for how they're doing deals. So
4 it sounds to us like they will be fitting into the 506(c)
5 general solicitation category.

6 And from our conversations so far, it sounds
7 like a lot of startups don't know about that. And a lot
8 of the people who hold these pitch events also don't
9 start that and may or may not advise the issuers
10 correctly if they're participating in these events again,
11 triggering an unintended consequence. If they do miss
12 their filings and the cure of the 30 days, you know, they
13 do lose the ability to raise cash for a year.

14 And with some of them having very little cash,
15 very little sales, they really don't have a way of
16 continuing. So they would go out of business or many of
17 them would. Many of them might have to file multiple
18 Form Ds because they keep changing their models.
19 The idea of the disclosures in the legends sound like a
20 great idea, but it might take away some of the
21 advertising opportunities -- the new ones that they could
22 take advantage of. For instance if they want to do a
23 tweet or something like that, the legends are actually
24 longer than an actual tweet. So you want to kind of

25 figure that out.

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1 And then I think, you know, providing all the
2 materials that they might want to do which some of them
3 might not understand all of the things that they need to
4 provide, but that's videos, it's PowerPoint, it's all
5 kinds of materials that will be difficult for the issuers
6 to provide. And I guess we also kind of wonder what the
7 technology is to be able to accept all of these materials
8 kind of in one place because it's a lot of stuff and in a
9 lot of different formats.

10 And the other piece for us is, you know, while
11 this is really about the issuer, this does add additional
12 risks for us as investors. It's already a very risky
13 type of investment for us. And if we're increasing the
14 risk that the entrepreneur might accidentally break these
15 rules, or perhaps not take care of the verification
16 correctly, then they need to unwind from the investment
17 and that's additional risks for us. So it's some of our
18 members are actually already intending to not invest just
19 based on that increased risk, some but certainly not all.

20 So our recommendations for discussion among
21 this group really is we'd like to see the rules withdrawn
22 as they're proposed. But as I said when I started this,
23 you know, certainly we do understand the need for data in
24 understanding what's going on with this huge change to
25 capital raising.

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1 So if you're working on a redeveloped proposal,
2 the couple things we think are important is to remove the
3 harsh penalties for noncompliance when it's accidental,
4 you know, not requiring an advance Form D, requiring the
5 legends and disclosures only when the terms of the
6 investment are communicated and also thinking about other
7 ways you might collect some of that data. There's groups
8 like this and other advisory groups that I think the
9 Commission could work with to get some of that data and
10 reports in monitoring to get that information without the
11 additional burdens and penalties on the issuers. Turn to
12 the accredited investor definition.

13 MR. VERRILL: Thank you. Just very briefly, I
14 think the definition of accreditation has been noted a
15 couple of times today. But I just want to reiterate it
16 within the context that the SEC has been asked to revisit
17 this on a regular basis. And I want to make sure that we
18 all understand what the implications might be of changing
19 this in any dramatic way. So again, accreditation is an
20 individual whose net worth is above a million dollars,
21 not including that person's house, or through income of
22 \$200,000 in each of the last two most recent years, with
23 a spouse \$300,000. And that must be anticipated as being the
24 case in the current year as well.

25 The recommendation that the ACA has is to make

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1 no change in income or wealth thresholds for
2 accreditation. If there is the need for additional
3 questions added to the questionnaire to prove
4 sophistication, we think they're relatively -- there are
5 three really simple approaches to doing that. One, the
6 individual is a member in an angel group, which again,
7 provides another layer of proof of accreditation or some
8 other professional organization or angel platform.

9 Secondly, work experience if somebody has been
10 a director of a private or a public board, then certainly
11 they are a sophisticated business person and/or those
12 that have already made an investment under the existing
13 Rule 506. These are three very easy, reasonable
14 approaches to providing additional sophistication to the
15 questionnaire.

16 And I wanted to also indicate what the effect
17 of increasing the wealth threshold might have on the
18 existing group of accredited investors. This is a
19 graphic done by Wiltbank & Boeker based upon AIPP data, I
20 think it was commissioned by the Kauffman Foundation,
21 which essentially says that if you used inflation over
22 the past decade, what would that impact be if you
23 increased the accreditation threshold according to the
24 increase in inflation. Essentially it would double it to
25 \$2 million as the net worth requirement.

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1 And the graphic shows that nearly 60 percent of
2 angel investors would not be accredited at that point,
3 so I think that's a scary number, and it points to the
4 fact that we're not all members of the Shark Tank show.
5 I know if any of you have seen that show, but they have
6 the misnomer of calling it a reality show. It does not
7 reflect an ounce of reality on how the angel world works,
8 and I do not have Warren Buffett in my angel group.

9 We're not the 1 percent. We are low-high net
10 worth individuals who have become very effective and
11 efficient at being angel investors. And indeed, the SEC
12 had put together some data reflected in the GAO report of
13 July of this year that showed a similar potential loss of
14 accredited investors should the threshold move from \$1
15 million to \$2.3 million.

16 So I think this is real. I think that this is
17 something we need to be careful of not pushing out a very
18 experienced set of savvy investors. I think it would be
19 catastrophic for the angel community. It would be
20 catastrophic for startups. There would be certainly half
21 as many startups created and certainly half as many jobs
22 and half as many chances for the next Starbucks.

23 And just to make a couple of observations about
24 the Dodd-Frank Act on these standards, there was a change
25 with Dodd-Frank. There was the removal of the investor's

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1 primary residence. And I think that was a relatively
2 significant change. And I think, to reiterate, that this

3 should be revisited under three circumstances to protect
4 investors, to be in the public interest and third, and
5 perhaps more importantly, in light of the economy. And I
6 think if we dramatically change the rules of
7 accreditation, we would harm our economy.

8 MS. HUDSON: Great. So just to, you know, wrap
9 things up, I think it is important to have that balance
10 of protecting investors but thinking about the economy.
11 And as David showed before, companies that are five years
12 or less create the net new jobs across this country.
13 These are the kinds of companies that angels and others
14 invest in, so we just want to remind you of that.

15 And what angels are really trying to do is help
16 those companies get the base, so that they get to their
17 next five years and these become the companies that
18 really explosively grow our economy and jobs, the Yahoos
19 and the Facebooks of the world are successful examples.
20 So we're really here to do that and to work with you to
21 figure how we meet all of the goals of these kinds of
22 regulations because they are important to us. And really
23 appreciate the time and we're here to answer questions or
24 be part of the dialogue.

25 MR. GRAHAM: Well, thank you, David. Thank

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1 you, Marianne. I think that was very helpful and it
2 certainly kind of gave me and probably most in the room a
3 greater appreciation for the role that the angel
4 community plays within the smaller company ecosystem.
5 Questions, comments?

6 MS. JACOBS: I have one.

7 MR. GRAHAM: Okay.

8 MS. JACOBS: Without speaking to the specifics
9 of your recommendations today, I think those of us in the
10 room that have maybe been through all those phases which
11 I have the good fortune of having been through that, not
12 the angel phase but the growth, one of the things we did
13 as our company -- it was a public company -- grew, was we
14 went on an M&A.

15 We went on an M&A streak and over on my watch
16 alone looked at 2100 medical device companies, okay. We
17 ended up buying four but over the course of those years -
18 - and when you talk about the lack of sophistication, I'd
19 like to echo that and say as we deliberate putting rules
20 into effect for a particular sector being an emerging
21 company, we really need to be careful. They are not
22 sophisticated. Just take the investing aside, you have
23 no clue what you will find when you go looking in their
24 books. And it's not intent to defraud. It's just lack
25 of sophistication.

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1 And I think this is the one area as we begin to
2 make rules -- throughout our two years, one thing we
3 noted from the folks at this table is that we have asked
4 for our regulators to recognize that one size does not

5 fit all. And I think this is one particular area, you
6 know, just "sans your specific recommendations." But
7 when you go looking at these 2100 companies and, you
8 know, their accounting is as creative as how they've
9 gotten to that point. But man, these are the job
10 creators.

11 And, you know, I can't tell you how many of
12 them we would sit there and as part of the M&A process --
13 and these people have double digit growth in medical
14 devices. Well, the big companies are never going to get
15 it. And so this is tangential to what your issues are,
16 but it is the one size fits all issue for small and
17 emerging companies that we really need to step up and say
18 please be careful. We have enough challenges and hurdles
19 in front of us with these small companies.

20 So I'm not commenting on your specifics, I'm
21 just saying let's just take this whole scheme and say,
22 you know, please can we be careful that we don't strangle
23 this industry.

24 MR. GRAHAM: Well, I'd like to echo that a
25 little bit, Chris. I mean I don't -- I'm not speaking

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1 directly to your recommendations or maybe to the issues
2 specifically. But it seems to me that, you know, it's
3 clear when you look at the numbers, that the angel
4 community is very, very important to emerging companies.

5 I mean without the angel community there's \$23 billion
6 at least that would not have been put into the system.
7 And so my sense is that the issues that have been raised
8 are real. I'm not sure what the answers are, but it does
9 seem to me that we need to be careful that whatever we do
10 does avoid harm, that whatever is done does avoid harm.

11 It seems to me that, you know, again this part
12 of the -- we're talking about the way -- we've spent a
13 lot of time talking about the way the markets are broken
14 and it's all for this reason, that reason, it's difficult
15 for smaller companies to raise capital and preserve
16 capital. This seems to be -- you know, one part of the
17 systems that's working. And nothing is perfect, but it
18 seems like this is one part of the system that is
19 working.

20 And so it seems to me that in that regard we
21 should kind of look for ways to kind of enhance the way
22 it functions and not to insert additional friction into
23 the way it functions. Again, don't know what the answers
24 are, but I think those are the kinds of things that we
25 need to think about.

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1 I mean I know all about these demo days and
2 fairs and all the rest. We have done similar things in
3 my own firm. And, you know, just that alone raises some
4 significant questions. And it could have a chilling
5 effect which could result in certain investments not
6 being made, and these things add up in terms of

7 investments not made, costs incurred, one job lost here,
8 one job lost there. Pretty soon you're talking about
9 real numbers. But in just that one situation for
10 example, that one scenario, you know the reason why we
11 started down this path to begin with in terms of
12 modifying 506 to permit general solicitation was the view
13 that the important thing was not how you got the
14 investor, but the important thing was the nature of the
15 investor.

16 And it seems to me that at least when we were
17 talking about certain demo days and fairs and that sort
18 of thing, maybe we shouldn't decide whether or not that
19 is or is not general solicitation. But maybe we can do
20 something which says that, you know, for purposes of
21 determining whether or not someone who gets accredited
22 investors by attending such an event, that they will not
23 be deemed to have violated the rule because they are
24 there and, you know, there a bunch of non-accredited
25 investors in the audience.

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1 So again, don't know what the answers are but I
2 do think that my sense is that the issues are real and
3 that we should find ways to enhance as opposed to ways
4 that cause friction. I mean obviously, investor
5 protection is something we never lose sight of. Yes,
6 Pravina please.

7 MS. RAGHAVAN: So I just actually wanted to --
8 on the point of demo day I guess because you mentioned
9 SBIR. People in the SBA actually helped monitor and run
10 the SBIR program. And part of our mission and priorities
11 in the next -- actually even in the next coming months is
12 to have several demo days across the country for both
13 SBIR, as well as high growth entrepreneurs.

14 We just finished one right here at the White
15 House a month ago, so I would really take under
16 consideration that you will have quite a few of our
17 federal agencies participating in these demo days,
18 because it is a way of highlighting the high growth
19 entrepreneurship. And it's part of all of our
20 priorities, including I know my folks at the Department
21 of Commerce that are looking at the similar thing, to
22 actually highlight these high growth entrepreneurs across
23 the country and support them trying to find different
24 mechanisms.

25 So if we consider that general solicitation, I

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1 don't think any of us are in the -- we don't move them
2 into a category that they weren't considering being in,
3 especially for some unaccredited investors in there. And
4 the other thing I would say is we should really look at
5 the cost of verification. Having been with the high
6 growth firms for the past year and a half, the costs of
7 verification might actually just put them out of trying
8 to even raise capital in this market with the general

9 solicitation.

10 I understand their reason for looking for
11 accredited investors but having them bear the burden, I
12 think we need to look at the costs. These guys don't
13 have a lot of money as people have been -- well, as you
14 artfully said. It's a lot of credit cards, a lot of
15 friends and family, and it's something we should really
16 take into consideration not to increase the burden for
17 them to go ahead and get that capital. And we know that
18 they are the net job creators. We've seen a tremendous
19 amount of growth in them for the past year.

20 In fact one of our very big success stories is
21 Chobani Yogurt started off as a small little company in
22 upstate New York, and all of sudden now they are the
23 number one leading yogurt producer across the country.
24 So it would be terrible to see someone like that not be
25 able to get jobs into the market.

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1 MR. GRAHAM: Thank you.

2 MS. MOTT: I was just going to maybe piggyback
3 on what Christine was talking about, the fear of one size
4 fits all on two fronts. One is this could impact, you
5 know, the earliest -- let me say this first. Areas where
6 there is a very healthy ecosystem, San Francisco and
7 Boston, you'll find a lot of sophisticated attorneys and
8 accountants that can help these companies get off the
9 ground. And some of them do pro bono work because they
10 know they can't afford it, or defer charges, things like
11 that.

12 But in other parts of the country where job
13 creation is more important than, you know, some of the
14 larger cities, you don't have that sophisticated law
15 firm. And you don't have that sophisticated accounting
16 beast. We experienced it ourselves when we put a smaller
17 chapter in a city north of Pittsburgh in Erie,
18 Pennsylvania. When we started talking with
19 entrepreneurs, they were -- the advice they were getting
20 from their attorneys and from their accountants actually
21 scared us, so you know, again for that one size fits all.

22 The other if I can speak to the accredited
23 investor status for one size fits all, I think the
24 previous recommendations according to the Dodd-Frank Act
25 was to raise the income from \$200,000 a year to \$450,000

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1 a year and from \$1 million to \$2.5 million. I will tell
2 you that in Pittsburgh, Pennsylvania, where I live,
3 making \$200,000 a year is comparable to making \$450,000 in New
4 York City. And if it was raised to \$450,000, I will tell
5 you that the doctors that are in my group and the
6 attorneys in my group will be ruled out. They will not
7 be able to invest anymore.

8 And, you know, here in Washington, D.C., a home
9 that sells for \$1 million probably sells for \$250,000 to
10 \$300,000 in Pittsburgh. So net worth is very different in

11 Pittsburgh as it is in so many other areas. So when we
12 think about this one size fits all, let's think about the
13 middle of the country, other parts of the country beyond
14 the big metropolitan areas and how those rules impact
15 those regions and particularly job creation for them.

16 Oh, and one other thing -- M&A. You couldn't
17 have said it better, Christine. Large companies do not
18 put the money into R&D that they used to, they don't get
19 the credits. There are other things that are happening
20 that they just don't do. They're not going to take the
21 risk and quite honestly they have become a culture that wants
22 to avoid risk. And so as a consequence, those cultures
23 don't cultivate new products, new drugs, new anything.
24 So what large companies find, it's better to let the
25 ecosystem create these small companies, take the risks.

0099

1 And the angel investors and the venture
2 community -- and that's how we get our exits and of
3 course that's how new products get delivered into the
4 marketplace. So a pretty critical component as we think
5 about one size fits all.

6 MR. GRAHAM: Thank you. Milton?

7 MR. CHANG: I have a slightly contrary view to
8 all of this. I think when it's not broken, don't fix it.

9 And I don't think over-regulated is better than under-regulated
10 to avoid problems and build a bad name for investing in
11 that kind of a deal. You now already have 35 exemptions,
12 35 unsophisticated investors on the rules.

13 So I think it's trying to make it easy up front, but make
14 it a lot more difficult back end, because dealing with
15 unsophisticated investor isn't funny either.

16 MR. GRAHAM: Please.

17 MR. ABSHURE: Skunk at the party, here I come.

18 And I realize everyone here is talking about concerns
19 over having an unsophisticated issuer and them getting
20 caught by the rules. But you've also got to remember
21 what we're talking about doing here is opening up the
22 doors of advertising and general solicitation to, as Mr.
23 Chang said, unsophisticated investors. And they're going
24 to be even less sophisticated than the unsophisticated
25 issuers that you're talking about. And I think that when

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1 you talk about allowing them to advertise and sell to the
2 public, that has to be reasonable.

3 And when you consider the speculative nature of
4 startup investments, the illiquid nature of startup
5 investments and the death rate of small companies, you've
6 got to figure out a way to balance the burden on that
7 issuer with the burden on educating and informing a small
8 investor. Now I understand concerns about the rules and
9 the proposed rules are problematic for, you know,
10 startups and they might get caught. If you are going to
11 take advantage of an exemption that allows you to
12 publicly sell and advertise your securities without

13 registration, learn the rules.

14 I mean to me we're talking about such a drastic
15 sea change in how we regulate securities that if a small
16 company wants to take advantage of that, learn what the
17 rules are. Now as I've said before, I think the SEC
18 should provide guidance. Startups don't have the
19 resources. They can't afford experienced lawyers, many
20 are raising capital for the first time, all of the
21 reasons that you need to give more information to an
22 unsophisticated investor, but those are also all the
23 reasons that the SEC needs to take a more active role in
24 reaching out to these entities and explaining what the
25 legal playing field is.

0101

1 And many startups will not be aware of rules
2 and accidentally break them. I don't know if there are
3 any enforcement people here, but I can tell you at the
4 Arkansas Securities Department that is an extremely
5 common defense. I get a whole lot of that one, "I didn't
6 know fraud was illegal." Now I'm not saying that that's
7 what we're talking about here, but that's what you're
8 going to get, a whole lot of I didn't understand the
9 rules and it wasn't there.

10 Now with concern to filing multiple Form Ds as
11 business models change, if I understand it correctly,
12 you're going to file a Form D if you have a material
13 change in the structure of your offering. I don't even
14 think filing additional Form Ds are going to be your
15 biggest issue. I think your biggest issue is going to be
16 determining whether you have just made a material change
17 in an ongoing offering of such a size it's going to
18 require you to go back and get confirmation from all your
19 previous investors that they want to stay in, or if
20 you've triggered rescission rights. And I think the
21 skunk shall be quiet at this point.

22 MR. GRAHAM: Okay, Heath. Thank you for that.

23 One thing is that you talked about unsophisticated
24 investors but it's -- we're talking about 506 and then
25 we're talking about often they're limited to accredited

0102

1 investors.

2 MR. ABSHURE: And my answer to that is if
3 anyone in this room thinks accreditation equals investor
4 sophistication, you're crazier than I am.

5 MR. GRAHAM: But that's the best system that we
6 currently have.

7 MR. ABSHURE: It's the best the system
8 currently has, and it's what we would have to work with.
9 I've given you an example that's very common.

10 MR. GRAHAM: You're going to have to give me
11 time, don't you understand that?

12 MR. ABSHURE: I understand that. I accept
13 that, I stipulate to that.

14 MR. GRAHAM: So you stipulate to the fact that

15 the accredited -- does not -- investor standard in no ways
16 measures sophistication or the ability of an investor to
17 do anything other than to absorb loss after a couple
18 hundred thousand dollars, and now we're going to
19 publicly advertise to that person.

20 MR. ABSHURE: I'm saying -- and I think we're
21 both -- so we're both agreeing that that standard also
22 should be changed.

23 MR. YADLEY: Isn't the standard -- no, just to
24 break this up. By the way, he's right, sorry. We're
25 talking about disclosure and that's what the system is

0103

1 built on. And I'm -- my first job at the SEC was
2 enforcement. I believe in it, but you can't create a
3 system that assumes that people are going to be bad guys
4 and that everybody is out to defraud people. That
5 happens and that's unfortunate, and people lose money and
6 we need to do what we can to fix it. But you can't tilt
7 the playing field so far in that direction.

8 I'm from Florida. Florida has a private
9 placement exemption and it mirrors 506(b), okay. You can
10 have up to 35 unaccredited investors. And it has an
11 information requirement, and it says that you must do a
12 private placement memorandum or provide 31 specific items
13 of information. Florida does not have a Form D or any
14 other filing that talks about the offering.

15 I stipulate that Florida has had lots of fraud,
16 but not because there's not a Form D filing because
17 people don't make the information that they're supposed
18 to to investors. And it's in the law and the rules and
19 they're available. They're available on the state's
20 website which is easy, you just type what you want. So I
21 think that the focus is -- and you were talking about it
22 earlier and I'm not saying that Form D -- that we
23 shouldn't have a Form D.

24 But all the information that an investor needs
25 doesn't have to be in a Form D. I think rules that are

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1 clear about what needs to be provided -- and that's clear
2 in Regulation D now. No specific information
3 requirements except you look to what the appropriate
4 registration statement requirements would be if that
5 applies.

6 MR. ABSHURE: But if you're selling to
7 accredited investors, there's nothing. The Form D would
8 be it.

9 MR. YADLEY: And the theory is they can ask for
10 what they need. And I think the presentation today was
11 very instructive, and thank you both for doing that and
12 it was very lucid. Unfortunately, as your slides point
13 out, there are 265,000 angels and only 15,000 in groups.

14 So Heath isn't worried about you and your members and
15 your investors. And it's the other people out there, and
16 I get it. And so I think that's where a lot of our

17 discussion has to be and it's not one size fits all.

18 MR. ABSHURE: That's the one thing I would say
19 that I would agree that the one size doesn't fit all,
20 both with regard to the issuer and the investor and it's
21 the problem we're struggling with.

22 MR. GRAHAM: I want to make sure that everybody
23 has a chance, so Leroy.

24 MR. DENNIS: Oh. There we go. I have a
25 question along the same lines for Marianne and David and
0105

1 then I'll ramble a little bit to give you a chance to
2 think about it. And so the question is the \$1 million
3 threshold, and \$200,000 has been around for a while.

4 Do you think the sophistication of that investor has
5 increased over the years? And the reason I ask it, as I
6 listen to this I could see a train wreck coming.

7 If the sophistication is not improved so you
8 would say well, geez, you should index that for some kind
9 of inflation -- maybe it's not CPI but maybe it's growth
10 and income or something like that, so that you've got the
11 same investor investing that did 10 years ago that does
12 today, especially when I'm faced with a situation where
13 I've got a set of companies that now are less
14 sophisticated or less able to provide accurate
15 information.

16 So it becomes very important for that investor
17 to be able to sit across the table and ask critical
18 questions of that investee as to whether or not they can
19 -- so that make an informed investment. So absent
20 everything being the same you would say well, you should
21 index for inflation those accreditations. But, you know,
22 Internet, new world, new information, so I would think my
23 perception is that the sophistication of a person owning
24 a million dollars of investments 10 years ago -- let me
25 rephrase that.

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1 A person who owns a million dollars of
2 investments today is much more sophisticated than a
3 person that owns a million dollars in investments 10
4 years ago. And to me that's the reason why you wouldn't
5 change the accreditation rules along those lines. But
6 I'm curious what you guys see with your investor
7 community that you guys deal with.

8 MS. HUDSON: I think there are a lot more
9 people that hit those thresholds that are sophisticated
10 now than there were. So the proportion of people has
11 definitely increased, and that's come through the
12 Internet. It's come through a lot more information about
13 what angel investing is, a lot more dissemination of best
14 practices. Even, you know, 20 years ago I think the term
15 angel even wasn't that common.

16 And so people are starting to hear about that
17 and share that and do that through angel groups, through
18 certainly these investment platforms, the accredited

19 platforms. We're seeing a lot of dissemination of
20 information to the investors and to the issuers. So I
21 agree that a lot more of them are sophisticated. I guess
22 if I also build on that a little bit though, I also think
23 that perhaps originally when those thresholds were set,
24 they might have been set too high. And we might just be
25 getting to the level where they're correct as far as

0107

1 financials go.

2 MR. GRAHAM: David.

3 MR. VERRILL: Yeah. I don't really have
4 anything incremental to add. I think that's right on,
5 it's just the size of the angel ecosystem and the
6 mechanisms that accredited investors have to learn about
7 being an angel are just more prevalent. Our sister
8 organization ARI educates tens of thousands of people,
9 not just the members of our groups every year. And they
10 do that not just in this country but in others. I agree.

11 MR. BORER: Stephen, I don't think I've gotten
12 through a morning session in the last two years without
13 opening my mouth. First of all, I've been in the
14 investment banking and the private investment business
15 for a long time. And I must say that I've become far
16 more sophisticated through the money I've lost than from
17 the money I've gained. So for this to be something to
18 keep anybody from losing money and where we're better
19 off, obviously sophistication comes with age and some
20 amount of wisdom through learning.

21 When we had the discussion and made the
22 recommendation here at this committee, I think if I
23 recall correctly most of the discussion was around what
24 is the harm we're creating by advertising or soliciting a
25 broader audience if we maintain the level of investor

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1 qualification that we had previously. I don't recall
2 more than two or three minutes in that discussion
3 involving let's change the whole definition of who we can
4 go to if we're soliciting generally, and even come up
5 with a C instead of an A and a B.

6 What happened is through the JOBS Act, through
7 the implementation we've changed that pretty
8 dramatically. And I think a lot of this discussion is
9 around those particulars, either creating footfalls that
10 can take place, the landmines, various things that will
11 take place. And I must admit I'm not versed at all in
12 the angel investment communities. I probably qualify as
13 an angel, but I've lost more money than I've made. In
14 individual investments I've still got more than I started
15 with though.

16 One thing I'd like to make though -- because a
17 point I'd like to make is there were a couple of comments
18 here today that early stage companies, they don't need
19 broker-dealers and agents. And I absolutely agree.
20 Agents and broker-dealers do not want to in many cases

21 take those on.

22 But in the cases where the companies are far
23 enough along the development chain where agents and
24 broker-dealers may be helpful in the due diligence, in
25 the qualification, in putting a brand on a transaction

0109

1 that's getting done where it's not early stage, there are
2 certain requirements that are enhanced here under --
3 where general solicitation is used with respect to
4 filings and those types of things.

5 FINRA put in place last year a series of
6 private placement filing requirements on the broker-
7 dealer community which I think intersect with some of
8 what's taking place here. And from my thought and some
9 of the discussion I've had with some of my peers, is
10 there may be a discouraging element of having a greater
11 level of disclosure if general solicitation is required,
12 because all those same things will have to be provided to
13 FINRA.

14 And to the point of is there even the
15 sophistication within FINRA of being able to accommodate
16 the intake of all of that, everything from links to
17 websites, all the content that may be on that website
18 that's hyperlinked, even if it's just in a tweet that
19 isn't big enough to contain all that information, et
20 cetera, I just wonder if there had been thought given to
21 that in the imposition of these requirements, the form
22 requirements and the filing requirements, and the content
23 with the FINRA requirements on the broker-dealer
24 community.

25 MR. GRAHAM: Thank you, John. We haven't heard

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1 from Richard.

2 MR. LEZA: On the part of increasing the levels
3 for sophisticated investors, let me give you an example
4 of what a difference eight years have made. I lived and
5 invested in the venture capital business in the Bay Area
6 for about 27 years. About eight years ago I retired, I
7 moved to Palm Springs. And in the Bay Area when you're
8 taking about sophisticated investors, you got a ton of
9 them. In Palm Springs when you're talking about
10 sophisticated investors, eight years ago you really
11 didn't have it.

12 But in eight years the kind of learning curve
13 that has increased in the number of people, that I think
14 it would be a mistake to increase the \$1 million and
15 \$200,000 up because you don't need to. You could really
16 go down, because people have become much more
17 sophisticated than before. So it seems to me that you
18 should leave the \$1 million or the \$200,000 where it
19 is. I think that's very significant.

20 MR. GRAHAM: Thank you, Richard. Kathleen.

21 MS. MCGOWAN: I agree with Richard on keeping
22 the threshold to where it is because of the

23 sophistication. But my one concern is something that
24 Christine brought up about going and looking at 2600
25 companies and the accounting. What are some of the

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1 accounting requirements that you have for some of your
2 investments that you make? Are they audited financials,
3 are there some sophistication in what they're reporting
4 and what they're saying is what their needs are and their
5 ability to project forward?

6 MR. VERRILL: Sure. Most of the documents that
7 we have in at closing are Series C financing or Series A
8 financing, have requirements of information rights that
9 often include financial information, particularly audit
10 on a regular basis. So yeah, they typically are.

11 MS. MCGOWAN: Mm-hmm. So I guess I think
12 what you were saying about some of the financials behind
13 some of the companies you were looking at.

14 MS. JACOBS: But I'm going to go back to
15 something that Catherine said. Audited financials out of
16 Philadelphia may not be the same as what we're going to
17 see out of Tucson, Arizona.

18 MS. MCGOWAN: Okay.

19 MS. JACOBS: And I'm from Atlanta. A lot of
20 these companies stated they had audited, but when you are
21 a public company buying a private company and the way
22 things have been accounted for and assets have been
23 identified, it's not always the same.

24 MS. MCGOWAN: It's not the same rigor that you
25 would have.

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1 MS. JACOBS: Yeah, exactly.

2 MS. MCGOWAN: Okay.

3 MS. JACOBS: And there's not fraud, it's not
4 bad intent. These guys have done their best given what
5 they could afford in their local markets.

6 MS. MCGOWAN: Right. Okay. Okay, thank you.

7 MR. GRAHAM: Tim.

8 MR. WALSH: Good morning. I'm going to ask a
9 non-accredited investor question or comments. It might
10 have been easier to ask these when the presentation was
11 going on, but the ying and the yang and the ham and the
12 eggs presentation was so smooth I didn't want to
13 interrupt. So just a couple of rapid fire questions.

14 The 15,000 investors in angel groups, so what is
15 that? And then a couple of times you mentioned angel
16 sites which sort of my ears went up when I heard that
17 too. What exactly -- these are Internets. You have to
18 have passwords I assume to be accredited investors.

19 And then the one thing that sort of jumped out
20 and there wasn't a page number on the presentation, we
21 talked about the returns from the angel sites. It seemed
22 very sort of data mining, 2700 data points over 12 to 13
23 years. Could you give a little more clarification on who
24 did this, why the 2700, how various investments are

25 thrown out or put in.

0113

1 And then lastly, I thought it was interesting
2 you mentioned the Kauffman Foundation was in some of the
3 charts in here. And I'm wondering if this was the same
4 article I read in the Kauffman Foundation maybe two years
5 ago when they were highly critical of the venture capital
6 industry. And maybe they were positive on the angel
7 industry, which I hope they were.

8 MR. VERRILL: I'll take the first two and give
9 you the last two. So the first question was the angels
10 within the groups that are members of the ACA. So my
11 group has -- we're structured as a fund. There are 40
12 people in that fund. Catherine, how many people are in
13 your group -- 65? Marianne, how many people are in your
14 two groups?

15 MS. HUDSON: One has 40 and one has 85.

16 MR. VERRILL: So rough order of magnitude there
17 are 50 to 100 people in every angel group, and 200 angel
18 groups are members of the ACA. That's where the number
19 of angels within our membership ecosystem comes from.

20 MS. HUDSON: And actually beyond. So we
21 collect data on any angel group that we know about.

22 MR. VERRILL: The second question was about
23 accredited portals and an example may be Angel List.
24 Angel List is a platform where you must (a), be referred
25 into and (b), show proof of accreditation. It's again,

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1 check a box. And then you can be on their platform where
2 they present deals that Catherine might have invested in
3 and because of her reputation, Marianne and I might look
4 at it even though we're not in that geography. We may
5 not ever have that company present to us. But based upon
6 the fact that Catherine and her reputation -- she's
7 invested in that company, we may choose to do it as well.

8 Angel List did submit a no-action letter to the
9 SEC which has made it into the safe harbor treatments
10 under the recent ruling. So they are I think the biggest
11 on the block but there are many, many, many other
12 accredited platforms lying in wait.

13 Some of them are sector focused and others of
14 them have different types of areas of focus. Some of
15 them offer different bells and whistles, but at the
16 end of the day, they are an effective mechanism for
17 anybody anywhere in the country to look at deals that
18 somebody else that has a reputation might suggest that
19 you want to invest as well.

20 MS. HUDSON: And maybe to follow up on that,
21 most of them have a process to accept them where not only
22 do they self-certify that they are accredited, but they
23 also have a process where they check with one or possibly
24 two members to confirm that they're accredited investors.
25 And most of them do require a password

0115

1 or something to look at the deals behind the scenes.

2 On your other questions, I'm hoping I'm getting
3 them right and for full disclosure, I am a former Kauffman
4 Foundation employee myself. And a lot of the work that
5 the Angel Capital Association does, and particularly the
6 Angel Resource Institute, is actually a spin out of the
7 Kauffman Foundation. So I think they did have a belief
8 in angel investing as a good way to support startups,
9 particularly geographically across the country. And the
10 focus was really on how do we make sure that more
11 investors are sophisticated and supporting those
12 investors.

13 As far as the study on the returns of angels
14 and groups, it was done in 2007. It was done by two
15 academics from Willamette University and the University
16 of Washington. They had a process where they wanted to
17 best collect these deals. I think it was closer to 3200
18 investments -- actually at exits with again, the majority
19 of the exits not being so good.

20 They wanted to be able to put in a process
21 where they would be able to generalize as much as they
22 could. So for I think it was six groups they will
23 collect all of the investments and exits it ever had. So
24 they made sure they got the good and bad and they
25 compared that then with other groups they may not have

0116

1 gotten full information on. But they wanted to make sure
2 there wasn't too much of a selection bias, in other words
3 there were not too many of the deals that were put in
4 that had a good result as opposed to a negative result.

5 And it was sent out to -- I'm going to get the
6 numbers wrong -- but more than 80 angel groups
7 participated in it. And more than -- I think it was 550
8 individual investors were part of that investment. And
9 then finally on other question, I think yes, the Kauffman
10 Foundation has put out a report on its own investments
11 and what that's meant for their returns with venture
12 capitalists.

13 I don't know much more about that study now,
14 but certainly they have been behind making sure that more
15 angels are sophisticated and they have the education
16 information that they need. Hopefully that answers your
17 question.

18 MR. GRAHAM: And Dan, I don't think we've heard
19 from you. Have you got something? Want to tell us about
20 your hike through Europe?

21 MR. CHACE: That would be interesting. I don't
22 have a lot to add. I mean this isn't necessarily where I
23 have any value to add, but it just strikes me that the
24 ongoing balance of investor protections versus capital
25 formation and which side do you come down on that. I

0117

1 think to me the most interesting question is the \$1 million
2 threshold and the income are reasonable proxy for

3 sophistication. And I don't believe that it is, but I
4 also can't think of any other, you know, reasonable way
5 to define that. And maybe the ability to absorb a loss
6 is what's really relevant here versus your acumen as an
7 investor in startup companies.

8 So I don't feel that I have a lot to add, but
9 my bias would be to come down on the side of letting
10 people take risks within a regulatory structure that
11 provides information that's relevant. But you can't
12 protect everybody from everything.

13 MR. GRAHAM: Thank you, Dan. David and
14 Marianne, thank you very much. I think this has been
15 very interesting and useful. We're actually finishing a
16 minute early, so that qualifies as being on time. So
17 we're going to take a lunch break. The ideas for places
18 to have lunch, they're kind of listed in your folder.
19 And we'll reconvene promptly at 2:00. Thank you.

20 (A brief recess was taken.)

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

22 MR. GRAHAM: Okay. Let's go ahead and get
23 started. It's -- we want to try to stay on schedule, and
24 this afternoon's schedule was to begin at 2:00, and it's
25 a little bit after 2:00.

0118

1 As you know, we're going to be spending this
2 afternoon talking about the JOBS Act, the impact the Act
3 has had on companies and markets after a year or so and
4 new ideas for capital formation.

5 We've got three speakers this afternoon. Two
6 have appeared. We're hopeful that the third will appear.

7 But we have with us right now Joel Trotter and Alex
8 Cohen, both of Latham & Watkins.

9 Joel is global Co-Chair of Latham's Public
10 Company Representation Practice, and he is the Deputy
11 Chair of the Corporate Department in D.C. As one of two
12 lawyers on the IPO Task Force, Joel played a leading role
13 in preparing a report to the Department of Treasury
14 addressing job creation by improving access to the
15 capital markets for emerging growth companies. Joel also
16 served as a principal author of the IPO-related
17 provisions of the JOBS Act.

18 Alex is Co-Chair of Latham's national office,
19 and his practice covers capital markets, registration and
20 reporting with the SEC and corporate governance. Alex
21 also served at the SEC, first as Deputy General Counsel
22 for Legal Policy and Administrative Practice, and later as
23 Deputy Chief of Staff of the SEC.

24 We also expect Jeffrey Solomon, who is the CEO
25 of Cowen and Company. I will go ahead and introduce him

0119

1 in his absence. Jeff is a director of the Cowen Group,
2 and he oversees all of Cowen and Company's business,
3 including investment banking and capital markets, sales
4 and trading and research. Now previously Jeff served as

5 Cowen's chief operating officer and head of investment
6 banking. He was with Republic, the New York securities
7 corporation, now part of the HSBC Group, and the Mergers
8 and Acquisitions Group at Shearson Lehman Brothers.

9 Jeff is also a member of the Committee on
10 Capital Markets Regulation, a research organization
11 dedicated to enhancing the competitiveness of the U.S.
12 capital markets, ensuring the stability of the U.S.
13 financial system.

14 So with that, I will turn it over to Alex and
15 Joel.

16 MR. COHEN: Well, Steve, thank you very much.
17 And I wanted to thank the entire Committee and the Chairs
18 and also the staff of the Division of Corporation Finance
19 for having us today. I think within Latham sometimes
20 people are a little tired about hearing us talk about
21 Title I because it's a topic that we really enjoy and
22 gets us excited. So we're awfully -- especially grateful
23 for the chance to talk about Title I to an audience of
24 people who are going to be -- I think share our passion
25 for it.

0120

1 As Steve already mentioned, Joel did play an
2 important role in drafting Title I, and I like to think
3 of him as James Madison whenever I have questions or
4 issues that come up about Title I. But what we thought
5 we would do today, if it would be useful for the
6 Committee, would be to go through an updated version of a
7 report that we put out in April which surveyed Title I
8 and looked into some data on what was happening and what
9 kind of accommodations, particularly, people were using.
10 And some of the data was, you know, to us kind of
11 surprising, and we'll talk about why that should be so.

12 MR. TROTTER: And just a note on how we -- the
13 methodology for the survey data.

14 MR. COHEN: Yeah, that's important.

15 MR. TROTTER: What we did was we started with
16 the universe of issuers that called themselves -- that
17 identified as emerging growth companies, and we excluded
18 from that universe the ones that were not listing or
19 expected to list on a national securities exchange. So
20 we basically looked at offerings by emerging growth
21 companies where they were either listing or reasonably
22 expected to list on a national securities exchange. So
23 that brought the universe of 500 emerging growth issuers
24 over the first year of the JOBS Act down to about 180,
25 184 issuers that were doing an IPO in that first year

0121

1 after April 5, 2012.

2 MR. COHEN: Yeah. We've included a copy of the
3 report in your materials, and it's online. But what was
4 -- one of the things that was interesting to us when we
5 started to bring down the data in order to prepare for
6 this meeting was that the trends that we had identified

7 in April were continuing. That was one of the first
8 takeaways, not because we had such a great crystal ball,
9 but I think more because a year's worth of time was
10 enough time to get a sense of how Title I was working in
11 practice and how people were using it.

12 So what did we find in the data? I mean one of
13 them was that -- you know, who are the EGCs? There have
14 been a lot of them actually. I mean it was really
15 striking to us, the take-up of Title I in IPOs. In fact,
16 I think we counted that about 85 percent of IPOs -- as we
17 put up in the slide -- since April have been by EGCs, the
18 companies that, as Joel said, self-identified as EGCs.

19 So it's certainly the case that Title I has --
20 the people have been interested in following Title I or
21 at least call themselves EGCs, and it -- get some sense
22 for whether or not Title I scoped the world of EGCs
23 correctly, but it did pick up, you know, as we say, about
24 85 percent of IPOs. That's a high percentage.

25 MR. TROTTER: Well, a couple of things you can

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1 draw from this. One, it certainly changed the playbook
2 for the IPO process for all but the largest IPOs. And in
3 terms of opt-in by the emerging growth company
4 population, nearly all of them are using at least one of
5 the accommodations provided under Title I of the JOBS
6 Act.

7 MR. COHEN: And one piece of data which -- sort
8 of near and dear to my heart -- was that there were more
9 than 10 percent of EGCs who were foreign private issues.

10 It's near and dear to my heart because I spent a long
11 time in my career doing cross-border capital markets and
12 was, in fact, practicing in London for Latham when
13 Sarbanes-Oxley came out. And there was a period where it
14 was very difficult to persuade -- to make the argument
15 for non-U.S. companies to come to the U.S. capital
16 markets because they had, you know, various concerns, and
17 regulatory burden was one of them.

18 But to some degree Title I has been -- there
19 has been quite a deal of -- a good deal of interest in
20 Title I. We've made presentations to a number of
21 different securities regulators all over the world who
22 really wanted to know what Title I did and how the
23 decisions were made. So it's really kind of path-
24 breaking in that way.

25 Chart by industry. You know, Joel, we were

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1 talking about this earlier. I don't know -- I guess I
2 would have -- before we had seen the data, I would have
3 thought that the technology line would be bigger. I was
4 struck that it was more broad-based than we would have
5 thought, you know.

6 MR. TROTTER: It's a good point. And if you --
7 this chart has been updated since the one that's
8 reflected in our report, but the trend lines are the

9 same. So basically what you see is, on a percentage
10 basis, these are very much similarly proportioned from a
11 few months ago in April of this year when we did the
12 initial breakdown.

13 And one other thing about this, Alex, in
14 addition to what you just pointed out is I think there
15 was recent news coverage about the fact that -- or in --
16 according to this story, technology offerings were
17 under-represented in the emerging growth company
18 population. And to me that was just -- it was yet
19 another instance of where you read something in a news
20 report, but when you look at the actual data after you
21 crunch the numbers, they tell a completely different
22 story, which is the preponderance of -- or certainly the
23 plurality of emerging growth company offerings.

24 If you're looking again at the sub-population
25 of offerings that are on a national securities exchange,
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1 they're mostly technology offerings. But then you have
2 it across all industries. It's not -- to Alex's point,
3 it's not that they're all technology offerings. It's
4 just that the greatest single slice is technology
5 companies.

6 MR. COHEN: You know, and I -- we didn't run
7 the data. I suspect there's something that -- you know,
8 Jeff, that your firm might know. But to me, just on a
9 kind of qualitative level, this looks like it maps
10 reasonably well to what you'd expect in an industry
11 breakdown for IPOs. It's a lot of technology companies,
12 which you'd expect, but also the other company mix --
13 nothing really jumped out at me. Maybe there's more
14 financial services than I would have expected, but I
15 don't know if there's anything in this bar chart that
16 strikes you as out of proportion to the -- what you would
17 normally expect in the run of IPOs.

18 MR. SOLOMON: I actually think -- you know, I'm
19 not surprised about anything on here. I think the good
20 news is it's taking a while for people to get the word on
21 what it means to be classified as an EGC. So I think,
22 you know, in the days just following the JOBS Act, there
23 was a lot of debate and discussion about whether or not -
24 - if you were going to be an issuer that was labeled as
25 an EGC, you know, was that going to be a stigma.

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1 And I think -- so there was a lot of discussion
2 in and around some of these areas about whether or not
3 that was a negative thing. I don't hear that at all
4 anymore, so I actually think -- and I would say, once
5 companies go public, publicly traded investors,
6 institutional investors that we cover are not drawing
7 distinctions between EGCs and non-EGCs. So that to me is
8 more -- this kind of represents what I would think is a
9 good smattering, and it just happens to be the industries
10 that have embraced it most quickly.

11 MR. TROTTER: Jeff, you just mentioned the
12 stigma issue. I'll just throw out that was something
13 that when the task force was making its recommendations
14 prior to any of this becoming law, that was an issue that
15 was an area of focus for us, was how do we do this in a
16 way that creates meaningful change and doesn't just
17 create a small co. system. So we wanted changes that
18 would avoid that kind of stigma.

19 You see the 85 percent statistic that Alex
20 cited earlier. I think that's an important thing to bear
21 in mind, is from my personal standpoint it's a -- it's
22 right at the -- that's exactly what we would have liked
23 to see, basically changing the landscape broadly for all
24 but the very largest IPOs that don't need the assistance.

25 MR. COHEN: Yeah.

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1 MR. TROTTER: So if you're a large -- a very
2 large old industrial line company that's emerging from
3 bankruptcy, you can -- you don't need these
4 accommodations. Similarly, if you're a household name
5 major technology company, you don't necessarily need
6 these accommodations if you're over a certain revenue
7 threshold. You can debate what that was. And Congress,
8 at least last year, settled that debate for the moment.

9 But the billion dollar threshold for the
10 definition gives you a very broad meaningful category
11 that has a significant impact. At a billion dollars of
12 revenue, you're talking about a category of companies
13 that's roughly three percent of total market cap. So
14 it's not taking over -- relative to the size of the total
15 market, it's a small number.

16 Relative to the IPO market, it's a big number,
17 and that's where we were trying to -- that is the balance
18 that the IPO Task Force was trying to achieve in defining
19 the category the way that it was defined, but all of
20 which is -- you know, and Jeff mentioned the stigma
21 point. It was a significant policy issue. How do you do
22 this in a way that's tailored, that doesn't -- that isn't
23 over-broad but also avoids this issue of creating a
24 shadow system, a small co. system, a junior varsity
25 system that people are not going to want to use because

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1 of the stigma associated with them.

2 MR. COHEN: Well, you know, Joel, really to
3 that point, if you go ahead two slides to the breakdown
4 of revenue, it's really quite interesting, I think, that
5 nearly two-thirds of EGCs, as we put up there, have less
6 than \$100 million in revenue. And then if you map to
7 less than \$250, you pick up 80 percent of EGCs.

8 And so, you know, I -- there was a lot of
9 discussion when Title I came out, precisely on the point
10 about whether a billion dollars was an appropriate level,
11 was it too high, would it pick up too much. But it's
12 interesting that the EGCs have been, to such a large

13 extent, smaller cap companies. And it's -- really has
14 covered the lower end of the market in terms of cap -- in
15 terms of overall capitalization without, as I think
16 you've said, segregating in some kind of box really small
17 companies.

18 So it did achieve the trick of getting what
19 you'd think of conceptually as smaller companies without
20 confining you to a -- you know a small group of micro
21 caps. Put it that way.

22 MR. TROTTER: So I'll just address what I'm
23 imagining as a counterpoint to what Alex just said, which
24 is, "Okay, well, then why didn't you just set the bar at
25 \$250 million in revenue." And there's - here is the point -

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1 - or the policy we're driving at is scaled regulation.
2 So it's not a one-size fits all transition period, right?

3 It's a period of up to five years depending on the size
4 of the company. And so you can go public as a \$250
5 million revenue company and still have plenty of
6 additional time where you're going to enjoy the benefits
7 of these additional accommodations until you phase out.

8 So if you quickly become a really large
9 company, you're no longer -- you will no longer have
10 these benefits, or at the outer limit, even if you stay
11 at \$250 million of revenue sort of indefinitely, the
12 phase-in ends after the year-end following the five-year
13 anniversary of your IPO. So you're really -- you're
14 limited to a five-year phase-in, but the extent of that
15 phase-in varies according to the size of the issuer.

16 And that's in contrast to some of the older
17 technology, right, under the securities laws where
18 everybody, regardless of their size had the same period.

19 You have until you're -- take, for example, SOX 404(b),
20 the internal controls audit. You have until the second
21 annual report that you file as a public company, at which
22 point it doesn't matter if you're a \$10 billion revenue
23 company. It doesn't matter if you're \$250 million. You
24 have to do SOX 404(b) compliance at that time under a
25 prior rule.

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1 So this, again, was something that we were
2 driving at in terms of a meaningful period of relief that
3 would scale according to the size of the issuer in a
4 meaningful way, not just at a transition period, which,
5 although definitely meaningful in the past, was really
6 kind of one-size-fits-all and pretty unforgiving for
7 smaller companies.

8 MR. COHEN: Well, one of the pieces of data we
9 looked at was which exchange just to see if there was any
10 you could map to listing on NASDAQ rather than the New
11 York Stock Exchange, which might have been one's initial
12 instinct. But it turns out that, in fact, it was quite
13 evenly distributed, slight edge to NASDAQ. But on the
14 two national securities exchanges, they were just about

15 50/50. And, again, I -- without having run the numbers,
16 I would imagine this is -- roughly correlates to overall
17 number of IPOs, non-EGCs and EGCs although not, of
18 course, by market cap where there -- you might see a
19 distinction.

20 So Title I accommodations, we thought -- we
21 assumed that people on the Committee are quite familiar
22 with what these accommodations are, so we won't summarize
23 them -- but obviously happy to do that if anyone were
24 interested.

25 But one of the things we -- questions we said

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1 for ourselves was, "Well, what's popular? You know, what
2 in Title I is popular? What have people used? What do
3 they use more of? What do they use less of," because we
4 all had ideas, I think when JOBS was passed, what might
5 prove to be popular or less popular. And to some degree
6 the results were kind of surprising.

7 And one that was, again, interesting to me
8 because of my experience over the years in the foreign
9 private issuer world was that the confidential submission
10 process was extremely popular. In fact, we counted that
11 almost 85 percent of EGCs used it. That number -- of
12 course, you can't tell the number of people who put it in
13 confidentially and never went through, so it may actually
14 undercount a little bit.

15 But it's a very simple idea, had always been
16 very popular for the foreign private issuer world because
17 it allowed people to get some degree of comment back and
18 forth without exposing their entire business plan to the
19 world. And it's -- you know, it's been one that people
20 really -- when you talk to issuers, our experience has
21 been that really -- potentially IPO candidates -- that
22 really speaks to them. It's also just interesting to see
23 how many rounds people go confidentially. It turns out
24 we count about two.

25 So they just submit a document, get comments

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1 back from Corp Fin, do another document and then go
2 public, which, Joel, I don't know when -- from the
3 Committee's perspective whether there was a concern about
4 people doing kind of the entire process sort of in secret
5 and then suddenly popping up with a fully baked document.

6 But it hasn't quite worked out that way it looks like.

7 MR. TROTTER: No, that's true. I mean on
8 average it's about 49 days from the first public filing
9 until the launch of the road show. And then the typical
10 timing is about 10 days after that to price the deal. So
11 people are not running right up to the line on the 21-day
12 requirement, but you know, even -- and with some of the
13 recent coverage about this procedure, even among some of
14 the critics, I've seen some commentary to the effect of,
15 you know, it is a meaningful benefit to these companies
16 to be able to do this without -- to initiate the process

17 without exposing their most competitively sensitive
18 information on the very front end of this process.

19 And the JOBS Act requirement of three weeks
20 prior to the road show, unveiling everything, including
21 the initial submissions in each amendment so everybody
22 can trace through the whole progression of the amendments
23 that resulted from the review process -- three weeks is -
24 - there was a pretty vocal critic in this area who was
25 recently writing about how three weeks is ample time to

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1 look over these filings if you're interested in figuring
2 out the back and forth and really studying the documents.

3 You've got a minimum of three weeks and, in practice,
4 over a month to do that.

5 And so, you know, this person was raising the -
6 - you could, I guess criticize this as too short, but
7 what meaningful benefit would you -- I mean at a certain
8 point you would need to -- if you believe in this
9 accommodation, you would need to cut it off somewhere
10 anyway.

11 The point was minimum 21 days on the theory
12 that that gives, in the information age with the 24-hour
13 news cycle and instant availability of all of this
14 information to anyone with a browser there is -- there is
15 plenty of time to look at everything that you want to
16 look at in three weeks.

17 MR. COHEN: Well, we also put up there 404(b),
18 the phase-in on 404(b) as well as the scaled CD&A have
19 achieved very, very broad acceptance. It's -- I'd say,
20 probably almost every EGC IPO has taken advantage of these
21 two. And to me what's interesting about the data is that
22 it does help inform the question about -- I mean I know
23 the committee has been considering scaling various kinds
24 of public company regulatory aspects. And this is at
25 least, I think, sort of market feedback as to what

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1 issuers find, you know, helpful and what they're less --
2 you know, what they need less in terms of accommodations.

3 So 404(b) -- probably not surprising given the -- all of
4 the conversations about the internal control audit over
5 the years. But 404(b) is one of them.

6 But the CD&A is another. And I think if -- to
7 the extent that you're thinking about exec comp
8 disclosure, at least in the initial years as initial
9 filing as a public company extents of CD&A, people didn't
10 think that, I think, it was ultimately so critical for
11 the investment decision. There were other aspects that
12 investors were more focused on.

13 MR. TROTTER: Another continuing theme is just
14 that all of these accommodations are based on some
15 precedent in SEC policy or regulation. And here with the
16 streamlined executive compensation disclosure as an
17 example or the financial statement requirements -- those
18 are directly borrowed, of course, from the smaller

19 reporting company system where a similar policy judgment
20 has been made in a similar context; how do we offer
21 relief. How do we provide a tradeoff?

22 And so we were borrowing from a similar
23 tradeoff that had been made in a different context and --
24 with the result that, you know, CD&A is not required for
25 emerging growth companies, and some of the additional

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1 financial statement disclosure is not required.

2 MR. COHEN: On this slide we talk about the
3 take-up of accommodations with respect to financial
4 statements. I have to say I actually found this
5 surprising because maybe it's just that three years of
6 financials is so deeply ingrained in my psyche it's hard
7 for me to imagine people going public on two. And I
8 think before --

9 MR. TROTTER: But you don't represent a lot of
10 smaller --

11 MR. COHEN: Well, that's true too. That does -
12 - it reflects my practice actually. But here -- and I
13 think in advance people would have predicted though that
14 three years -- investors are used to three years. They
15 would expect it. But there's been a fairly significant
16 take-up of it, not -- and I think not just in situations
17 -- there are obviously specific situations like in the
18 third year, a company's done a material acquisition and it
19 might be hard to find the financials, or the company's on
20 such an accelerated trajectory that, you know, in year
21 one they were just a couple of people in a garage and
22 then by year three, they are really a huge company.

23 But, you know, it was -- I think it's a trend
24 that not only we've observed but to some degree has sort
25 of increased. Initially it was relatively little take-

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1 up, but now it's stabilized at a certain relatively
2 healthy percentage, I'd say.

3 MR. TROTTER: One thing also that's noteworthy
4 is, even though most companies present the full three
5 years of audited financials, about one third of the
6 companies that do present the three years are taking a
7 pass on the selected financial data. So the additional -
8 - you know, years four and five they're not presenting.

9 So there is -- if you look at it very broadly,
10 there is wide scale acceptance of the financial statement
11 accommodation if you include selected financial data in
12 the presentation.

13 MR. COHEN: You know, that's, of course, not to
14 say that people are not diligent, say, in the out years.

15 I mean you wouldn't be surprised to know that that's an
16 important focus of activity. And, you know, it would be
17 -- you can imagine that, if there was an interesting
18 story to be told about an out year, you'd have a
19 different view about whether you'd include it or not in a
20 registration statement. But, you know, you're right that

21 some of the earlier selecteds are not appearing as well.
22 MR. TROTTER: And both in -- so for both those
23 and the material acquisitions above, say, 50 percent
24 significance were previously a company would have to go
25 to Corp Fin staff and get a waiver, part of doing their

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1 IPO, they no longer have to go through that kind of a
2 waiver process for these pretty far out years for
3 companies often that have limited operating history and
4 are growing at 30 percent.

5 MR. COHEN: And that's been an area -- it was
6 one of the areas where there were helpful interpretations
7 from the Corp Fin staff about -- particularly in the 305
8 area but, you know, on a wide variety of other things.
9 And, Keith, one of the things we did want to say was how
10 much we appreciated all the hard work of the Corp Fin
11 staff from the practicing and in getting out a huge
12 volume of interpretations in a short time. It made a
13 huge difference.

14 The -- another Title I accommodation is one we
15 -- the bullet point on the slide may be a little too
16 actually narrow because we said "Testing the Waters" was
17 deal-specific and industry-specific. And that has been
18 the case, but I think that's changing. I think "Testing
19 the Waters" is actually becoming a much more standard
20 feature of the playbook almost across industries.

21 It takes unlearning a lot of instincts to think
22 it's okay. I mean certainly I would -- all of my Section
23 5 antennae are twitching when people were talking about
24 it initially, and I think that's probably one of the
25 reasons why it's taken some time to gain acceptance, but

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1 it's gaining acceptance. I think that's pretty clear.

2 MR. CHACE: Question.

3 MR. COHEN: Yeah.

4 MR. CHACE: Just which, you know, types of
5 deals and which types of industries did you see take that
6 up initially?

7 MR. COHEN: Life Sciences was --

8 MR. TROTTER: Yeah, and biotech --

9 MR. COHEN: Biotech and life sciences.

10 MR. TROTTER: In biotech -- was almost
11 completely standard, those deals in particular.

12 MR. COHEN: Yeah.

13 MR. TROTTER: I think the buy side wants to
14 meet the management team. They want to understand the
15 technology in a more intimate way than a 40-minute
16 PowerPoint presentation on a road show can really permit.

17 So -- Jeff, do you want to add to that?

18 MR. SOLOMON: No question about it. And
19 actually it's interesting. You know, even as companies
20 are considering making confidential filings, they're
21 doing so so they can have a banter back and forth with
22 Corporation Finance. And actually all that's missing

23 from the public domain is just that banter back and
24 forth, right. And so by the time these companies are
25 getting out there, everything is already publicly

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1 disclosed that needs to be publicly disclosed, and
2 they've had substantive conversations in "Test the Waters"
3 that dovetails very nicely with "should we go or should
4 we not go".

5 And there are definitely times when we've been
6 through "Test the Waters," especially in life sciences,
7 where we're saying, "You know what? Our recommendation
8 is not to go. And we got some feedback about this or
9 your strategy or this isn't resonating or that's going to
10 be a problem." And so not surprisingly, you're seeing
11 fewer -- in particular in life sciences -- fewer
12 companies actually priced below the range.

13 That's not foolproof. That still happens from
14 time to time, but it gives you -- even though we're not
15 discussing in that process valuation, we are gauging a
16 level of interest from investors, and we can give advice
17 to the company at that point very clearly about whether
18 or not now is the right time before they start to get out
19 on the road and end up in a situation where they spent a
20 ton of money and there's a lot of -- and there's lot of
21 deal expense and hung costs.

22 And I think the -- a lot of frustrations I've
23 heard from CEOs is, you know, "I'm in the middle of an
24 offering process. I didn't get a lot of transparency in
25 how that was going to go. It doesn't go well. I've

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1 spent all this money. I'm standing there with a -- an
2 only invested one-sided bet." All the investors are
3 saying, "We got you so back up the truck, and I want to
4 buy this cheaper".

5 And so, you know, that was a very unhealthy
6 dynamic, especially in life sciences where you saw that a
7 lot. And now "Test the Waters" is actually -- you can
8 almost identify which of the investors are likely to be
9 anchors. That gives the existing investors, the existing
10 private companies and venture firms, a chance to think
11 about whether or not they want to be partners with these
12 people going forward. Are they going to put up more
13 capital at the -- at new issue? Is that going to be a
14 relevant investment decision? For them they know that
15 earlier so that they're not at the end scrambling around
16 and say, "Okay. We'll step out for a certain amount."

17 And what it's just allowed for is a lot more
18 balance and less stress in the offering process. I would
19 say, you know, the public offering process, especially in
20 IPO -- you're fitting 10 pounds of stuff in a 5 pound
21 bag. You have all these investors you got to see. You
22 get 30- to 45-minute meetings. Sometimes they're group
23 meetings. It's not a conducive environment for an
24 institutional investor to make a rational, thoughtful

25 investment decision.

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1 That's when the investment banks used to say to
2 me when I was in that seat -- they would say, "Okay.
3 We're pricing tomorrow. Are you in, or are you out?"
4 And I would be like, "I have like three more questions."
5 "Yeah, yeah. We hear you, but we need to know if you're
6 in or you're out." And I'm like, "I didn't get my
7 questions answered," and then I'm making an investment
8 decision with partial information, or I'm not
9 comfortable.

10 So if I'm in, I'm not really in. I'm in only
11 if it trades up, all right. And so -- and if it doesn't
12 trade up, I don't have enough information to know whether
13 or not I should stay in, so I start selling. It's a very
14 -- was a very, very unhealthy dynamic for small
15 companies.

16 And what we're seeing now is there's a balanced
17 thought. So when you're taking companies, there's a
18 higher probability around those offerings being
19 successful because there's been a discussion and a
20 discourse and setting expectations well in advance of an
21 offering. So a company can say, "Here are the benchmarks
22 I think we're likely to reach over the next 12 months."
23 And then when they come back for the offering, "We hit on
24 these three, we missed on these two, and here's why,"
25 okay.

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1 It's just -- and so when it comes time for that
2 one week or two weeks to make an investment decision,
3 you're simply going out to a group of investors that's
4 well informed and you're not asking them at the end of
5 the day, "Are you in, or are you out? And you have to
6 make your decision by tomorrow with less than perfect
7 information."

8 So I think it's -- these two areas of Title I
9 have been game changers, especially in life sciences
10 where -- I mean let's face it -- even the best investors
11 have difficulty pronouncing the names of the drugs when
12 they're in clinic. It's that -- it's complex. And so I
13 always like to say most of the work in those companies --
14 most of the fundamental investing work is done outside
15 the room.

16 There's the presentation, which is a half an
17 hour, 45 minutes, maybe an hour, and then there's hours
18 and hours spent fact-checking, talking to your scientific
19 reference people, you know, getting into -- getting
20 whatever information you can get to validate that and
21 look at all the competitive -- and look at the
22 competitive landscape. It's a lot of work. So it's
23 really helped out tremendously.

24 MR. COHEN: I'm putting Jeff down as the -- in
25 the fan column of "Testing the Waters."

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1 MR. LEZA: Question.

2 MR. TROTTER: Yeah, please. And keep them
3 coming. We really -- you can tell I like this.

4 MR. LEZA: Thank you. As you keep going and
5 testing the waters, do you see the price range as more
6 and more companies will be able to hit in the price range
7 that they started off with?

8 MR. SOLOMON: I think the stats have said
9 that's the case. We were not allowed to talk about
10 valuation, and that's a tricky thing, you know. So --
11 there there's definitely still games that go on in terms
12 of -- in investors' minds where they want to be included
13 in an offering, so they're always more positively
14 disposed to saying, "I want to see more," because as soon
15 as you say, "I'm not interested," then you stop getting
16 information. So where we've been learning is how to
17 gauge "Test the Waters."

18 MR. TROTTER: And you can actually under the
19 law talk about valuation. But there are -- different
20 banks have different procedures along a continuum of sort
21 of prudential constraints, right? So where you draw the
22 line on what you discuss in your "Testing the Waters"
23 conversations can vary. And I think what you're saying,
24 Jeff, is a fair number of banks have drawn the line at
25 avoiding the valuation talk in the meetings.

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1 MR. SOLOMON: So this is a point of
2 clarification that should be -- I mean if there's a point
3 of clarification, it would be great follow-on. It would
4 be giving clear guidance on whether or not it's okay to
5 talk about pricing in "Test the Waters," all right.
6 Because I'm not -- we've gotten guidance that, because we
7 don't have, that we just should not do it because then we
8 have Section 5 things we may be concerned about, so we
9 just don't talk about it. We're just gauging your level
10 of interest. If this company were to come, you know,
11 would you be interested? Would you be a participant?
12 How do you think about it? Is this an area where you'd
13 like to have some interest?

14 And so it's -- we're just having these
15 discussions now. As the IPO calendar has heated up
16 significantly, actually, there's just a contention on the
17 amount of time. And so we're seeing so many "Test the
18 Waters" meetings and so many IPOs that I actually -- I'm
19 wondering now, well, how much good information we're
20 getting from "Test the Waters."

21 Interestingly, like early on when there wasn't
22 a lot of IPOs, we got a lot of great information because
23 a lot of people had a lot of time to spend and give you
24 good feedback. Now they're so busy looking at deals,
25 they're sort of like, "Yeah, I'm sure I'm interested,"

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1 and that's not helpful. Like that's not a helpful thing.

2 So I think it's -- there will be an ebb and a

3 flow, but I would say we're definitely seeing, at least
4 to date, more companies coming in the range, and we're
5 able to really have substantive, sometimes difficult
6 conversations with issuers before pricing.

7 I had a conversation in the last week where it
8 was a tough conversation because the investors in the
9 company thought they were worth X, and the feedback we
10 got suggested that, if we were to go in that range, in a
11 range, that it was not going to be in that range.

12 MR. LEZA: It always starts there.

13 MR. SOLOMON: Yeah, it does. But in this
14 particular case it was pretty universal. It was pretty
15 universal. And so I sat down -- when I sat down with the
16 management, I'm like, "Look, here's the good news. I can
17 have a tough conversation with you now before you've rung
18 up all the expenses." And you're sitting there. You're
19 saying, "Oh my God. I'm so pregnant with this; I got to
20 go forward."

21 So you need to decide if you're willing to go
22 forward in this range. If you're not, we could talk
23 about alternative sources of financing and other
24 milestones that we can come back at this later on. But
25 now it's -- you know, thankfully you're not already

0145

1 pregnant with it, and you go in with both eyes open. So
2 --

3 MR. TROTTER: And speaking of which, that goes
4 back to the confidential submission process --

5 MR. SOLOMON: Yeah.

6 MR. TROTTER: And the benefit that that allows
7 for pre-IPO companies to combine the two and start
8 talking on a substantive level with institutional
9 investors long before they have initially submitted a
10 draft registration statement or even while their
11 registration statement is under review with the SEC
12 staff.

13 MR. SOLOMON: Right. So this is a company
14 that's -- you know, hasn't disclosed yet. It's gone
15 through the confidential filing. It's pretty much at the
16 end of that, and they're making sort of a go/no-go
17 decision. And when they decide not to go -- because our
18 best advice is to -- that the range that they were
19 thinking about isn't going to work, and so they may
20 decide not to go, in which case they're not tainted the
21 next time they decide to -- because they will come
22 eventually. I am a hundred percent convinced this
23 company will be a public company. It's just when --

24 MR. GRAHAM: This is a great conversation, but
25 I want to make sure that Jeff has an opportunity to

0146

1 present his slides.

2 MR. COHEN: We were just thinking that, yeah.
3 We'll stop.

4 MR. GRAHAM: Okay. So -- and then see how much

5 time we have left so we can continue.

6 MR. SOLOMON: I don't want to cut you guys off.

7 So --

8 MR. COHEN: No, that's quite all right. We'll

9 --

10 MR. SOLOMON: Okay. Are you guys at kind of a
11 wrap-up point --

12 MR. COHEN: Yeah.

13 MR. SOLOMON: -- because I don't want to cut
14 you off, either. That's -- No, no, no. That's quite all
15 right. You know the dangers of leaving us in front of an
16 open microphone. You can tell.

17 MR. SOLOMON: We all share that character
18 quality.

19 MR. COHEN: Maybe we'll just -- we'll leave it
20 on this slide and then turn it over to Jeff because we --
21 you know, really this is, I know, the focus of some of
22 the things you want to talk about -- is what is to come.

23 We already covered the first point. We haven't talked
24 at all about research, but -- which is a complex topic
25 and would take up a whole hour. Just suffice it to say

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1 that research is not yet -- pre-deal research, immediate
2 post-deal research hasn't yet developed for a whole
3 variety of reasons. And, you know, we'll see what
4 happens in the future.

5 But Jeff, let's turn it over to you. I'll turn
6 this off. And you have a clicker.

7 MR. SOLOMON: Yeah. That would be great.

8 Thanks.

9 So real quick, I, first of all, what to say,
10 thank you. I mean I appreciate the opportunity to come
11 and spend some time and give you some real-time feedback,
12 as these guys have, on what's happening in the
13 marketplace. And I wanted to say to you I'm not -- I'm
14 here today not just as a person whose primary
15 responsibility is to run a firm that helps finance
16 emerging growth companies and small companies, but I'm
17 also a small capitalization company myself. So I'm a
18 named executive officer for a small cap company called
19 Cowen Group.

20 And so some of the things that we're going to
21 talk about today -- or I'm going to talk about today --
22 are some of the challenges of being a public company that
23 does not meet EGC standards. And so we'll talk about the
24 JOBS Act and where it's been helpful, and I'll also give
25 you some insight as to some of the daily stresses that we

0148

1 deal with simply as a small cap stock. And we'll talk a
2 little bit about some areas where perhaps we can have
3 some improvement as well.

4 When I'm asked to discuss this stuff, like I
5 always start with the following premise, which is that a
6 positive environment for equity capital formation for

7 small companies fosters economic growth and advancement
8 in a number of ways. So jobs we talk a lot about but
9 also increased technology development and research
10 funding. And those are key tenets. So the dollars are
11 spent to get these companies public, and they're either
12 spent, you know, in the process of getting public or
13 spent in the process of developing the company. And for
14 a lot of these companies, that's a real decision; that's
15 a real economic decision.

16 I think that, if you look at the sum total of
17 what's happened in our country, if you just look at the
18 last century, you know, I think we did a really good job
19 at balancing the needs of investor protection and
20 creating a fair and balanced framework for regulation
21 that made it safe for investors to invest and also had
22 healthy capital formation. And I want to be clear.
23 People made money and lost money in the stock market.

24 And yet if you look at the sum total of just --
25 if you invested in stocks post the '33 Act and '34 Act

0149

1 and you were a company that got formed in -- some of the
2 greatest companies the world has ever seen got actually
3 to where they were after the Securities and Exchange
4 Commission was created because there is this need to have
5 a balance between good regulation that protects investors
6 and regulation that fosters economic growth that doesn't
7 get in the way or impede it.

8 And so a little bit about what we're going to --
9 -- we'll talk about this good. But if there is one
10 thought I would like you to leave with today, it's that
11 it's very possible to meet this dual mandate of
12 maintaining effective investor protections and fostering
13 economic activity.

14 And let's recognize the fact that there are
15 people and individuals and lobby groups on both sides
16 that will always advocate for less regulation and always
17 people that advocate for more regulation. And our job --
18 I think the job of, you know, industry participants who
19 are balanced and thoughtful and this group is to try and
20 maintain that balance. And so as we talk about these
21 things today, there will always be points of view that we
22 should be factoring in, but we should be thinking about
23 the balance. And that's where the JOBS Act fits in.

24 So what's gone on with the JOBS Act is it
25 demonstrates in a new regulatory environment, a difficult

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1 regulatory environment in which the bar is much higher
2 than it used to be, that we can put forth regulation as a
3 -- and legislation as a country that fosters economic
4 growth and does not get in the way of all the valuable
5 investor protections we've set forth.

6 So a lot of people were opposed to this because
7 they were worried about it. I think there's probably
8 good reason why people were worried about it. And yet

9 we're seeing that the market activity afterwards has
10 actually been beneficial to individual investors and
11 institutional investors alike. And that's a really
12 important thought process as we go through this because
13 I'm going to spend a lot of my time on where we've been
14 effective with the JOBS Act though I think you've heard a
15 lot of this. And then where can we go from here is
16 really, I think, something I'm going to spend a little
17 bit more time on.

18 So I definitely think in general that, you
19 know, we did a great job for small private companies in
20 the JOBS Act, and that's been detailed. One area that
21 has not been addressed is existing public companies or
22 companies that were public already that would have
23 otherwise qualified or otherwise look and walk and talk
24 like EGCs but aren't characterized and so don't get any
25 benefits. By the way, Cowen Group is one of those.

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1 Just for frame of reference -- I didn't even
2 think about it. But one of the things I heard from a lot
3 of newly minted public companies that didn't meet the
4 deadline -- that kind of became public before the
5 deadline -- "if I had known this was going to happen, I
6 would have waited because now I have a structural
7 competitive disadvantage for all the people that do what
8 I do that came after that date" -- December 5th is the
9 date, right? Is that the date?

10 A PARTICIPANT: December 8, 2011, yeah.

11 MR. SOLOMON: "They have a structural -- they
12 have a cost advantage, and I don't." So that's -- it's
13 an interesting dynamic. Not that there's that many of
14 them, but there's enough of them that a lot of other
15 companies are saying, "Wait a minute. There's some
16 benefits here to characterizing yourself as an EGC, and
17 I'd like opt into that." So we'll talk a little bit
18 about that.

19 But I do think, again, when we talk about where
20 we go from here, there are a couple of key tenets I want
21 you to think through. One is how do we create and provide
22 trading liquidity in the secondary market? So if the
23 JOBS Act effectively is -- the analog to the JOBS Act
24 would be the '33 Act. What should we be doing to think
25 about things to make the existing public markets function

0152

1 more efficiently to induce capital formation?

2 One of them is trade and liquidity. And it's
3 not just like more trading. That's not the point here.
4 It's actually quality trading where -- can we provide an
5 environment in which fundamental buyers and sellers in
6 small companies -- I want to be really clear -- for small
7 companies -- can actually meet in a more rational,
8 simplistic market environment where real price discovery
9 works and where fundamental analysis matters more than
10 the speed of execution.

11 And I think we're talking about a very small
12 percentage of the marketplace. And we're -- on this
13 theme of one size does not fit all, if we can sort of
14 imagine small companies in and of themselves are really
15 like a protected class, we should be doing things to
16 foster maybe a different structure for them that promotes
17 a more healthy environment for capital formation. We can
18 talk about that in a little bit.

19 The second is, I think, you know, we have to do
20 that within this dual mandate of making sure that
21 investor protections are not squandered or we're not
22 going back to the way it used to be. And I think that's
23 a favorite refrain I hear from a lot of people that are
24 opposed to any change, you know, "We're not going back to
25 the way it used to be like in the '90s when a lot of bad

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1 stuff happened."

2 And I will just say I was -- I spent most of my
3 career as an investor not as a CEO of an investment bank.
4 So most of my career was spent looking at companies and
5 investing in them and putting capital to work. Like most
6 players in the marketplace, I did not have a good
7 experience at the end of the last century. I didn't like
8 that way the world was going. And so some of the changes
9 that have come into place -- I was a loud proponent for
10 them.

11 And so I feel like we made a lot of progress.
12 And all the things we're going to talk about here today
13 and maybe in the future are not about going back there
14 because I don't think there's any market participant --
15 well, left -- who can with a straight face say that that
16 was good and we should go back there. The question is
17 can we bring, again, a balance back because we can
18 recognize the trend that I -- I wanted to show you, which
19 is that we've had a dearth of capital formation.

20 We've seen these slides before. And so if you
21 look at the slide carefully here, you can see not only
22 how we had fewer IPOs but what -- the size of IPOs -- the
23 number of small IPOs, which I'm defining as less than \$60
24 million has gone down significantly. And that's really
25 what we're trying to talk about here. We're trying to

0154

1 talk about not just more IPOs. But for growth companies
2 where -- you can clearly see, we've seen a clear drop
3 off.

4 And why are we doing that? We're doing that
5 because at the end, if you look at the companies over
6 here, each one of these companies started as a small IPO.

7 Well, started before small IPO, but they came public as
8 small IPOs.

9 And I just had a conversation with the
10 gentleman who was a founder at Home Depot. And I hadn't
11 focused on Home Depot because it's not a technology
12 company; it's not a life science company. But Home Depot

13 -- \$70 million public offering -- today Home Depot
14 probably doesn't get funded, period. If there's another
15 Home Depot out there -- and it has nothing to do with
16 technology or -- if there's another Home Depot out there
17 or a company like that, it probably doesn't get the
18 attention of investment banks or institutional investors.

19 And it's a numbers game. Let's think about
20 this for a second. In 1983 when Home Depot went public,
21 there were not trillion-dollar investment management
22 firms. Some of the biggest investment firms today that
23 we all have our money with, our 401(k)s with or wherever
24 -- or you've invested in mutual funds -- they're huge.
25 And so the dynamic is set up not to benefit the smaller

0155

1 companies. And the reason why -- part of the reason why
2 a number of companies are waiting to go public is because
3 they feel like they need to offer enough stock to the
4 marketplace to actually get large firms interested.

5 So, again, I think if our job here is to create
6 that balance for smaller companies, let's acknowledge the
7 fact that there has to be a different regime to induce
8 those big firms to actually carve out and grow their
9 small company portfolios because they think they can
10 provide positive returns for their investors.

11 And that's where this balance thing really
12 happens. If we do this right and if we get regulation
13 right and we can induce institutional investors who make
14 up the preponderance of the way that the retail investor
15 today enters the marketplace, if we can get them back,
16 they are the primary providers of equity capital for
17 America's growth.

18 So I actually -- I acknowledge that there's
19 room for conflict, and I acknowledge that there's always
20 going to be room for bad actors to do things they
21 shouldn't be doing. But I would say to you that there is
22 a far higher probability that market forces can conspire
23 to create positive good that benefits both individual
24 investors and institutional investors and companies. And
25 at the end of the day, that is the responsibility of all

0156

1 of us, regulators, market participants -- is to see if we
2 can find that center point and so that companies like
3 this can add to positive economic development.

4 So the three areas, I think, that are really
5 critical that we can talk about that have changed over
6 the last decade are just the change in market structure,
7 an increase in listing requirements, and changes in the
8 research ecosystem. And I'm not here to prescribe
9 outcomes today; I'm here just to highlight some of the
10 challenges. And we can talk about

11 -- if you want to talk about some of the potential
12 solutions, we can talk about them. But there are -- we
13 can acknowledge objectively that almost all of the
14 challenges that people agree that impacted capital

15 formation fall into one of these three buckets.

16 And so this is the problem as we've seen. And
17 I think we've all seen this statistic also, that IPOs --
18 that we've seen a slowdown in the unemployment rate. And
19 there's a lot of debate around causality here, so I don't
20 want to spend a lot of time on this slide, but I think
21 the next one sort of sums it up.

22 The Kauffman Foundation talks about the fact
23 that from 1996 to 2010 IPOs created 2.3 million jobs,
24 which is a 45 percent increase in employment post-IPO.
25 And so they estimate that small company IPOs -- which

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1 their small company definition doesn't exactly line up
2 with ECG, but it's close enough for statistics, so --
3 created about a million jobs or 156 percent growth. So
4 these firms have almost, you know, grown two and a half
5 times after they've gotten access to capital.

6 And so their estimate is -- which is, I think,
7 a lot more balanced than some of the other numbers we've
8 seen historically -- is between 1980 and 2000, had we
9 maintained that same growth trajectory as we had in the
10 20 years before the turn of the century, we would have
11 had another 1.9 million jobs from these companies. Now
12 that's just too much to ignore. And, again, if our job
13 is to help create economic -- a forum for capital
14 formation that leads to economic growth, we have a
15 responsibility to fix that.

16 We've gone through some of these numbers, so I
17 do think it's been -- you know, the JOBS Act was a great
18 start. And if I look at who's benefitting -- total
19 dollars raised for all EGCs, by the way, all sectors, is
20 -- you know, let's talk about numbers -- \$16.1 billion, so
21 big enough to be meaningful. But really at \$16.1 billion
22 -- we live in a world where the largest 20 institutional
23 investors probably have close to a trillion dollars
24 apiece. Just --- it's not a lot.

25 And that's a theme that you'll hear me talk

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1 about because the changes and the improvement's we're
2 making -- some people will say that it's going to be
3 changing the entire way the business works. And the
4 reality is we're talking about just a small subsection
5 that we believe should be treated as a protected class.
6 And then we'll see how it goes. So it's actually -- I
7 don't think -- I think there's actually very little risk
8 in doing some of these things in terms of major market
9 impact but very high reward if we get it right.

10 And so I looked at the biotech industry.
11 Again, it's just an area we do a lot of work in. And I
12 just -- I want to be really clear. Everybody thinks
13 we're in the middle of the greatest biotech IPO market in
14 memory, and we are. But I want to put it in clear
15 numbers for you. \$2 1/2 billion has been raised in the
16 biotech industry this year -- or actually since the JOBS

17 Act. That's 31 EGC companies. Just to put it in
18 perspective, I wanted you to know that the NIH budget for
19 this year is \$147 billion. Again, I think we're doing
20 great things, but there's so much more to be done if you
21 really want to try to talk about making an impact.

22 In particular, in this area in drug discovery,
23 if I look at the drugs I know we funded that would not
24 have gotten funded, I mean it's just -- there's a whole
25 story line that goes to the good associated with getting

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1 orphan drugs funded that would never have seen the light
2 of day without access to public capital.

3 You know, one of the companies that we did
4 financing for is a company called Bluebird. Bluebird Bio
5 is working on a -- their lead compound is genetic -- it's
6 a gene therapy. And their lead compound is for
7 adrenoleukodystrophy, which is Lorenzo's Oil if you've
8 seen the movie, all right. I encourage you to go to the
9 website and learn about Ethan and learn about how, when
10 Ethan turned nine years old, he started seeing signs he
11 was not developing. And they misdiagnosed him with ADD.

12 And by the time he was 10, his brain had swelled, and it
13 was just a matter of time, all right.

14 That company got financed this year in part
15 because of Ethan's story but in part because we were
16 actually able to raise them a significant amount of
17 capital at a decent rate. And that trial, whether it's
18 successful or not -- we hope it will be -- is now funded.

19 And we'll see if we can get to an end point there.
20 These are very real stories, and I can tell you that
21 trial would not have been completed if we hadn't been
22 able to get the company public.

23 So who else benefits -- because not every
24 company out there is doing that kind of work -- you know,
25 individual and institutional investors -- so after market

0160

1 performance -- you know, if you look at the 64.4 percent
2 average price appreciation for EGC IPOs versus 26.2
3 percent for non-EGC IPOs -- pensions, pension funds. You
4 know, when you look at -- and they're clearly playing in
5 this space either through their institutional investment
6 arms or directly themselves.

7 And so I actually think in some respects we're
8 actually monetizing private portfolios that have been
9 private for a long time. And that recycling of that
10 capital for venture firms and for private equity firms
11 really goes to being able to provide positive returns for
12 investors more broadly, pensioners.

13 And so there's a whole host of people that
14 benefit. And to date we haven't seen the abuses that
15 people were concerned about. I'm always looking out for
16 them frankly, but we haven't seen them.

17 So I put it in the slide package, which you can
18 read at your leisure, the benefits. And I thought it

19 would be helpful to at least put some real stories in
20 from some real people on job growth. These are things
21 that -- where we've gotten some really positive feedback.
22 I went out to a few people when I knew I was going to do
23 this, and I said, "Can you give me your thoughts on job
24 growth or on the benefits of being a public company, on
25 the challenges of being a public company?"

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1 And so I think, if we can focus on the
2 challenges for a second, you know, for a small cap public
3 company the largest concern is building an investor
4 interest and maintaining liquidity in my stock. This is
5 a constant and continuous effort requiring significant
6 attention to the company's senior management team. So
7 here he's saying, "I could either spend my time focusing
8 on execution or helping to get liquidity on the stock.
9 Boy, it would be great if the liquidity in the stock
10 thing kind of took care of itself. I could spend a lot
11 more time executing."

12 Now I can tell you I know that contention
13 because I do have to get out on the road. We have one
14 research analyst that covers us. I would like to take an
15 insurance policy out on him because if he -- something
16 happens to him, I don't know who I'm going to go to
17 because I'm not sure there are other people that think
18 it's worthwhile to cover Cowen Group as a public company
19 because I just don't think we trade enough. Maybe we do,
20 but I'm not sure we do, and we're not likely to pay an
21 investment banking fee to someone for a while or at least
22 it's not obvious if we will.

23 So the interest on the part of the sell side
24 just to pick up Cowen group as a small company -- not
25 high, you know. And so I worry about it. He does a

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1 great job, and I'm always happy when he puts me in front
2 of institutional investors, but I have to do a lot of
3 asking for that.

4 So we still have challenges raising capital. I
5 think liquidity is one of them. Lack of research
6 sponsorship is another one -- regulatory burdens. You
7 know, there are certain aspects of the JOBS Act that have
8 not been implemented. We can talk about those, but if
9 you -- I tried to put it in a little chart here that
10 showed, you know, what are the challenges faced by a
11 small company. So each of these are addressed in some
12 fashion by the JOBS Act. Some have worked and some have
13 not.

14 I think if you look at scaled regulatory
15 requirements for small cap companies, it's something that
16 -- it's very real. We talk about it all the time. It's
17 certainly an inducement -- or it's certainly an
18 impediment -- I would say -- to people thinking about
19 becoming public. They are always looking at what they
20 have to do in terms of cost and expense and

21 infrastructure.

22 Reg A -- there's a wonderful section on Reg A
23 in the JOBS Act that just hasn't gone anywhere yet
24 because, again, as an issue -- as a capital raiser in the
25 market, until we get some clarification around state

0163

1 securities rules, it's just going to be hard to utilize
2 that. And I think that's a valuable path for a lot of
3 small companies to raise money.

4 In research we still haven't seen pre-IPO
5 research. The blackout periods for IPO research -- I
6 mean we've talked about it. There's just -- there are
7 some areas we can increase the opportunity for there to
8 be more research in the marketplace. And I think this is
9 one we can talk about a little bit. So I just -- if I
10 have a few more seconds, I'll just go through these
11 because I think it's really important to highlight them
12 in some level of detail. Then you can look at the
13 packet, and I'm always happy to answer questions.

14 This is interesting. So "Trading Liquidity -
15 Essential for Capital Formation" -- everyone thinks that
16 this is a individual versus institutional battle that
17 goes on here. Actually it isn't. You know, we've taken
18 a look at the data. The data suggests that, for
19 companies that are under \$250 million, you know, 68
20 percent of those companies is owned by individuals.
21 There's a lot of capital formation that goes -- that
22 could go on there if we could induce the institutional
23 market -- the institutional investors to come back to
24 those markets.

25 Even if you were to go up to \$500 million in

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1 market cap, you're only -- half of those companies are
2 still owned by individuals versus at a billion and north
3 -- you know, 83 percent are owned by institutions. And
4 this reflects our world and the post-Global Research Analyst
5 Settlement. And more liquidity means more people are
6 just focusing on bigger fund companies, bigger cap
7 companies. So I think there's a lot to be said for that.

8 And we talked about how, if we are going to
9 make changes to market structure to improve trading and
10 liquidity or recommend those, we're really talking about
11 a tiny subset, and that's the second chart here. Look at
12 it -- you know, you can see the chart -- the bars all the
13 way to the right are -- that's billion and north. So
14 you're talking about a tiny percentage of trading that we
15 think should be treated somewhat differently with a --
16 maybe a modified market structure.

17 We talked about research and research
18 sponsorship. I gave you my own personal experience, but
19 you can look here, and you can see all of these
20 companies, 40 percent of the companies between \$51 and \$100
21 million market cap -- I only have one analyst. There's -
22 - if you're below \$50 million, heaven help you trying to

23 get a research analyst. But even
24 -- you know, even between \$100 and \$200 it's still a --
25 only a handful.

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1 When I talk to companies, they like to go -- if
2 they're going public, they want to have four to five.
3 It's really sort of -- everybody's trying to crowd four
4 or five research analysts onto the cover of an
5 underwriting. So if you're already public, it's really
6 hard unless you're doing the financing to add research
7 coverage.

8 And so I think we should be -- we can be doing
9 things to try and create a better economic model that
10 provides for maybe increased research in the marketplace.

11 And here I just want to say -- this is a huge hot button
12 issue that needs to be addressed and needs to be
13 addressed in a very balanced way, so I go back to my
14 theme of balance.

15 Right now for these companies, the way the
16 market is set up we're telling these companies it's
17 better to have no information than potentially biased
18 information about you. So I want to be really clear
19 about that. If investors are making investment decisions
20 based only on sell side research, that's a mistake.
21 Institutional investors do not read a research report and
22 buy stocks. Individual investors should never do that,
23 and that needs to be really clear.

24 But more information in the marketplace about
25 the prospects of a company is a good thing even if people

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1 read it and say, "I think this could be biased." So --
2 because what is happening in some instances -- in a
3 number of instances we have a number of venues now where
4 people can take opposing views and publish them. You
5 know, we all see them. Seeking Alpha is a wonderful
6 repository of great information. Here's the difference
7 though. In the absence of research, that becomes the
8 standard. And there's no certification for those pieces.
9 So we have this great Reg AC (Regulation Analyst Certification)

regime here and

10 this great research independence mandate that should be
11 upheld in every way possible, and we make it really hard
12 for those analysts who write research for emerging growth
13 companies because of the compliance requirements. So
14 we'd rather have -- the way it stands today we'd rather
15 have non-certified people in open forums providing the
16 only source of information for many of these micro cap
17 companies.

18 I would argue that we're better off being in an
19 environment where we have more information even if that
20 information is potentially biased and is labeled as such
21 with conflicts -- which it already is -- than having no
22 information. And so we should be asking ourselves the
23 questions, "What do we need to do in order to induce sell

24 side firms to produce more research for debate and
25 educating individual investors about the dangers of
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1 reading a research report and buying a stock," because
2 the real investors do not do that.

3 And so if we can create that kind of framework
4 where we could get more information labeled as such, we
5 will end up in a situation where more idea flow comes and
6 more institutional investors are likely to come back to
7 the market.

8 I'll give you an example in our own stock, all
9 right. We had a decent second quarter for the first time
10 in a while. And our stock was trading around \$3.30 a
11 share when we announced. We did our morning call. There
12 were a few crickets chirping on the other end of the
13 phone. Most of the people who dialed in were our
14 employees. A few of our biggest investors were there,
15 but by and large nobody listened. Maybe people read the
16 transcript, but whatever. There weren't a lot of people
17 on the call, no different than any other quarter.

18 We did this announcement. We're feeling pretty
19 good about it because we had a decent quarter. Stock
20 trades down 10 cents on like 250,000 shares. We're like,
21 "Wow. Okay. Let's go back to work," because we know if
22 we keep doing it, eventually that's going to get
23 rectified.

24 Over the weekend the one research analyst we
25 have writes a research report on us unbeknownst to us.
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1 He didn't call us to say, "I'm going to write a research
2 report." He just -- he took what we said, he synthesized
3 it, he added to it, and he extended the investment theme
4 in ways we can't do because of Reg FD. And he got most
5 of it right frankly. It was a good piece.

6 We were up 40 cents. Then we traded 2 1/2
7 million shares on Monday. Now when I hear people tell me
8 that sell side research doesn't matter, I know first-hand
9 that it does. Nothing changed between Friday's earnings
10 call and Monday's research report other than an
11 independent person took what we said and added and
12 extended that thesis and called a few institutional
13 accounts and said, "Hey, you should take a look at what's
14 going on at Cowen Group. Here's my research report."

15 That's a big difference. Now we still have to
16 produce in order for that to be sustained. I'm not
17 resting on those laurels. I feel like a lot of pressure.

18 Now I've got to produce a lot to make sure we hit those
19 numbers. But the fact of the matter remains -- is we
20 didn't do anything different on Monday than we did on
21 Friday. And so I can tell you first-hand that sell side
22 research in this day and age, post-Global Research Analyst
Settlement,

23 with Reg AC and all the independent requirements is good,
24 better than not having any.

25 And if you're a bad analyst, I promise you, you
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1 get weeded out quickly. So if you're an analyst who just
2 writes stuff that doesn't perform for people, people just
3 stop listening and -- as it should be by the way, as it
4 should be.

5 And so I feel like we had to clean up a lot of
6 the act, as I told you, at the end of the last century.
7 A lot of bad stuff was going on. That needed to happen.

8 But we should probably take a fresh look at whether or
9 not some of those things can be scaled back moderately
10 for a small subset of companies that could benefit from
11 having more information in the marketplace rather than no
12 information in the marketplace.

13 And so with that I'll stop. I think we've
14 covered a number of grounds, but I just think now seems
15 to be as good a time as any to have this discussion. And
16 I appreciate the fact that this group provides a forum
17 where we can come in and have this kind of discussion and
18 debate and hopefully have it be heard and resonate. So
19 thank you.

20 MR. GRAHAM: Well, thank you, Jeff, and thank
21 you, Joel and Alex.

22 We have a few more minutes, and I guess, you
23 know, one thing that I just wanted to put to you three --
24 you know, clearly there have been a lot of benefits from
25 the JOBS Act. And clearly it's -- and the JOBS Act has

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1 changed the way IPOs are done. And as you pointed out, a
2 lot of that is good. What I'm a little bit afraid of is,
3 while it will change the way IPOs are done, we haven't
4 necessarily come up with a way to generate more IPOs.

5 If you -- and one of the things that we've been
6 focused on from the beginning is how do you bring back
7 the smaller IPO. And if you look -- I think I've got
8 this right. If you look at the stats, IPOs that raise
9 \$100 million or less -- there are actually fewer of those
10 done after the JOBS Act than before. And so I see a gap
11 there, and you know, clearly there are some needs. And I
12 think, Jeff, you were kind of alluding to this. You
13 know, there needs to be a way to address that market if
14 you will.

15 MR. SOLOMON: Yeah.

16 MR. GRAHAM: And, you know, one of the things
17 that we as a committee are searching for or -- you know,
18 what can be done in terms of changing market structure,
19 somehow generating research, you know, all the things
20 that people have kind of talked about. And maybe there
21 is a JOBS Act II coming. But any thoughts that you might
22 have in that regard would be -- I'm sure you've thought
23 about it.

24 MR. SOLOMON: Yeah. I mean I -- you want to,
25 guys?

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1 MR. TROTTER: Go ahead.

2 MR. SOLOMON: So I think in some respects, you
3 know, Rome wasn't built in a day, all right. And so I
4 don't want to understate what the JOBS Act has done in
5 terms of providing a framework. But like everything, you
6 know, we've got to get people to change their mindset and
7 their business models a little bit. So we've had 10 or
8 15 years, almost 15 years in which going public wasn't at
9 the forefront of peoples' minds. In fact, they were
10 building businesses that didn't require a lot of capital
11 because they were worried they wouldn't be able to fund
12 them.

13 So interestingly enough, like when you see
14 social networking companies and software companies going
15 public, those are not big capital users. You know, we're
16 in a market now that a data networking company -- it's
17 the first data networking IPO in like five years. Think
18 about all the data networking companies that went public
19 that are -- actually, you know, we could argue about
20 whether they were right or wrong pricing-wise. But
21 Cisco? I mean Juniper? These are huge users and
22 consumers of capital and creators of jobs.

23 And the business model in the venture community
24 over the last decade has not -- has been to focus on
25 companies that do not require the public markets in order

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1 to create exits. So that's going to take some time. A
2 lot of them have been funded companies they think can be
3 sold to bigger companies because that's a better -- you
4 know, you got to have exits if you're going to be raising
5 more money. Venture guys are capitalists. They've got
6 to have -- they've got to see where the door is going to
7 be.

8 So better to fund a company -- med devices is a
9 great example. If you're going to build a med device
10 company, you better make sure it fits into Stryker's
11 portfolio or J&J's portfolio. There's like four or five
12 consolidators.

13 I would argue we got some great companies in
14 the -- you know, 10 years ago that got funded that
15 actually -- you know, Guidant was a great company for a
16 long time until they had issues from a -- you know, they
17 were an innovator that had great impact and great job
18 creation. You know, if Guidant had been a stent company
19 that was geared to selling to J&J out of the gate, it
20 never would have ever done what it did.

21 And so it's going to take some time for people
22 to get their heads around the fact that going public is
23 actually -- funding companies that need to raise equity
24 capital is an okay business strategy. That's first.

25 The second is we really do need to address

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1 market structure in a meaningful way. And it -- you
2 know, there's been a lot of great changes that have

3 occurred to market structure that should not go -- that
4 we should not change back. So -- and everyone talks
5 about tick increment and quote size. For the vast
6 majority, as we've demonstrated, nothing should change.

7 But for this group we should be discussing
8 whether or not there needs to be a change that fosters
9 liquidity. So not changing economics so much but can we
10 put a simpler framework in place where institutional
11 investors feel like they can actually engage in price
12 discovery without getting front-run. We don't have that
13 today. And so they're -- because they're big and because
14 they need to move a lot of capital around, it's just
15 easier for them to say, "I'm not going to focus on that."

16 And so we've got to demonstrate it's okay to
17 come back to the marketplace where we've -- and that's
18 where, you know, I think sell side firms have been hugely
19 beneficial as middlemen to create that liquidity that
20 attracts fundamental buyers and sellers.

21 And so there are some things we can do there.
22 And I think if we're able to do those things, we'll look
23 back in 10 years, which is kind of -- you've got to take
24 a long-term view here. And we'll say, "Wow. Look at all
25 the companies that became public." But if we expect the

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1 giant -- the little acorns to be giant oaks in the first
2 year and that's going to be our judgment period, that
3 doesn't happen.

4 And so we can do a lot of things here and tell
5 -- and particularly the SEC can do a lot of things here
6 to seemingly help and have such a short judgment period
7 that we'll never get from here to there. And so you've
8 got to give it some time and let's see if it regenerates.

9 And if it does, I think you're going to find that people
10 are going to be a lot more productive.

11 MR. TROTTER: I would just add to that -- and
12 Jeff, you put your finger on something really significant
13 when you talk about basically how IPOs have to compete
14 with the M&A company sale as a means of capital formation
15 for companies providing an exit to their early stage
16 investors. And that was really at the heart of a lot of
17 where we started on the IPO Task Force, which is you look
18 at the last two decades of IPO activity, and you see the
19 dramatic fall-off in the most recent decade.

20 You also -- over the same period you see
21 another trend, which is where two decades ago the trend
22 was roughly 50/50 M&A versus IPO as the method of exiting
23 and providing returns to the early stage investors. Now
24 it has been part of the JOBS Act. It's been 90 percent
25 private company sale as the exit and only 10 percent of

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1 these companies are getting out as public companies.

2 And first year of experience has not been bad.

3 It's been pretty darn good. I think, Jeff, you're
4 right. Over time what we would hope to see is, maybe

5 through some additional reforms but also just with
6 additional track record, as more small companies are
7 drawn to the process, as they're no longer deterred by
8 some of the -- you know, the confidential process, for
9 example, removes a significant deterrent for a lot of
10 these companies weighing those two alternatives of
11 selling the company privately versus going public.

12 These, over the long term, could be really --
13 could have a significant impact, Steve, toward the point
14 that you're making where are we really going to see the
15 kind of bump that we want to see in the really smaller
16 company IPOs not just more IPOs of really large
17 companies.

18 MR. GRAHAM: Okay. Well, thank you for that,
19 and thank you again to our panel. We're going to take a
20 short break and then reconvene at 3:30 sharp.

21 (A brief recess was taken.)

22 MR. GRAHAM: Okay. Well, I think we had a good
23 meeting today. Our speakers, I think, were well
24 prepared, and I, for one, learned a fair amount. One of
25 the things that was really brought home to me -- and that

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1 is that we seem to have some real issues with the
2 proposed rule under Regulation D. And as I said earlier
3 today, I'm not sure what the answers are. I think it
4 does require more thought.

5 It's clear that the SEC has done a lot of work
6 on this, but I think it's equally clear that it might be
7 a good idea to think about these things a little bit more
8 before things are set.

9 My concern -- and I hope you share that -- is
10 that of the -- the rules as drafted might have the
11 opposite effect of what we're trying to do here, and that
12 is to facilitate capital raising obviously and also work
13 to protect investors. But certainly we don't want to
14 make capital raising more difficult, and if we're dealing
15 with a system that needs to work, I think we need to find
16 ways to make it work better as opposed to finding ways to
17 create friction.

18 And so I don't think we have enough time to
19 think through many of the things that need to be thought
20 through, but what I would like to put on the table is a
21 recommendation that we ask the Commission to extend the
22 comment period so that more of these thoughts can be
23 articulated, more of these issues, and give ourselves a
24 little bit more time to vet some of the issues. So I'd
25 like to hear from you.

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1 MR. YADLEY: So moved.

2 A PARTICIPANT: Second.

3 A PARTICIPANT: Second.

4 MR. GRAHAM: Okay, moved and seconded. Let's -
5 - have any other comments?

6 MR. YADLEY: I think what you just said is

7 spot-on. The -- our very first recommendation was to
8 focus on who bought securities privately, not how they
9 were found. Fortunately that made its way in the JOBS
10 Act. But very specifically and in pretty much in that
11 same vein it said -- well, we know what it said, that --
12 eliminate the prohibition on general solicitation for 506
13 offerings made solely to accredited investors. Congress
14 added the verification but didn't say, "Change the rest
15 of the rule."

16 And so I think that we should be cautious in
17 making changes, especially to a reporting forum, the
18 initial purpose of which was to provide analytical and
19 statistical data, that that doesn't swallow up the
20 benefits of the expanded exemption that Congress and this
21 committee endorsed.

22 MR. GRAHAM: Thank you, Greg.

23 Any other comments?

24 (No response.)

25 MR. GRAHAM: Okay. All those in favor?

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1 (Chorus of ayes.)

2 MR. GRAHAM: Okay. All those opposed?

3 MR. BOCHNOWSKI: Aye.

4 MR. GRAHAM: Oh. That was David. Thank you,
5 David. It sounded like an aye.

6 MR. BOCHNOWSKI: I've been on the call since
7 earlier, but somehow I just got cleared to --

8 MR. GRAHAM: Yeah. We wanted to hear your aye.

9 Now -- okay. Well, again, as Chris and I had an
10 opportunity to speak with most of you over the last few
11 months -- and at that time we didn't know whether or not
12 this committee was going to be re-chartered. As we heard
13 this morning, it will be re-chartered, and so we have to
14 take the next few days and weeks to figure out exactly
15 what that means.

16 But for the time being I would like to say that
17 it's been a fast two years, and I've enjoyed working with
18 all of you. And once again, I'd like to thank each of
19 you for your contributions and your efforts.

20 Chris, do you have anything to add?

21 MS. JACOBS: Only that I totally concur with
22 the thanks, the commitment, the attendance, and your
23 candor. What has really become clear, especially as we
24 have made our recommendations over the past few years, is
25 that they have been thoughtful on our part, brought to us

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1 by people who are out there doing it every day. And for
2 that we thank you because it's very clear our work has
3 become important and that folks are paying attention to
4 what we see and experience every day. Case in point was
5 Catherine's issue today. So thank you all again for a
6 great two years.

7 MR. GRAHAM: Okay. Can I get a motion to --

8 MR. LEZA: Thank you for your leadership.

9 MR. GRAHAM: Thank you, Richard.
10 Can I get a motion to adjourn?
11 MR. CHACE: So moved.
12 A PARTICIPANT: Second.
13 MR. GRAHAM: All right. All those in favor?
14 (Chorus of ayes.)
15 MR. GRAHAM: What about you, David?
16 MR. BOCHNOWSKI: I'm an aye.
17 MR. GRAHAM: Okay. I guess we're done. Thank
18 you all.
19 (Whereupon, at 3:19 p.m., the proceedings were
20 concluded.)
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1 PROOFREADER'S CERTIFICATE

2
3 In The Matter of: SMALL AND EMERGING COMPANIES ADVISORY
4 COMMITTEE MEETING
5 File Number: OS-917
6 Date: September 17, 2013
7 Location: Washington, D.C.
8

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4 foregoing transcript of 179 pages is a complete, true and
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9 I further certify that this proceeding was recorded by
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