U.S. SECURITIES AND EXCHANGE COMMISSION

MEETING OF THE SMALL BUSINESS CAPITAL FORMATION ADVISORY COMMITTEE

Tuesday, February 4, 2020

9:32 a.m.

U.S. Securities and Exchange Commission

100 F Street N.E., Multipurpose Room, LL006

Washington, D.C.

PARTICIPANTS:

JAY CLAYTON, Chairman
HESTER PEIRCE, Commissioner
ELAD ROISMAN, Commissioner
ALLISON HERREN LEE, Commissioner
CARLA GARRETT
JEFFREY SOLOMON
GREGORY YADLEY
YOUNGRO LEE
GREG DEAN
ROBERT FOX
STEPHEN GRAHAM
SARAH HANKS
BRIAN LEVEY (by phone)
SAPNA MEHTA
MARTHA LEGG MILLER
KAREN MILLS
CATHERINE MOTT (by phone)
POORVI PATODIA
MICHAEL PIECIAK (by phone)
JASON SEATS
MARC OORLOFF SHARMA
JOSEPH SHEPHERD
HANK TORBERT (by phone)

PARTICIPANTS: (cont'd)

JAMES GELFER
PAMELA GIBBS
DARCY HOWE
JOHN C. McILWRAITH
DARNELL SMITH
MATTHEW COOK
MELANIE LUBIN

C O N T E N T S

P R O C E E D I N G S

MS. GARRETT: Good morning. I hereby call the February 4th Small Business Capital Formation Advisory Committee to order.

I would like to thank everybody that is here today, and we have some members that are participating via phone and web, and I wanted to acknowledge who those people are. I believe that we have Hank Torbert, Brian Levey, Catherine Mott, and Mike Pieciak. Can we confirm that?

MR. LEVEY: Yes. Brian is here.

MS. MOTT: Yes. Catherine is here.

MS. GARRETT: Hank and Mike?

(No response.)

MS. GARRETT: Okay. And, additionally, Poorvi Patodia will be joining by call or video later this morning. She is another Committee member.

Julie, is there a quorum for the meeting?

MS. DAVIS: Yes, we have a quorum.

MS. GARRETT: Great. Thank you very much.

Thank you, Chairman Clayton, and Commissioner Peirce, and all the Committee members for being here this morning. We have a very interesting agenda lined up for today where we are going to learn and discuss about funding gaps in terms of that -- with respect to areas that may impede capital formation for small businesses, which, you

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know, given our Committee's agenda, should be a very good core way to learn about some of the underlying issues that affect small businesses.

We hope that through today's meeting we raise awareness of these funding gaps for the Committee and for the Commission, and we want to consider those today, and also consider those at future meetings.

I'd like to welcome Chairman Clayton and Commissioner Peirce for being here today, and we also will have Commissioner -- we believe Commissioner Roisman will be joining us later in the meeting. And Commissioner Lee will be in the SEC's Denver office, and she hopes to join by videoconference later this morning.

Chairman Clayton, would you like to speak?

MR. CLAYTON: Yes. Thank you. Thank you, Carla. Nice to see all of you. Thank you for your service. It's good to be here with you.

And I'm very happy that you're dedicating this morning to take a deeper look at small business capital formation. It's timely as we at the Commission continue to explore potential regulatory changes to facilitate capital formation in this space. I also want to thank Martha and the Office of the Advocate for Small Business Capital Formation for their comprehensive first annual report.

I would encourage all market participants and

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anyone interested in these important issues to read the report. It provides an overview of the state of small business capital formation, including: one, how businesses are actually raising capital; and, two, where the capital raising is taking place across the United States.

The report also illustrates challenges small businesses throughout the country face, including for women and minority entrepreneurs. Some of these challenges appear to be connected to the reduction of bank financing for small businesses, limited access to early-stage debt, and a decline in startup activity in certain areas in recent decades.

The report shows that we need to focus on addressing the geographic imbalance in capital formation and the availability of capital more generally for small businesses throughout the United States.

I understand that you will also be hearing about the role of funds in supporting small businesses during critical capital-raising milestones. I encourage you, to the extent you have not already done so, to take a look at the recent amendments that the SEC and our fellow financial regulators proposed to the regulation commonly known as the Volcker Rule, the covered funds aspect of the Volcker Rule.

In particular, one provision of the proposed amendments is intended to promote the financing of startups

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and small- and medium-sized businesses through qualifying venture capital funds. I recognize that venture financing is less readily available between the coasts, and this provision could allow regional banking entities to more effectively support entrepreneurship in local areas that they know so well. I would be very interested in your thoughts on whether this is going to have a positive effect or not.

In addition, as part of our efforts to promote small business capital formation, we should continue to think of ways we can promote breadth and diversity and opportunity, including by supporting America's minority and women-owned businesses.

I am grateful that Pam Gibbs, the Director of our Office of Minority and Women Inclusion, will be here today to talk about ways in which we can collaborate to expand investment and other opportunities.

Robert Marchman, who recently joined Pam's office as a Senior Policy Advisor on diversity inclusion, will continue this great work as he focuses on working with the Commission's divisions, offices, advisory committees, et cetera, to promote diversity inclusion.

Let me say that one way in which Pam's office and our Office of Acquisitions reaches out to businesses in different communities, including small businesses, is by

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conducting educational events on how to navigate the federal procurement landscape. Not an easy thing.

I'm proud to say that here at the SEC over 30 percent of our contract dollars went to minority and women-owned businesses, many of them small businesses, in fiscal year 2018.

Thank you for your continued thoughtful and pragmatic exploration of our rules, regulations, and policies, and in particular how they impact small business. I look forward to a productive discussion today.

MS. GARRETT: Thank you very much, Chairman.

Commissioner Peirce, would you like to speak?

COMMISSIONER PEIRCE: Sure. Just want to welcome everyone here, and thank you again for taking the time to be here today.

I want to congratulate Martha on a very successful first year. You have accomplished a lot, and I think putting together this Committee was a really big piece of it, and the work that you all have already done is really important. I think today's discussion will be really helpful to provide us some data to think about these issues, so this will be useful to me, and I hope to you as well.

And also, I am very happy that you will have someone talking about the Midwest later today. In fact, I believe he attended my alma mater, Case Western Reserve

University. So always happy to have a little Ohio connection here. Looking forward to the discussion.

MS. GARRETT: Thank you very much.

Next, I'd like to introduce Jenny Riegel, who is the Special Counsel in the SEC's Office for Advocate for Small Business Capital Formation. Jenny is going to provide an overview of the annual report from the SEC's Office of the Advocate for Small Business Capital Formation that was released in December 2019.

If you have not read this annual report, I highly recommend it. It's very interesting and has put together an amazing amount of data, and the office did a fantastic job.

I will also just say that the conference call that you put together a couple of weeks ago going through this report was fantastic, so thank you very much.

Jenny, we look forward to listening to your overview of this report.

MS. RIEGEL: Thank you so much, and thank you for having me there. And since I'm the first staff member to speak today, I get to give the disclaimer for everyone that the views we express today are our own and do not necessarily reflect the views of any other staff member on the Commission or any Commissioner.

So, with that fun disclaimer, let's get started.

So thank you again for having me, and happy to do

a high-level overview of the report. I'm going to have to try and talk and press buttons at the same time, which I can do, but work with me.

So to download a copy of the report, we have the QR code as well as the link, and we highly encourage you to look at it. We will do a very high-level overview today, but please check it out if you have not yet.

Just wanted to highlight, while we're going to focus on data today, I wanted to just highlight a few brief things that we did in our first year of operations and places we engaged with people, learned about small business capital formation, and just other initiatives.

We sought to in this slide highlight in three to five minutes a rulemaking that impacts small businesses, to give a teaser, to -- a lot of people don't have time in their day to read every release that comes out of the Commission, and we wanted to highlight those that impact small businesses and give them an avenue to start to engage with us.

Turning to that, we're going to really focus most of the day on the data. And I love data, so this is an excellent start to my morning. So data sources. And so what we did is we wanted to take data from our economists here at the SEC and supplement it with other data and sources in the market, wanting to provide that complete

picture of capital-raising to give a full perspective on the market.

So turning first to the different regulatory options that are available. So these are the regulatory options that are available for investment capital-raising. And as you can tell, historically and continues in present day, the two primary front runners are private placements under 506(b), as well as registered public offerings. Other newer offering types, such as Rule 506(c), or crowdfunding that came about after the JOBS Act in 2012, have not yet caught up in prominence.

For those interested in industry data, what we did is we took the top six industries by the amount of capital raised, and we took the top three types of regulatory offerings and we put it on a graph, essentially showing that a significant amount of capital is raised using registered public offerings, followed by Reg D, private placements, and then Reg A.

And for this analysis -- and you'll notice kind of a slight change from the prior graph -- we omitted pooled funds because we wanted to focus on those operating companies.

And then geographic differences are very important to understand not only where capital is being raised but how it is across each of the different exemptions, across the

United States, including in the U.S. territories. And so we wanted to look at where people are finding success as well as facing challenges across the United States.

The next few slides are going to go based on life cycle of a company. So we're going to start with the early stage small business, and this goes to why we need to provide -- to look at all different data sources. And so when looking at investor capital in a vacuum, it doesn't tell the whole story as to how small businesses are accessing capital.

And one notable thing about this slide is if you look at the top two ways that companies are accessing capital, it's personal funds and retained business earnings. And these -- you essentially need to have either more established companies that have that retained earnings, or you need to have a high net worth individual.

And as our Chairman mentioned, community banking trends, so historically, as many of you know, for early stage businesses community banks have played a key role for accessing the market for early stage businesses. And we have all heard the statistics about the decline in community banks, and we continue to hear that businesses, particularly those in rural communities, are facing challenges in accessing capital when their bank down the street is no longer an option.

Continuing with early stage businesses, angel investors play a key role in providing equity to these companies. And while individually the dollar amounts are dwarfed by the public markets, in aggregate angel investors play a major role in supporting early stage companies.

So bringing together kind of that idea of angel investors and a regulatory framework, angel investors are essentially accredited investors. And these accredited investors for individuals has historically been defined as high net worth or high income persons.

In December, the Commission proposed changes to the accredited investor definition. And what the -- in large part what the changes do is add in alternative means of qualifying for individuals with financial expertise; in other words, those persons who are making investment decisions for other people professionally.

And we encourage everyone to comment on this proposal as well as any other proposal that impacts your business, but check it out if you have not yet.

Turning now to the next stage, mature and later stage businesses, as this slide illustrates, venture capital is critical to the pipeline of the future public companies. And, similarly, private equity plays a similar role for many companies who will one day go public.

So what the prior two slides was looking at was

retrospective data, and what this slide does is looks ahead, and this says what analysts expect: the number of IPOs from companies backed by private equity and late stage venture capital to become the next generation of public companies.

So on the public company side, we care about the number of companies entering our public markets. And while the numbers on this slide are often discussed, we wanted to point out an interesting observation on the graph.

So the green shaded area is the market cap of publicly traded companies over time in current day dollars. And while everyone is aware that the number -- the individual number of listed companies has declined, we have seen a significant increase in individual market cap of public companies, indicating that there is still significant value and growth in the public markets.

It is important to look at both figures as we examine the trends in the marketplace. 2019 was a big year for IPOs and companies entering our public markets. It's important to keep in mind that many smaller companies are struggling in the public markets due to a variety of factors, one of which we have heard from many companies is the lack of research coverage, which directly impacts liquidity.

As many of you know, our office pays attention to unique challenges and variables affecting diverse founders,

whether across racial, gender, or geographic lines. It is important that we understand the impacts of the market and how it is affecting every business, so they -- every business can play with the tools in the tool book.

For women-owned businesses, women founders are on the rise in numbers, but they lag their male colleagues in the amount of capital that is used at startup.

When women go out and pitch for investments, statistics show that they are yielding fewer investment dollars than the baseline. In other words, women are not finding as much success as attracting investors. Relatedly, women are underrepresented as investors in smaller companies, whether as angel investors or in the VC industry.

For minority-owned businesses, there is a great diversity of founders. Similarly, with women-owned businesses, the numbers of minority-owned businesses are increasing. However, those businesses are typically starting with significantly less capital than their white or majority-owned counterparts.

When minority entrepreneurs go out and pitch for investments, statistics show that they are yielding close to the baseline rate of investment dollars. In other words, when minority entrepreneurs do seek capital, many are finding success. However, similar to women investors, the representation of minority investors still lags and is not

representative of the general population.

So switching gears to specific regions of the country, we analyzed this -- we analyzed how businesses in areas affected by natural disasters are raising capital across various exemptions. Compared to the affected population, businesses in natural disaster areas tend to raise less capital relative to the rest of the country, with one notable exception: crowdfunding.

Looking at rural areas of the country, the picture is more stark. While approximately 19 percent of the U.S. population lives in rural areas, the capital-raising activity in those areas is significantly less than the rest of the country.

So quickly turning to policy recommendations. So our report contained five policy recommendations that I encourage you to explore in much more further detail. I'm going to give a very high-level point now.

Now, when pulling together these policy recommendations, we took into account the feedback we had received from hundreds of entrepreneurs, founders, investors, and other marketplace participants about the pain points they were seeing both across the coast, from startup to small public companies. We just -- we wanted to bring in that feedback and hear where the pain points were.

We were also looking for pragmatic and principles-based solutions that would address the most serious issues that were raised with our office. We also -- in any solution, you have to make sure that there -- that you are considering both investor perspectives as well as company perspectives. So we really sought to bring together both perspectives in our recommendations.

So, without further ado, the five policy recommendations. So the first is harmonization, and so harmonization is short for the harmonization of the exempt offering framework, which essentially means the way in which companies are raising capital, investment capital, outside of a registered public offering.

The second is investor participation in private offerings, and this really brings up two sets of issues. One is the accredited investor definition, and the second is pooled investment vehicles, otherwise known as funds.

So the third recommendation relates to how investors and companies are connecting with each other through the engagement of finders.

The third relates to feedback on ways to improve the crowdfunding rules.

And the fifth relates to -- or the recommendation encourages continued scaling of the obligations of smaller and less complex reporting companies.

And I, again, encourage everyone to download the

report. Hopefully, I enticed your -- intrigued your interest in wanting to learn more. There is lots more information and tons more data, so I encourage you explore it.

Happy to answer any questions.

MS. MILLER: I do. If I can, I want to jump in and just thank you, Jenny, for providing an overview. Jenny had the lovely task of tackling what is significantly more information than you could possibly digest. I mean, some of these visuals, these are pulled directly from our report. And it's only a handful of the data points and areas that are covered, so I do encourage you to check it out. Let us know what you think.

If you spot things that you think that we should cover next year, we want this to be something that we annually update and it becomes the compendium resource that pulls together information on trends, so that we are not only talking about stories, but we are backing that up with what the data shows about capital formation, because particularly if you look at maps of the states -- and what we did is they are color-shaded, they are heat-mapped, by how much capital is raised there, but we also put the number of each type of offering on the state.

And it's really shocking to see in a lot of states the number is actually zero for certain offering types, that

there has actually been no -- we have no data on certain activities happening, and that occurs across many regions. And that is something that there is no amount of heuristics that actually can compare to seeing the number zero on a state and realizing that there are some real challenges.

And so encourage you to share feedback with us, positive and negative. The negative is what helps us learn what we need to change, so I absolutely welcome it, and I just -- I thank you, Jenny. And one more time, just to give a shout-out to our team, to Julie, Jessica, Jenny, Colin, who is in the audience, Malika, who is upstairs, and others who have helped us over this first year.

Friday marked 365 days of our office, and we would not have been able to get everything done without the support of many. So thank you all.

MS. GARRETT: Thank you, Jenny, very much. I mean, that was a great overview of a very large report, and I really appreciate it.

And thank you, Martha, for -- and Julie and Jessica for all of your help on this. This is great.

I am now going to turn it over to Jeff, the Vice Chair, and he is going to continue with the next phase of the meeting.

MR. SOLOMON: Thanks, Carla. I just want to highlight one thing that I think is particularly telling

about the report that you -- that we see at Cowen. So of the 4,400 public companies we have in the United States, 400 of those companies are healthcare companies that have come public in the last seven years since the JOBS Act.

And I think it is particularly relevant because many of these -- 300 of those are biotech companies, which is a really interesting statistic, particularly when you think about small companies that have been huge users of public capital in order to fund their businesses. It is good news/bad news, right? It has worked really well for that particular sector, which is a capital-intensive sector, but it also highlights that it's a lot of the -- of the capital formation of the public markets has occurred in a relatively small geographic area.

I just looked at our stats from last year at Cowen. The top two states we financed businesses in in the public markets are California and Massachusetts, again, echoing some of the things that we talked about in our first three meetings.

So for as much progress has happened in the public markets, and as great as the JOBS Act has been for creating a forum for small companies to get access to capital, we still have a lot of work to do. And I just thought before we go on with the formal part of the program that it might be just good to highlight that we are not done yet. We still have a long ways to go.

MR. CLAYTON: Yeah. Do you mind if I echo that? You know, I love that you've been diving into this data and, you know, we're -- the country is not the same. Varies greatly from state to state. Varies greatly from industry to industry. Varies from offering type of -- can you just -- can you flip back to the public -- I just want to make a point that I think echoes what Jeff is saying about our public markets and how our public markets are being used.

He had a wonderful slide about the number of companies, but also the aggregate market cap. And, yeah, it -- but, you know, it's kind of -- like that one. Yeah. So I think I have these numbers directionally correct.

So we've got the number of public companies going down. We've got the aggregate market cap of our public markets going up. But I think if we take the top 500 names or use the S&P 500 as a proxy for that, of that 31 trillion, it's like 26 trillion are 500 of those names. So the other 4,000 companies don't make up much that -- we have to -- we have to understand that not all public companies are the same. The large caps are much different.

And it also goes to that liquidity issue, like how are we looking at our public capital markets, so that the companies that are becoming public are served in the way -- or at least somewhat close to the way our very large cap

companies are served. And that is a -- that is another challenge that we face.

Lastly, on your recommendations, our agenda is public. Many of your recommendations are on it, so I'm glad we are kind of linking up there. So wanted to say that.

Thanks.

MR. SOLOMON: Thank you, Chairman. It's actually -- so, again, these are great forums for us to have these kinds of conversations, and I think it's -- you know, many of us spend most of our time talking about these issues privately with clients or amongst ourselves.

And the fact that the Commission has created a forum where we can have this conversation and open really raise some of the challenges and identify them. You know, it gives -- it gives us a lot of fodder and things that we can think about as we constructively try to address some of these gaps in funding, which really is I think our next -- our next area.

So, as we were preparing --

MS. MILLER: Before we punt, can I make one more comment about --

MR. SOLOMON: Sure.

MS. MILLER: -- this slide? And it's another --

MR. SOLOMON: You can make as many comments as you'd like.

MS. MILLER: This is a shocker. This is another plug for you to look at our report. We have additional data in there around what we think of for the pathway to companies becoming public is that they actually list as their own company, not that they get acquired by a public company, who -- many of which -- there is some interesting data, some of which we have in our report, some of which we did not put in there, where you have many of these large public companies that now are functionally aggregators of many smaller different companies and divisions.

And so we still do see many companies entering the public market, albeit in a very different path than we used to see years ago, which I think is part of the numbers. We have some statistics that we have been looking at around the inquisitive activity of public companies where you don't see the IPO. They don't have a ticker themselves.

They are wrapped in, and, you know, the big question is whether or not they are a part of the consolidated financials or not of the public companies that many already hold. So that is -- those are trends that we are looking at and are very interested in as well. I just thought I would flag that because it's very relevant to this slide.

This slide has a lot. We could talk about this slide I think for an entire day, so you'd better put it down

because I love this slide. It's -- I said it's my favorite graph of the entire chart because I think there is so much in here.

MR. SOLOMON: I mean, this is the chart, frankly, that got us all started a bunch of years ago working on the JOBS Act, if you look at that -- the front end of that, and you can see sort of the decline from 8,000. It's really -- I will speak personally, it's -- I had no idea -- I've been in this business for 30 years. I had been in the business for 20-some-odd years and hadn't realized that that had happened, and it was really -- seeing that graph for the first time in 2011 was the first time I realized, uh-oh, we've got a problem.

And so it's good to see that we've started on that path of fixing that problem, but, you know, obviously, we've got a lot of work to do still. So -- all right.

So as we discussed at the last couple of meetings, there has been -- currently an active rulemaking agenda at the Commission that includes seeking feedback on ways to simplify, harmonize, and improve the exempt offering framework, and expand investment opportunities.

As this effort is underway at the Commission, the Committee has provided specific recommendations on the accredited investor definition, regulation crowdfunding, and general principles on harmonization that we encourage the

Commission to keep in mind.

The Committee has also had broader discussions about areas where many of us see challenges or gaps in access to funding -- geography, demographics, growth stage, industries, gender, race. Today I'd like us to consider a recommendation that memorializes the gaps that we identify. Each of us has our own experiences, and by identifying and relaying the trends and gaps in which -- in where capital is flowing, we as a group are well-positioned to recognize and can provide strategic guidance to the Commission on topics that rulemaking teams should consider and address.

The Committee has expressed a continuous thirst for data, as we just witnessed, to help the Committee and the Commission better recognize and evaluate these gaps in access to the capital landscape.

So this meeting will be a little bit different than the ones that we have been doing. Where we have been presented with rulemaking that is already in progress, this is a chance for us to flex our creative muscles, and bring to fore some of the challenges that we see.

We'll get a chance to listen to some speakers over the course of the day who are going to present things that they see. And hopefully by the end of the day we'll be able to coalesce around a couple of really strong recommendations that would encourage the Commission to go forth and find --

help us to find opportunities to address some of the issues we raise.

So I'm going to introduce now James Gelfer, who is the senior strategist and lead venture analyst at PitchBook. PitchBook is a financial data provider that collects and analyzes detailed data on the venture capital, private equity, and M&E landscape, including public and private companies, investors, funds, investments, exits, and people.

James launched PitchBook's VC coverage in 2012 and currently leads PitchBook's research initiatives in private equity venture and emerging technologies.

Welcome, James, and thank you for joining today. Really appreciate it.

MR. GELFER: Thank you very much for having me. So before I get started, just a little bit of background on PitchBook. So we're obviously a data provider focused on the private market. So all the data that you see here today has been gathered either through public filings, through information that is available through the internet or other sources, and then also primary research.

We reach out to investors, service providers, and companies that are actually raising capital. So it's a combination of all those things that are going into the data points that you're going to be seeing today.

So starting off with just an overview of the

landscape of venture capital, I have some definitions here for you on the right. As most people are probably aware, these are fairly ambiguous in the industry. A lot of people will call something a seed deal that for all intents and purposes looks like a Series A deal.

So we do our best to kind of classify things in a consistent manner, but just knowing that those definitions are very much in flux. And this slide right here kind of illustrates how the landscape has changed over the last decade. As you can see here, an early stage deal in 2009, the characteristics of it now look much like a seed deal happening in 2019.

Similarly, a late stage deal in 2009 looks like an early stage deal today. And so the industry has really shifted. You'll hear, as you look at the venture capital space, you know, Series A is the new Series B, and you can kind of go through all of the series and make that argument.

And so one of the things that when we look at the data is happening is as everything is kind of getting bigger is it's creating gaps particularly at the very early stages of the market. So as you can see here, see now, minimum viable product is typically what the companies have. Oftentimes what we're hearing is that actually at the seed stage it's just a business plan.

And people who have connections in the industry,

have already raised capital, are often able to go out and raise a VC round at a $20 million valuation with literally nothing but a piece of paper that says what they're planning to do. And so that's one of the things that I'll touch on a little bit here as we kind of go through the ecosystem and how it has been evolving.

So just to kind of start off on a very high level, VC deal activity, as you can see here, the last two years have been out and away the two highest years on record, in terms of capital invested. We're still gathering information from the end of 2019, so we think that number will be able 140 billion when it's all said and done at the end of this year.

And kind of similarly to some of the trends that we're seeing in public markets, in private markets, a lot of this deal activity is heavily weighted towards large transactions. So we refer to megadeals as rounds of $100 million or more. Some people refer to those as private IPOs, but obviously a lot of capital being raised from private markets.

We saw 250 of those transactions this year. That accounted for $60 billion of the deal value. So nearly half of the deal value that you see here is coming from 250 transactions.

You can see this kind of breakdown by stage activity. Unsurprisingly, the capital is dominated by late stage deal-making. About two-thirds of the capital invested comes at the late stage. But increasingly we are seeing those large financings happen at the early stage as well. So of those 250 megadeals that I mentioned earlier, 100 of those actually happened at the Series A or Series B round.

So, once again, these are companies oftentimes three, three years old, sometimes just a little bit of revenue, off and on profitable raising $100 million in private markets.

A PARTICIPANT: In some parts of the country.

MR. GELFER: I was going to say, some parts of the country, but it's interesting, you will find little pockets. So of those 250 deals, I was in Florida last week, and they have actually raised five of those megadeals in the last year as well. So there is some variation, heavily concentrated in Silicon Valley, but we are seeing these deals really drive deal-making across the country.

In terms or regional activity, it is a little hard to see it on the screen here, but you can see in your printout obviously the west coast is the main driver of deal activity, but we are slowly starting to see that shift.

One thing was that the capital and funds remains highly concentrated there. So right now we are showing around $100 billion of capital available to be invested

dedicated to VC funds that has yet to be deployed. About two-thirds of that is held in funds in Silicon Valley.

This is one of the more interesting chart I think in terms of just geography and where capital availability is. As you can see, late stage activity has always been an area where companies typically have to travel a good distance to be able to raise capital. But what we've seen in recent years is as those early stage deals have gotten larger, companies are having to travel further now in order to raise those national Series A/Series B rounds.

So this chart right here, we did an analysis showing, based on CSAs, combined statistical areas, which is essentially taking a whole bunch of different MSA groups on a bureau map and putting them together into clusters that kind of make sense in terms of funding and, you know, an economic system.

What we found, obviously, is that the capital availability is, you know, several times higher in California than it is in most other places. So in San Francisco, for instance, for companies that have already raised capital, there is $12 million available for each one of those from locally based investors.

When you go out to the rest of the country, what you can see is that those numbers drop pretty starkly. In the least-funded ecosystems, oftentimes there's only

$100,000 that is, you know, available from local investors to invest in those companies.

There is definitely movement in terms of concerted efforts to get more capital to those places. Actually, just last week on Friday there was a big summit in Utah called Silicon Slopes, as they are trying to brand their own version of Silicon Valley. And so DOMO, for those of you who know the company, it is a billion dollar VC-backed company. So the founder of that company, a couple of other local companies, are raising a VC fund. And they kind of had a big stage show explicitly saying, "We are doing this for capital in the area."

But, you know, I travel around to a lot of places in the country. And I was in Florida last week, for instance, which comes up here in one of the least funded ecosystems. There has only been one local VC fund raised there in the last two years.

And so when they actually had the panel of VCs investing in Florida, it was one VC who raised a fund three years ago in Florida, and then a VC from Atlanta and a VC from Raleigh, and a whole bunch of people who were from the region but weren't actually based in Florida.

You know, one area that we're looking at in terms of underfunded businesses is female founders. We don't currently have the ability to look at minority groups or

anything of that demographic, but we can break it down by gender. You know, similar to the stats that were shown in the prior presentation, obviously a big gap there in terms of funding.

One thing I want to know in terms of the deal count and the capital raised by female founders is that we are seeing a pretty strong and consistent uptick in the number -- or the percentage of rounds that are going to female founders. But what hasn't come along is the capital raised by female founders. And so obviously there are kind of some structural reasons, you know, for why this has happened, but one thing to note is that in these VC ecosystems as companies raise -- go through raising early-to-late stage rounds, the numbers naturally get bigger.

And so when we look at female founders, a lot of this deal activity that has happened more recently is concentrated very much on the seed in the early stage rounds. And so while those numbers are smaller if you look at, you know, the average late stage round for a female founder vis-a-vis a male founder it is going to be smaller. But a lot of the aggregate numbers that you see is dictated by the fact that there just has been categorical underfunding for a long time, and it is going to take several years before some of those female-founded companies are raising big rounds.

We have started to see that more with Glossier, Away, and some of these companies that have been around for three to four years, but I think that that's a number that you will kind of see tick up naturally as there has been more funding for the earlier stage companies.

One thing that isn't talked about much in terms of the venture capital kind of media but is a big area of the market and is only growing is venture debt. And so this for our definitions is essentially supplying debt to companies that are VC backed or in lieu of VC backing. I have a breakdown for you here of kind of how we think about it. There is also a link to an analyst note that we have done that goes into more depth about the sources for capital and the rationale behind raising them.

But what is interesting in this space is that there are a handful of lenders, primarily Silicon Valley Bank, that really dominate, you know, two-thirds to three-quarters of all lending that happens here. And typically what the kind of relationship is between these venture lenders and the VC-backed companies is when they supply a loan, the venture-backed company then moves all of their banking to that bank.

And oftentimes, you know, these Silicon Valley banks -- Bridge Bank is another big one -- they have longstanding relationships with VC investors. And given

that it's a relationship business and a VC investor might have dozens of companies that are all doing their banking there, what you hear is that the default rates are actually very low, because the VCs do not want to ruin the relationship. And so oftentimes in these situations the VC is kind of an implicit backstop for the company.

Another thing that is happening here is, as a lot of software companies have moved to assess software as a service model, they get in contracts for 12, 24 months, that can then be collateralized. And also, if you're doing all of your banking there, the bank has a direct line to the bank account, so they know exactly how much revenue is coming in and they can underwrite loans in that way.

And so we're seeing companies increasingly use this both at the early stage to avoid dilution, and increasingly at the late stage as well. So oftentimes when you see in the market a company raise $500 million in venture capital, a good chunk of that, if not the majority, is now becoming venture debt. And so that's something to be aware of in the market. And, you know, from the founder side of it, particularly as more money is being raised in private markets, it is just a way to kind of mitigate some of the dilution that is naturally occurring.

It also --

MS. GARRETT: And, James, may I ask a question

real quick?

MR. GELFER: Yes, please.

MS. GARRETT: So just to point out that that venture debt is, though, going to companies that have already raised venture capital financing.

MR. GELFER: Yes. So it's going to companies that have already raised venture financing, and then we also have a few firms in our database -- Lighter Capital is a good example -- that explicitly brands themselves as an alternative to venture financing. And so we count those companies as well that, you know, are essentially being targeted by VCs and a debt lender at the same time.

So we have certain entities in our database that automatically, if you are lending from them, you are a venture debt.

MS. GARRETT: So it's almost like a company that has already raised funding through venture capital then gives access to funding through a bank.

MR. GELFER: Yes. That's typically how it happens, but increasingly we're seeing companies raise the vendor debt in lieu of venture funding.

MS. GARRETT: Oh, okay. Thank you.

A PARTICIPANT: *11:58:16

MR. GELFER: So we combined angel and seed activity, but there obviously are some very kind of stark

differences between the two that I will go into a little bit. One thing, obviously, that stands out on this chart is that the deal count has been roughly flat for the last four to five years while the capital invested in these companies has shot up significantly.

So one of the things that we obviously hear, especially outside of Silicon Valley, is that it is very hard to raise these initial angel and seed rounds.

As you can see here, the deal sizes have been flat on the -- kind of the median and the bottom quartile level, and then risen precipitously at that kind of upper quartile, while valuations have gone up across the board and so, obviously, creating a more founder-friendly environment.

One thing that I want to point out here in terms of the angel activity is I think that this is one spot where, really, there can be a lot of movement in terms of underfunded activity.

One of the best examples of this is Hashtag Angels, which is a group of women and minority investors who came out of Twitter initially doing angel investing and now have started to raise funds specifically to invest in female-founded companies and minority-owned businesses.

And so particularly in the last three to four years as we've seen a lot of big exits and, you know, other people besides the founders being registered to these companies, I think that those angel networks are kind of explicitly going out and seeing themselves as kind of torchbearers in terms of spreading the capital more broadly.

And so as I mentioned earlier, it's obviously the early stages before you see that kind of percolate into later stage, but a lot of these networks have had success raising hundred million dollar funds, which, obviously, lawyers for venture capital explicitly going after kind of minority and female-owned businesses.

One thing that really stands out in the data when we look at these kind of early rounds are the background of the person who is raising the capital. And so we did an analysis that looked at serial entrepreneurs, which we describe as someone who has founded a VC-backed company and had a successful exit. We also have what we call unproven entrepreneurs, who have launched at least one VC-backed company without an exit, and then novices.

And consistently throughout the data what you see is that serial entrepreneurs are able to raise more capital earlier in the funds' life cycle at a higher valuation. Oftentimes they take a little bit more dilution, but then what you see is that they, throughout the funding life cycle, are able to get bigger valuation step-ups in between their rounds and get higher, you know, absolute valuations

either at exit or the last round of financing that we have.

And so we think that, you know, that obviously is one area of the market that there is a strong bias towards particularly when it comes to the valley and finding ways to kind of access capital for people who maybe don't have the relationships or the know-how to go through that venture financing ecosystem.

One other thing to note here in terms of serial entrepreneurs and that angel kind of investing, for the serial entrepreneurs that we have in our database, we have at least five percent of them who have gone on to become angels. We think that number is probably higher because a lot of people are hesitant to advertise their angel investments, but, you know, one out of 20 successful founders who is becoming an angel, we think that that is kind of a natural route for people to go, and, obviously, ways to kind of encourage that as well.

And then, you know, one than one percent of these serial entrepreneurs launch their own VC fund eventually, too, and so there definitely is evidence that people who have been through the VC funding life cycle both kind of have the knowledge of how to do it and are more inclined to do it as well.

As the space has evolved, oftentimes people think that the kind of current nomenclature isn't adequate enough,

and I think that that is kind of indicative of where people see gaps in terms of financing. So one of the things that has popped up lately is a term called "pre-seed." So now that seed rounds have become, you know, $2 million on average, people think that that's too big, and so they are trying to launch their own strategy.

Whether or not that is actually a strategy I think is left to be determined, but I think it is just very emblematic of where people see financing gaps. Some people are referring to it as "dirt stage," and so basically trying to go as early as they can to differentiate themselves as these VC funds get bigger and there is more kind of pushback of, are you actually doing VC at this point, or is this now a fundamentally different strategy?

The breakdown by sector here you're going to notice is fairly consistent as you go across angel, early stage, and late stage. Where we do see some differences, though, is in this vertical activity. And so we have industries on the previous slide that we show are kind of what you would think about in public markets, and then we have what we refer to as emerging verticals which are much more focused on what's happening typically in early stage private market companies.

As you can see here, artificial intelligence and machine learning, the AI/ML, has broken out significantly

since 2016. And as I go through kind of the rest of these slides, what you'll notice is that AI/ML line, the breakout comes later and later in terms of early stage/late stage, and I think that is just kind of a good illustration of how these VC ecosystems take a little bit of time in terms of financing, whether it's new types of founders, new types of companies, new regions, it just takes a while before everything kind of grows from that first baseline.

In terms of early stage deal activity, you know, much the same story that we have seen, angel seed and across the whole ecosystem, in terms of growth at the top range, record-making deal activity over the last two years. Again here, kind of a similar story, both in terms of deal sizes and valuations.

You can see on the bottom end those deal sizes have remained relatively stagnant, whereas the valuations have seen an uptick across the board, once again just pointing to kind of more founder-friendly conditions in terms of financing. People are able to raise more capital now or the same amount of capital at a more attractive valuation, obviously taking less dilution.

And so people have the ability to kind of play around with those metrics how they want, so people can raise more capital at a bigger valuation, less dilution. They can raise less capital. You know, there's essentially the three metrics that go into how these financings work.

Again, by sector here, what we're starting to see at the early and the late stage is that software, traditional software, is kind of falling off, and there has been more investment into traditional consumer services, consumer packaged goods, and that VC is really expanding beyond just traditional software plays.

Obviously, in this day and age, every company is somewhat tech-enabled, but what we're seeing is that there is more focus now on businesses where their core business is not necessarily technology and they are using technology to create greater efficiencies.

Again, like I mentioned on the angel and seed side, you can see here that AI/ML line, the breakout really doesn't occur until 2018, and so, once again, just indicative of how it takes usually, you know, 18 to 24 months before we see kind of that early stage financing start to go into the bigger rounds in the early and late stage.

Finally, at the late stage here, once again, as you can see up and to the right, record-making deal activity. One thing that kind of stands out at the late stage is just the sheer size of the valuation. So on the right-hand side there, you can see that the top quartile valuation now is $260 million for a late stage company.

And so, obviously, thinking about those private market companies who aren't going public anymore, we're seeing kind of unprecedented size in private markets as these companies continue to grow.

As I mentioned kind of a slow shift away from software, we are seeing that in the late stage as well. And here I think like the AI/ML trend kind of comes into view where it's not even the top sector at the late stage yet. We still see life sciences there. And I thought it was an interesting comment in the previous presentation about healthcare IPOs, because that's definitely something that we have seen in our data.

When we look at VC-backed IPOs, healthcare IPOs have gone from about 20 percent of the IPOs at the time of the JOBS Act to almost half today. As you can see here, life sciences has consistent been one of the areas in terms of late stage financing where there have been investors.

And what we see in health care is that just given the nature of, you know, drug trials and the capital intensity that you mentioned, that typically as companies get to this stage they are either looking to be acquired or go public and there isn't that mechanism to kind of, you know, provide $250 million on a hope and a prayer.

And just the financing in health care tends to be categorically different than what we see in a lot of the VC

space. A lot of the analysis that we do is actually a binary cut of health care, and then everything else. So that's definitely something that is coming through in our data as well.

MS. MILLER: James, can I ask a question?

MR. GELFER: Yes.

MS. MILLER: As you talk about the top quartile -- and we've seen this trend on a couple of different slides, where the top quartile, the average, when you factor that in, skews the rest of the data. Have you correlated where that top quartile, those valuations and the deal activity, is happening in the country?

MR. GELFER: Yes. In terms of regional activity, we do have that data available as well. I kind of cut it off at like 60 slides. So if you want any of this stuff, I'm more than happy to provide that to you.

MS. MILLER: I think it would be really interesting to see, because that's something that we see when we're out doing outreach. People talk about the very different valuation their company would have based on where they are currently located versus where there is pressure for them to relocate.

MR. GELFER: Yeah. And there's a couple of different things that go into play there. Uniformly, when you go across the country, that's the story that you hear.

Even in places like Chicago where the cost of living, frankly, isn't that much different, you will hear that a company is getting a, you know, 40 percent valuation cut.

You know, part of that, quite frankly, is in certain areas there is a cost of living adjustment. You can raise the business, you know, on just less capital. But I think, quite frankly, there is kind of that bias outside.

One thing that's interesting is you mentioned, you know, at the state level we even find differences when we go down a little bit more granularity to the MSA or the CSA level. And that's one of the reasons why we use that as well, so we've done different ecosystem kind of analyses looking at both the state level, the MSA level, which is extremely granular, and the CSA level. So we have all of that data available if you're interested.

MS. MILLER: Very interested. Thank you.

MR. GELFER: Absolutely.

So now I'm going to talk a little bit about growth in PE activity. What we define as "growth" is -- I have the definition up here for you -- is typically a non-DC-backed business that is receiving a minority strategic investment. And I have also included here private equity buyout deals for companies that have valuations of less than $250 million.

Kind of different to VC, you can see that the activity here has been fairly stable on a capital basis over the last several years. Part of that is it's just a different set of investors, but increasing what we're seeing is that these traditional -- what we call them, private equity growth investors -- they have been fairly active in places like energy and other kind of Old World industrial sectors.

Manufacturing, as you can see on the chart here on the right, particularly that has started to shift in recent years, and they are increasingly going into more of the VC realm of technology companies and software companies. And there is a few reasons why PE firms have been attractive for them.

One of the things I mentioned earlier is that SAS business model with the recurring revenues. And so a lot of PE firms who are -- kind of came to put that on the company have shied away from technology businesses because they don't have a lot of assets that can be collateralized. Now that you have a revenue stream that a lot of banks are willing to underwrite, that has kind of unlocked kind of software tech for a traditional PE crowd.

The other thing that we're seeing is VC firms, as they raise bigger and bigger funds, it's not uncommon now to see a 2 billion, $3 billion venture fund that claims that they are going to do early stage deals, but quite frankly,

it's not possible to pool that much capital, so they are increasingly doing these kind of growth late stage rounds, oftentimes for companies that haven't been through traditional financing. Maybe they were owner-backed for a while, but they'll infuse now $200 million as the first investment into those businesses.

In terms of fund-raising, obviously, the first kind of stage of venture financing in terms of capital being allocated to new funds, what we can see here is that there was a slight down-take this year, but overall fund-raising has been very strong, and there is a few things that are contributing to this.

One is that -- the net cash flows from venture funds. So when we look at the capital that is actually being, you know, allocated from new LPs as opposed to the capital that is being returned to them, they have had more capital returned to them each year since 2012 than they have put into new funds.

And so what that means is that essentially they have to continually allocate to new vehicles in order to just maintain their allocation. At the same time, we have seen almost across the board, regardless of whether it's sovereign wealth funds, pensions, endowments, foundations, almost every entity type is increasing their allocation to VC. So going from five to eight percent, going from 10 to

12 percent.

And then, again, over the last 10 years, you've seen a kind of bull market in just about every asset class. So their whole pie has grown as well. And so you have these allocators of capital now who have a bigger pie, who are applying a bigger percentage of it to VC, and who are getting more money back from VC than they can put in.

And so all of three of those dynamics we think are contributing to, you know, a kind of sustained level of fund-raising that is unlikely to go away anytime soon.

One thing that is hard to capture in the data is that a lot of these entities are doing direct investments themselves now, and so oftentimes instead of committing capital to a fund they will just be investing off their own balance sheet or off of a committed pool within themselves, which is obviously difficult to quantify. But I think it just all points to capital flooding the space.

MR. SEATS: Hey, James?

MR. GELFER: Yes.

MR. SEATS: As you are going through this section, something that's on my mind just sort of watching the presentation, I mean, the sort of purpose of this Committee and the thing we are really focused on in many ways, like the earliest stages here, those initial stages, and there is a dynamic that I think is echoed even in that public equity

chart, I mean, that shows sort of basically the concentration of capital towards larger companies, and that dynamic is playing out in venture as well.

And so as you walk through this section, I would love to sort of have you pull out any things that sort of echo that, because the narrative to me, like our perspective is that as venture funds are -- that there is an alignment in the market.

Some of it is regulatorily influenced, but a lot of it is just the market dynamics, whereas funds are strongly incentivized to raise larger and larger vehicles, and they are deploying those vehicles in effectively the same number of companies, which means you are, by definition, moving later stage and writing bigger checks and sort of -- that dynamic is capital starving, the earliest stage.

And so, to me, that's the narrative sort of underpinning those -- you could agree or disagree, but as you walk through the slides, would love to sort of have your contextual reaction to that framing.

MR. GELFER: Yeah. Absolutely. So I think there is a couple of things that are kind of pertinent to that. One is that as these funds are getting bigger, what you are seeing is a lot of the successful firms are often raising not just one fund, but they are raising two or three funds, oftentimes explicitly for these either follow-on or growth financing rounds.

So a good example is Andreesen Horowitz, which is, you know, one of the most prominent investors in Silicon Valley. They have just raised explicitly $2.2 billion just for late stage deals, in addition to all of the other funds that they have. Founders Fund, Peter Thiel's fund, is in a similar situation where they are raising $1.5 billion just for growth equity.

And so I think one way that these firms are trying to kind of adapt to say, "Hey, we have this separate pool of capital that is exclusively for these late stage deals, but we're still going to do early stage." But kind of to your point, you know, there is a lot of kind of pushback from traditional what -- they'll call themselves early stage investors who are investing out of a $50 million fund that will say, "You call yourself early stage, but you are a billion dollars." And so how much can one of these early stage deals actually move things for you?

MR. SEATS: Yeah. Because in those two examples, even though -- I guess my point would be, however many billions of extra dollars that is equals no new company formation.

MR. GELFER: Yeah.

MR. SEATS: That's into the existing portfolio

that they have of --

MR. GELFER: What's interesting is that you'll see Andreesen Horowitz -- they actually will participate in a seed round for a company that is its first financing. But, you know, the size of it often is, you know, 5-, $10 million.

Interestingly, as this has happened, as these funds have gotten bigger, you'll see teams who say, "I don't want to be investing in this sort of strategy. I'm going to spin out and start my own fund." But even then, those first-time funds now, the average size last year has been $100 million. So that's an average, right?

The median is going to be a little bit lower, but even these people now who are going out and launching their own first time fund, oftentimes it's orders of magnitude bigger than what we would have seen 10 years ago from a successful firm who has been doing it for a long time.

So, you know, quite frankly, that is something that we are seeing. One of our predictions for this year is that, you know, the median fund size is going to crest 100 million this year, just because those first-time funds, as they are coming out to market, oftentimes it's, you know, hitting that nine-figure mark on the first fund.

So, frankly, I think that that is a kind of huge gap in financing. I don't know how you kind of adjust it,

just because the incentives for a VC firm is you get paid on a management fee and carry, so the bigger your fund is, the bigger your management fee is. And so I don't know in terms of, you know, how you change the dynamic to incentivize people to want to raise less capital because everyone is going to want to earn more money.

In terms of dry powder here, as you can see, obviously, there has been a big buildup because of these funds. But what's interesting, just with all of these deals, is that we have actually seen like the dry powder that is available to be invested based on current investment levels actually hasn't gone up all that much, just given the record-making deal activity that we have seen.

Obviously, that means, though, that there is that gap at the smaller end of the market.

I mentioned briefly non-traditional investors who are investing in VC directly and not through the funds themselves. We break them down into a few different categories here, so corporate venture capital is going to be any kind of corporation that is investing either off of their balance sheet or has raised a dedicated fund to invest.

This last year we actually saw 21, you know, registered with the SEC, pooled investment vehicles raised by corporations to invest into venture capital. And one of

the things I think that is important about that is the last time there was a recession, one of the groups that you saw pull back most quickly was CVCs.

So now you're starting to see these firms not only build in-house teams but also have dedicated pools of capital that will, you know, not be able to be pulled back, if and when there is a recession.

We include private equity investors here, so increasingly we are seeing big buyout firms, as I mentioned, kind of move downstream and invest in these early stage companies. Asset managers as well, so big mutual funds like Fidelity, T. Rowe, and then hedge funds increasingly as companies are staying private for longer. They don't want to wait until a company IPOs, and they are coming in into these late stage rounds in order to get access, you know, one, for returns, and also, quite frankly, for a mutual fund. I think it's an advertising point to be able to say, "Hey, we are one of the only people where you can invest in Airbnb," or whatever the company might be, "before it goes public."

Some of these hedge funds have actually just launched dedicated venture capital funds in the last few weeks, which I think is kind of an interesting move. Two Sigma, which is a quantitative hedge fund, you think about just crunching numbers, they have actually raised a VC fund.

So I think there is evidence that, you know, there is appetite in the market, and everyone who can raise a vehicle for it is doing so at the time.

And then the last one I'm going to mention is governments and sovereign wealth funds. Particularly, what we see here is foreign sovereign wealth funds have become increasingly active in the direct investment space. Some have even set up offices in Silicon Valley to have more direct access to the companies that they are investing in.

This chart here is showing you --

MS. MOTT: This is Catherine. Can I ask a question, please?

MR. GELFER: Yes.

MS. MOTT: Can I ask a question, please? Thank you. One of the things we are seeing a lot of is family offices. Do you track -- can you track family office activity and where they play? I mean, you're naming these other entities or these other categories.

MR. GELFER: Yes. So --

MS. MOTT: We're seeing a lot of family offices as well.

MR. GELFER: Yeah. I apologize. We include family offices under that asset manager category. So we do track them to the extent that we can get data on them. Unsurprisingly, they are some of the most secretive entities

out there, so kind of similar to angels, we track them to the extent that we can. But, you know, we can't compel people to provide us information, so they're definitely included in the data that you see here.

MS. MOTT: In that aspect. Okay. Thank you.

MR. GELFER: Yeah. So this chart here, what we're showing is the percentage of deal value that these investors participate in. And so when there is a, you know, deal for $100 million per se, and there's five different investors, we will always know the percentage they contributed. So we just look at the aggregate deal value and whether a CVC or an asset manager was present.

As you can see here, over half the deal value last year had a CVC investor associated with it. And you can see those numbers, you know, obviously add up to more than 100 because there was a lot of club deals, but essentially every major financing has one of these non-traditional investors typically underpinning it.

You know, I'll point out the sovereign wealth funds again, just because they have been increasingly prominent in the marketplace. You can see that they've gone from about one to two percent of, you know, participation in capital to six percent in recent years.

Obviously, less active on the deal account side than the capital side, so, you know, it's these non-

traditional investors that typically are more involved in these late stage rounds, not so much supporting the early stages of investment.

In terms of exits, last year was far and away the record year in terms of exit activity driven by big IPOs, by Uber, Lyft, and a handful of other unicorn companies. What really stands out and I think is going to be interesting here is this is the dichotomy between the capital that has exited and the number of exits.

And so as you can see here, over the last several years in particular, the either plurality or majority of capital has been exited via the IPO market. And so what you find is, you know, an Uber, for instance, there is maybe two or three potential acquirers that could even, you know, manage a price tag like that, and the only real option for them to is to go public.

And so what you can see here is that less than 10 percent of exits happen through IPOs, but it's the vast majority of the capital. And so, really, it is the companies that have no choice but to go public that are choosing to go public now, or, as I mentioned, the healthcare companies which kind of stand out as an anomaly with, you know, almost half of them now choosing the IPO market.

But I think that it's really interesting just in

terms of the capital availability, which I'll go into a little bit more after this. But, really, companies are only -- are primarily looking to get acquired when they are VC-backed.

The other thing I'll point out here is that T-line on top, on the right-hand side of private equity firms being acquirers, they have gone from 10 percent of acquirers of VC-backed companies to 20 percent over the last decade. I mentioned some of the drivers behind that a little bit earlier, but that's another trend that we expect only to kind of continue going forward.

And then, lastly, what I want to touch on a little bit here is the secondary market and direct listings, because I think that there is a couple things that are happening in these areas that are really kind of driving a lot of the IPO trends that we're seeing in the VC space.

So the first is -- this is the median amount raised by companies at the time that they go public. And so what you can see here is that companies now are raising, you know -- half the companies are raising $160 million or more in private markets before they go public. And so it really is not a matter of needing the capital. What this is showing here is the offer size of the IPO divided by the pre-money valuation.

And so you can see we're at at least decade, if not all-time low, in terms of just the amount of capital that is being raised relative to how big the companies are. And so, obviously, the capital availability is there in private markets for companies who want it. And so what we'll see is companies raise as much capital as they possibly can in private markets before they go public.

I think Postmates probably provides one of the best examples of this. They filed in -- officially, it became public in early 2019 that they were going to go public. That was just a few months after they raised $300 million, and they went on to raise about $400 million throughout the course of 2019, while their filing was still out there.

And so with the market knowing that they are going public, that they can raise capital that way, they decided to raise money in private markets instead, which I think is kind of an interesting, you know, way that the markets are working.

Just yesterday, Casper actually announced that they were going to raise money publicly instead of privately because they couldn't in private markets, which is one of the first times that you've kind of, you know, even heard that concept. So it's definitely a shift in terms of, you know, where companies see the ability to raise the capital.

One thing that we think is really driving the move

towards companies staying private for longer is the secondary market. And so traditionally one of the big impetuses for an exit, whether via IPO or acquisition, was to provide liquidity to both early investors and to employees.

Now we've seen a growth in the secondary market where people can sell their shares in private companies back and forth. One of the things that we think has enabled this actually is the JOBS Act. So it used to be that you could only have 500 shareholders before you could go public. Now you can have 2,000 shareholders before you can go public.

And, you know, at the time the JOBS Act, Facebook, was ready to list -- and they actually said that they would have stayed private for longer if they could have had 2,000 shareholders.

And so, increasingly, what we are seeing is these companies now can expand their shareholder base and it is allowing them, we think, to stay private for longer as they are able to get liquidity for both early investors and employees.

Yes.

A PARTICIPANT: *12:22:31

MR. GELFER: Yes. So I think that those dynamics are definitely at play. Like I mentioned the asset managers, T. Rowe, Fidelity, the hedge funds, they know,

obviously, you are better off investing earlier before the IPO market goes up.

So I think it's kind of hard to disentangle because there are so many different constituents here. Like there is the founders who have, you know, different motivations sometimes than -- depending on where they are in the funding life cycle, but I think that is definitely something that is at play.

And so one of the developments that we think is kind of one of the best illustrations of everything that is going on in private markets is direct listings. And so this is essentially a mechanism for companies to move into public markets without actually raising capital.

And so, you know, going back to that kind of consistent theme of companies not actually needing the capital when they go into public markets -- Slack and Spotify have both done this in recent years, and there was a lot of consternation about whether there would be volatility or how these companies' after-market performance would be.

What we found is that the volatility has been relatively similar. The companies have traded down a little bit, but it has not been different than how their peer groups have traded it in public markets. There has really been a push by venture capitalists, particularly in Silicon Valley, who think that the IPO process is broken, that it

kind of just enriches bankers. There is no need to do a roadshow. We have technology now that opens markets every day with an auction. Why can't we just do that for our shares?

And so one of our predictions for this year is that there is going to be at least three more direct listings. We actually think that number might be a little bit low, just based on some of the bankers who have been involved in early deals and are advising.

But we think that this is an interesting trend in the VC space, just particularly as VCs are kind of keen to be innovative and disrupt things. And also, we think that there just is a dynamic in the market. Right now we're -- maybe that traditional IPO path isn't as needed as it once was for private companies.

And that's the end of my prepared remarks, but I'm happy to take any questions that you all may have.

MR. LEE: I have one question. So one of the FESIS and topics that has been a discussion of this Committee, including the Commissioners, was we also want to create more opportunities for our retail investors to responsibly, obviously, participate in this asset class. And I'm making some assumptions, but it seems to me that the vast majority of gains that you were describing in your presentation -- obviously, as realized by wealthy or institutional investors, not even, you know, wealthy, accredited investors.

So I was wondering if you can comment on that topic, of if you were -- knowing all of the data you have, given that this issue is very politicized, a lot of investor protection advocates, and so on, claim that the reason why retail investors shouldn't participate in this asset class, it's very risky, and it's dangerous, and so on.

And yet the data that you're describing seems to be the opposite. It's very lucrative, which is why everybody with money is trying to get into the space.

So if you were -- you're not on the policy side, but if you were on the policy side, how would you balance those, you know, valid claims, right? I mean, clearly, investment protection is an issue. But, clearly, this is an asset class that is not open to them and a lot of people have resources, are realizing a lot of gains.

MR. GELFER: So I think that one thing that is important to point out in venture is, basically, however you slice it, it is one of the most risky asset classes to invest in. So when you look at the returns, oftentimes it is biased towards the companies that have succeeded, the firms that have been investing for a long time. And so that's one thing I do want to note is that the level of kind of variability that we see in terms of returns is very, very

high.

So the average fund does not beat the market. The top quartile of venture funds typically does not beat the market. Oftentimes you have to be in that top decile of venture funds in order to actually beat the market. And so I think that's one of the challenging things for retail investors is a retail investor in public markets can go buy an S&P 500 index fund. They can buy an MSCI World index fund and get a little bit of exposure to everything.

If you actually look at an index of venture capital, it does not perform very well. The whole strategy is predicated on being in some of these companies that are driving, as I mentioned, that top quartile, that top decile of returns.

And so I think that that's the real challenge for a retail investor is, how do you give them a mechanism that is going to allow them to exit -- access the exit -- access the asset class, excuse me, while taking into consideration that it really is kind of predicated on access and being able to get into that top, you know, small percentage of deals and that indexing really isn't a viable option.

MR. SOLOMON: So there are some proposals that are in front of the Commission to change direct listing rules so that companies can raise capital. Have you been hearing more around that from VCs? And do you expect to see

companies trying to do that, you know, at some point in the not-too-distant future?

MR. GELFER: Absolutely. So they are actually working with the Chairwoman of the NYSE right now trying to get that kind of through to be able to do it. We think that, you know, there is a concerted effort, particularly from kind of the most prominent VCs in the space, and they are working with some of the best bankers, and so, you know, given everything that we have heard, there is a strong believe that the entry market is fundamentally broken.

So we don't think that any of the VCs are going to stop kind of trying to do this. And from what we have heard, that kind of being able to raise capital at the same time of direct listing is kind of the -- what you would need for it to become mainstream in terms of that space.

MS. GARRETT: One of the slides that I found interesting was early on where you talked about that for companies that have already raised capital, I think you said the average second deal size was 12 million for people in Silicon Valley, and 100,000 for people in Florida.

MR. GELFER: So that was capital availability. So when you look at the total amount of capital that's held in local VC funds, and just divide that by the number of companies there.

So like if every company was to go out and raise

an equal amount of capital from all of the local VC investors, how much would there be available?

MS. GARRETT: But I guess to me there were a couple of points there. One, obviously, there is the disparity in regions; and, two, these are also for companies that have already raised money, as you said. So where do you see the VCs? Are they angel, you know, investors raising money in the first round? Where are those dollars coming from? And what does that allocation look like?

MR. GELFER: So most of the first rounds that we see in our database are coming either from angel or for seed investors. What we do notice is when you go outside of Silicon Valley, the proportion of companies that either raise a grant or some sort of crowdfunding, definitely goes up in terms of having to raise additional capital outside of those routes.

And then friends and family, which is obviously hard to quantify, we actually have a piece of research that will be published next week that is looking at what we are calling alternative venture sources of financing of these very early stages of where companies are going.

But, in Silicon Valley, I would say almost all of the startups that we track are raising, you know, sizeable seeds. But then when you go outside of there, you are seeing more grant financing and more kind of support either, you know, from some sort of government-based entity or a non-traditional kind of VC route.

MS. GARRETT: And then would those companies outside of the Silicon Valley area be able to get a venture capital financing raise as their second raise of capital?

MR. GELFER: So typically what you hear from companies outside of Silicon Valley -- and this is not true just in the U.S. I was actually in Manchester, and it was the same story there, that when you are raising your Series A or Series B, you have to get a big Silicon Valley fund to anchor it.

So, like, it's not even in the U.S., it's halfway around the world, where people are saying, "Yeah. Like when you get to the Series A/Series B round, you kind of have to have connections in Silicon Valley."

MR. SEATS: James? Over here. Sorry. So what are -- one of the other big pieces of market data that I know PitchBook also tracks is LP data.

MR. GELFER: Yep.

MR. SEATS: And, in particular, public LPs who have to disclose and publish, you know, sort of how they are allocating money. And so I'll frame another narrative, would love to have you sort of react to it. But in a lot of markets, in a lot of the states, Martha, where there are zeroes, types of -- you know, for some of these financing

types, there are large public vehicles that have an increasing allocation to venture capital. However, none of that money is flowing to funds that are formed to invest in those local markets.

And so would love to hear about sort of -- we have -- you paint a picture about sort of where deal activity is, and we can go look at sort of the map, and it's obvious that New York and Boston and Bay Area are -- you know, that's the -- that's the majority of venture investing. That's where the funds are.

But it's interesting that the dynamic in many cases is the money -- the original source of the money is in the rest of the country, and then the screaming need for the capital is in those same markets. But the capital -- the capital allocators are incentivized and/or structurally aligned to move that money to the coasts, away from their local markets.

And so I would love to have you maybe talk about that a little bit or react to if you agree with that or not.

MR. GELFER: Yes. So I'd say that that is definitely accurate. One thing to note is just given that a pension system has ongoing liabilities, and VC is a very illiquid asset class, we tend to see a smaller allocation from pension systems than we do from something like an endowment or foundation that theoretically has an indefinite

investment timeline.

But in terms of the pensions that do invest, we have seen them start to invest a little bit more, and part of the reason was a lot of the most prominent VCs have traditionally been hesitant to invest -- receive investment from public pensions because of FOIA requests and the fact that we can go ask someone what their VC returns are if they have a public pension system.

Sequoia just about 18 months ago actually took public testimony for the first time in about 25 years because they have kind of said, "We're at the size now where we're fine taking public pension system money." So I think that one of the things, quite frankly, what these --

MR. SEATS: Don't just lock in on pension, though. I mean, include in -- like any large capital allocator. Same dynamic.

MR. GELFER: Okay. Any large capital allocator. So you definitely see that. I think one thing that drives it is for a lot of these institutions, like I mentioned, it's hard to get your VC allocation. And so if you're going to go invest in 25-, $50 million funds, and you're, you know, a pension system or an endowment, right, that has billions of dollars, it is just hard to move the needle on your allocation.

So I think, frankly, that's one of the things that

drives people to Silicon Valley. One thing that we have seen is a lot of kind of local initiatives where a -- you know, the pension system or a foundation will -- this actually was just happening in Florida. They started the Florida Growth Fund that works with some local angels and VCs to kind of bring in deals and supply some capital as well.

So that's I think the model that is going to have to be implemented, if it is going to work is, you know, that funding being provided from sort of a local entity that is seeding an angel group, or something else, that kind of is targeted towards an explicit purpose.

I think one area where this probably makes the most sense is impact capital, which is something that has really been getting traction lately, particularly as there has been a push to fund things outside of Silicon Valley. So I think like for a lot of these -- whether it's endowments, foundations, public pension systems that have kind of an explicit purpose behind them as well, that's kind of a natural avenue to team up with local investors who are operating from a similar mindset.

MR. DEAN: You mentioned as part of your discussion of public pension funds that some are doing their own direct investments rather than going through funds. Could you explore that a little bit?

MR. GELFER: Sure. So public pensions are some of the ones that we see kind of, you know, least likely to be doing this, just given how their liabilities are. But sovereign wealth funds in particular, like I mentioned, because they are big pools of capital, because they essentially have an indefinite investment timeline, they are not worried about the liquidity in venture capital.

And, you know, sovereign wealth funds are several billions of dollars, if not a trillion in some cases, and so they can't allocate to those VC funds. And so what they have done is actually built in-house venture capital teams themselves.

In private equity, this was referred to as the Canada Model because a lot of the big Canadian pensions have actually gone and started their own private equity systems. And so what we're seeing is a lot of sovereign wealth funds. Quite frankly, the most active ones are the ones from the Middle East who are coming and actually setting up offices in Silicon Valley to be doing direct deals themselves, you know, one, just because they can get bigger allocations that way, and it lowers the fees.

But I think there is a variety of things that are kind of pushing entities towards doing the deals themselves rather than having to go through an intermediary and a fund.

MR. DEAN: So not U.S. public pension funds,

per se, or --

MR. GELFER: So I did pool U.S. public pension fund data. The level of direct investment from them is actually very, very low. And like I mentioned, there's a few reasons for that in terms of FOIA requests and people just being hesitant to, you know, receive that capital.

MR. DEAN: Okay. Thank you.

MS. MEHTA: Hi. This is really, really insightful, very helpful. I'm just wondering if any of these valuation sizes and deal sizes, how much, if you know, is skewed by like Soft Bank, for example, that, you know, flooded the market with capital and kind of skewed the data a certain way?

MR. GELFER: So, as you saw, we have about 10,000 deals for the last year. We get valuations for about three-quarters of them. And so if you look at an average, it's going to be skewed a little bit, but we think like, by and large, when you look at those kind of quartile distributions, that Soft Bank effect probably isn't as big as you might think.

Another thing just to point out with Soft Bank and the market is it really is an outlier in terms of, you know, the financings that they are doing. Even, you know, Sequoia and Kleiner Perkins, these firms that have $8 billion funds, the type of financings they are doing look fundamentally

different. And so it's pretty easy for us in terms of analysis to be able to kind of lop off that kind of, you know, top little portion of what Soft Bank is doing and say they are a completely different sort of entity.

So we have included their deals here, but when we look at the aggregate and kind of strip them out, it doesn't tend to change the numbers so much, just given how big the sample size is.

MS. GARRETT: My question is related to that. You have a slide about U.S. VC deal activity by year. And, in 2019, you know, obviously, we -- it has gone up a lot, but I kind of wondered how much of that amount is skewed by really large transactions.

MR. GELFER: Yeah. So --

MS. GARRETT: And, therefore, what would be the kind of more average or median transactions?

MR. GELFER: Yeah. So it really is going to depend by stage. So like the early angel stages, likely can look at the deal counts and kind of break it down there. I think probably the most helpful metric to know is that from the kind of top line deal-making activity there was 250 deals roughly of 100 million or more that contributed about $60 billion of the total capital invested last year.

MS. GARRETT: And then how many -- I mean, if you have the numbers, how many deals would be -- would there be

that were smaller? And then what would that average be, if you took that?

MR. GELFER: Let me just run back --

MR. SEATS: I think Slide 18 is the one to look at. I mean, it's declining deal count at seed and angel stage.

So you could -- I mean, so the aggregate market charts are interesting, but in very real teams, I mean, think about how much the U.S. economy has grown and changed in five years from 2015. And there is a -- what is that? 15 percent decrease in effectively new company formation in this category, right?

MR. GELFER: And then I do have this proportional slide here, too, that might be helpful if you're just wondering in terms of the breakdown between the stages.

So the chart on the left is showing the count of deals proportionally stacked, and then the chart on the right is the capital invested proportionally stacked.

MR. LEE: I think -- so, I mean, kind of within the same theme, exactly because of the regime, one of the recommendations actually this Committee adopted is to kind of balance the investment protection issue that we talked about, allowing non-credit investors to participate in the same pooled vehicle as a professionally managed capital manager.

But if you could maybe touch on the dynamics of -- you put it greatly -- the incentives of the managers themselves, because even if we had that law, I can't imagine Andreesen Horowitz, for example, being, all right, we'll take 1,000 investors.

So, but I think a lot of the Florida managers would because they would love to invest a million dollars into their community. So have you -- do you have these discussions with the actual fund manager or analyze the growth or the incentives of the professional fund manager themselves? Because, you know, as an example, in the last meeting we had, we had the General Counsel of Blackstone, for example, talk about this, which is, again, very different from the small capital investments.

So I was wondering if you can kind of touch on that basis of, if we had that kind of rule, could that actually change the dynamics of increasing capital to small sizes and middle of the country?

MR. GELFER: Yeah. To your point, Andreesen Horowitz is not going to entertain an individual investor who is trying to write a $100,000 check to them.

So I think that, you know, obviously, they are not at the same scale as -- you know, of BlackRock or Blackstone that is trying to do the same thing, but I think that the answer is similar in terms of you're going to have to find

what we refer to as a fund-to-funds vehicle, so something where a whole bunch of retail investors can put their capital together and then go and commit as a single entity into a VC fund.

And so I know that Hamilton Lane and a couple of others have been looking at kind of pension plans, how do you do that with a 401(k) where you can allocate capital together to pool up, because even small institutions, quite frankly, small endowments and foundations, they don't have the ability to write a check big enough to get into some of the big VC firms.

So I think like in terms of a retail investor, the only way to kind of make it a kind of viable option, even for something like a small Florida fund, would be to have some kind of fund-to-funds mechanism where you could pull those endowments together.

MR. LEE: I'm saying, is it not possible to separate -- because I think what you're saying, yeah, you're going non-credit investors access to the asset class by giving them the funds and then they can go into Andreesen, or whatever, but I think the point is, no, they actually want to invest in their community, right?

So the fund-to-funds is not likely going to allocate to a $5 million angel fund in Florida. So, I mean, does that make sense? Like how do we align the capital to

the desire to invest in a specific part of the country that is just not getting it because of structural reasons?

MR. GELFER: Yeah. So I think that you definitely can set up a regional fund-to-funds. And there are actually angel funds that we have in our database where it is essentially 50 individuals who have gone out and said, "We are going to pool our capital together to make investments."

And then oftentimes what they will do is they will serve as what are called "scouts" for venture funds. And so that fund of, you know, obviously not retail investors, but people who are more like-minded to be going and finding local investments, they will essentially work with more prominent VC firms to help them find deal flow outside of their local market and use that as a way into venture funds.

And so, you know, quite frankly, I think it's going to be really hard for like a one-off individual, a retail investor, to find a way to effectively invest in these markets, and, you know, how you would want someone to be well-informed and being able to do it. I think like you have to have some sort of, you know, pooling of knowledge at the local level if you're going to be going it at any sort of scale.

MR. SOLOMON: So I have a couple questions to just -- just looking at some of the data. First of all, I think it would be really helpful -- and, obviously, you can't do

it now, but it would be great to see if there is a way to bifurcate by industry. And I think, you know, you highlight a few slides in here about, you know, health care versus non-health care. I think that actually tells a very different story. We do the same analysis.

I also think SAS and software, if you look at that versus some other areas, that will tell a very different story. And that we'd love to see the data with some of those sets, some of those bigger sets that are probably skewing medians, because it will probably be a little more granular for this Committee to be able to see if there are ways to maybe develop other vehicles or focus on other vehicles that maybe aren't going after the same industries.

And I think if we look regionally, you know, there are certain industries that are -- that are more well-equipped to sort of be in various regions of the United States, and we never get to really see that data. So I'm curious to see if you have -- you know, there is a big category in here for -- I was just looking through this on -- there is a section called "Other."

MR. GELFER: Yeah.

MR. SOLOMON: Like, all right, that's probably the largest allocation. Love to know what's in that "other."

MR. GELFER: Yeah, absolutely. I tried to aggregate things as much as I could for this conversation.

We actually have a team of analysts --
MR. SOLOMON: That was on page 27 for everybody that is --
MR. GELFER: We actually have a team of analysts at PitchBook on the emerging technology team that -- it's about eight people who are solely focused on different areas of the market, whether it be artificial intelligence, mobility, so, you know, automotives, fin tech. And so I'd be happy to share that breakout with you as well as, you know, if there are specific areas that you want to look at. We have a lot of different ways that we can slice companies, either, you know, by vertical or by traditional --
MR. SOLOMON: So I would say there are two vectors that I would love to see is -- the regional breakdown by industry. So it would be really interesting I think to see if there are pockets of activity happening regionally that maybe we, as a Committee, and maybe the SEC, can explore why that is happening in that area, and if there are some dynamics in that area that are really driving capital flows, then maybe we need to expand to other areas of the U.S. I think that would be one.
And then I have just a different question on page 9. So looking at this data, up until about 2014, people didn't have to travel so far to get early VC

investments. What happened in 2014?
MR. GELFER: So as I mentioned, over the last several years we have seen activity move out of Silicon Valley. And so while there is kind of, you know, under investment throughout the rest of the country, we actually have seen a pretty big uptick in other areas as well. And so I think that's one of the reasons why you have seen that number drive up so much.
Like I mentioned, I was just in Florida last week, and there hasn't been a late stage round that -- or an early stage round led by a local investor there, you know, in months. And so I think like as you just see these ecosystems develop across the country, the fact that, you know, most of the capital still is in Silicon Valley is that you are seeing that metric kind of just move up as those Silicon Valley investors are going further and further afield across the country.
MR. SOLOMON: Okay. So that's interesting. So what would be interesting to lay off across -- because it tells -- what you just said tells a very different story than what I was maybe intuiting. It would be great to see if there is an increase in the number of investments regionally that then have to travel.
That's a very different dynamic than, you know, if there has been a significant increase in the number of small

companies being formed in regions, that then actually go somewhere, that's a very different story than I think the one I intuited from this, which is, wow, the capital just moved out of those regions and into the coasts, and that's why people have to travel further.
MR. GELFER: Yeah. No, definitely --
MR. DEAN: You almost want to see --
MR. GELFER: -- more capital --
MR. DEAN: -- that chart that -- it's like three different markets versus the rest of the country.
MR. SOLOMON: Right.
MR. DEAN: Like what's the California version of that chart? What's the New York/Boston version of that chart? What's the rest of the U.S., excluding those three markets, version of that chart?
Because what I think the narrative -- the explanation I think is that it is actually capital becoming more available to the rest of the country. Is that right?
MR. SOLOMON: Yeah.
MR. GELFER: So there is actually a fund right now called the Rise of the Rest Fund, which --
A PARTICIPANT: She's right here.
MR. GELFER: But if you think about that fund and this chart, right, like we have a single location for the fund. And if you make an investment on two opposite ends of

the country, all of a sudden that metric goes up a lot, too. So I think like it is indicative of, you know, more capital being spread a little bit more thinly, but just, you know, any individual data point is going to pull up that number.
MR. FOX: You know, Jeff, that's -- while I was sitting here reflecting -- and I think your point on industry is I'm trying to get a handle on -- is the question where the money is? Or, you know, is it where the ideas and the concepts really are, right? Because, I mean, you know, from my viewpoint, and, you know, on the accounting side, we don't necessarily always -- at least in my firm, we always deal with the early stage, right?
But we -- you know, it seems to me that the world is a wash in capital to a certain extent, and good ideas, you know, I'm not saying they always get funded, but, yeah, I've seen a lot of examples where somebody has a good idea, and with the right contacts, you know, you can get funding easier than I could -- than I saw 10, 15, 20 years ago.
But, you know, when I started looking at this, I look at things like in Silicon Valley you also have alumni of a lot of those companies that were successful that come out and they know how to -- you know, they have ideas, they have seen how things actually get transformed, they know how to run that sort of stuff. You have a lot of research institutions.

I look at even like some of the other things around here, like Minneapolis, you've got 3M, Medtronic, you've got all of those alumni, you've got a big history of a lot of startups there. You know, and so you've kind of got pockets where you actually have, you know, idea creation going on.

And so I kind of wonder if the issue is, is like, are the other factual questions that are causing where funding is happening and startup creation is happening versus, say, where the capital is located? Because, I mean, I've got to tell you, I mean, my experience is is whether a venture fund/capital fund is located in San Jose or, you know, New York or Chicago or Miami, they get on planes and travel all the time, right?

And I don't know that they have a bias towards it being in one particular location, you know. Now you've got to have the right connections to connect you to those funds, so I'm not saying it's not a problem.

But I'm also wondering if it's truly just where the funds are versus, you know, for the companies that are looking to go upwards, and then there is another subset of the -- you know, the companies that aren't going to have this massive upward trajectory that are just the small businesses looking for capital that are going to probably stay small over time, and are they struggling because of the

flight of capital to the coasts? And is that two separate issues that we're talking about here?

MR. SOLOMON: Well, on that, so do you track the movement of companies? So is there a data that -- just like what Robert had mentioned, you know, companies who got to a certain size, got funding, moved to the coast. Like how many of those happened? Because that would be something that I think would help to -- help us to understand that narrative a little bit better. Or is it not happening? I don't know.

MS. GARRETT: Just to add on that point, I mean, we've heard that -- may not in this room right now, but we've heard that some companies are forced to then move.

MR. GELFER: Yeah.

MS. GARRETT: So they might be located in Florida or Missouri, but then once they get funding from their venture capitalist in these coastal regions, they are forced to move their headquarters to a Silicon Valley or a New York or a Boston. Are you seeing that?

MR. GELFER: So we definitely hear that as well kind of qualitatively. It is very difficult for us to quantify that because a lot of companies when they raise startup capital will open an office in the Valley, and we don't know whether it's their headquarters or not, so we haven't been able to actually pin down how many are actually

being forced to move, but we do have data on, you know, companies that, you know, have a headquarters elsewhere, and then also have an office in Silicon Valley as well.

MR. SEATS: Can you react to Robert's question, though, on -- you know, I don't know if there is a succinct reframing, just to refresh the question. But, you know, do VCs travel?

MR. FOX: Yeah. Do VCs travel or not? I mean, I'm just curious.

MR. GELFER: So the answer is --

MR. SEATS: And do they have preferences where they travel, or are all places equal?

MR. GELFER: So the answer is, yes, they travel, but I feel like the bar for traveling is pretty high. And you mentioned connection several times, so I think, like, if you're a VC, and you're going to fly out to Denver, like what is going to actually compel you to go out to Denver? Probably because you know that founder or some other founder has recommended them to you.

I think it's really hard if, you know, you're starting from scratch in Kansas City or something like that, and it's like, hey, I'm just going to, you know, attract investment here. I think that that's one of the big barriers, like you mentioned connections, that just -- it can't be overstated in the metrics space.

MS. MILLER: I also think it's telling to look at Slide 9, which is the chart that he put up early on in the presentation about the median distance between the investor and the target by stage, because you see that the number of miles is correlated to how much money they can deploy and make that flight worthwhile. They are not -- it doesn't look like the flights are happening, or if they are, they are not factoring into the averages or the median quite with the effect that you might hope. But early stage still remains the local metrics, whether you talk about it as a car ride that's an hour or two away, but those numbers I think are really interesting to the question that you were asking, Bert.

MR. GELFER: The other thing to point out here, too, is, you know, while VCs will be willing to invest outside of their local area, if you have -- you know, a VC fund typically has -- we'll call it 25 portfolio companies, there is obviously a limit on how many you don't want -- you want to have to go on a plane to, right?

So I think that that's another factor as well is like, out of a portfolio of 25 companies, you know, we can all think, how many of those are you actually going to be wanting to visit multiple times a month, having to go on a plane?

MS. MEHTA: Yeah. In addition, I mean, a lot of these VCs that we're talking about take, you know, a controlling position or, you know, a big stake of the company, and they often take a board seat. And so when you imagine, then, like having to travel for board meetings, and you're very -- you know, they tend to be very involved with the company, and it's just harder to do when there's more distance.

I mean, we're a different kind of fund because we don't take -- we typically don't take board seats. And we like to, you know, spread money around to a lot of different companies, and we like to be catalytic capital and encourage, you know, some of the regional funds as well to invest in those companies in their own backyards. And so, but I think we're a very different model than most.

MR. YADLEY: I think the information you have --

MS. MOTT: This is Catherine. Can I -- one of the things I can speak to is like more testimonial, is that what we see is that a lot of our big companies that have been well funded, like Argo out of Pittsburgh, it's a spin-out of a CMU, they have to locate to California.

I'm invested in another company where -- it's one of Peter Thiel's funds. Peter Thiel will not travel to Pittsburgh for a board meeting, but everybody else on the board has to travel to Peter Thiel's office.

So there is a dynamic that I see locally, which I

don't think you can identify in your data, but I think for this group to think about is what we see as the reason companies are getting funded by the California companies locally, and then of course having to locate, like Sapna was saying, because they have to locate to the west coast because they want to be close to the C suite.

The dynamic is that the reason our companies are getting funded in California is because a lot of those folks are CMU grads that from the previous companies are partners in those funds. So there is a personal connection to those funding situations.

So if you have -- so, you know, again, I see a fact, a dynamic, again, which we can't track because this is -- this dynamic is all about connections. If you don't have those connections to Silicon Valley, how likely will your company be even looked at? Thanks.

MS. MILLER: Catherine, I think further to that observation, one thing that we have heard -- and last week we heard it a couple of different times -- we were away from D.C., engaged in outreach, and particularly focused on Latin X and Hispanic business owners.

And we were talking about where are the sources of capital coming from, and we heard the narrative that we've heard before, which is, when you talk about their strategy, the people who are kind of the community mobilizers that are

trying to bring capital into the community, talk about their plans for creating these fly-in days, and their strategy is not around mobilization necessarily of local capital. They would love to see that happen.

But much of the energy is focused on figuring out, how do you get people on airplanes and buy them plane tickets to get there? That is what a lot of communities are thinking that's -- this is the ticket. This is how we get our companies funded is we start buying plane tickets for venture capitalists, and we fly them in together, and we put on these roadshows and try to show off our community.

And we have heard it again and again, that the strategy has moved away. In some ways, they have realized maybe the local mobilization is more challenging than buying plane tickets for those that we know already have a fund set up and capital that they are looking to deploy.

And I just think that's a very interesting dynamic, particularly in light of last week. So we were hearing all of that at the same time that the Volcker Rule proposals came out, which I know that Chairman Clayton highlighted earlier. I would encourage anybody who is interested in that topic to look at it and provide comments and feedback on the proposed changes to the rules that would have the effect of allowing community banks to invest and support venture capital funds.

It's something that we have heard a lot of people anecdotally talk about, the changes the Volcker and how that impacted community banks' ability to support companies locally to be the lead anchor in a local fund, but encourage people to take a look at it. Most people if you hear "Volcker" and "updates," you might not think, okay, small business capital formation; I plan to pull that out and look at it.

But I do want to just give a plug for anytime we put out something for comment -- and that is jointly with other regulatory agencies -- it is critical that we actually get feedback on whether or not you think this does something good, whether or not you think we need to make further changes to it, and so there is a lot in there, but encourage you to take a look at that because that is a very relevant topic.

As we look at the interplay with the topics that we are talking about today, I can't stop thinking about all of the other moving pieces of what we have going on here in the agency.

MR. YADLEY: James, thank you very much for being here. This has been really helpful. A couple of things you've said -- critically, the fact that most venture investments don't work out, which people have to remember. And the travel time and the energy it takes to make an investment I think focus on keeping the connection between local money/local companies is important because it takes slugs of money.

And Silicon Valley, you have this network of people who know each other, alumni of companies who can put together 300-, 400-, $500,000 through half a dozen people, and if it doesn't work and there is no promise, that's that. But there are successive rounds there. So sort of the pre-seed and seed rounds -- on the west coast of Florida we have tons of small companies, and they are raising money all the time from local people.

You can fly an investor in to look at these companies, but without a connection and a company that fits a platform that the VCs are constructing, it's just another company with a business plan and a good idea in a sector that's hot. And how do you make those investments?

So I think the pooled vehicles definitely is something that we're going to talk about because diversification for the investor side -- for the companies, the match -- making that match is always important. It's going to take contacts.

But at some point along the way, there has to be traction or you're not going to get beyond those smaller funds. I mean, to get some of the name-brand funds, they are not going to invest $20 million and there is no need for

them to invest $1 million, because there is nothing proven yet and there is no distinguishing factor.

MR. GELFER: I definitely agree with that. And, you know, I think the Utah example that I pointed out earlier of just, you know, you need those successful exits where you're going to have someone in the ecosystem who knows how to do it.

And, you know, one thing that we've been hearing a lot more, I mentioned a little bit earlier, is scouts. So essentially that is angel investors who have relationships with existing VC funds and are helping them to find deal flow, typically for areas outside of Silicon Valley.

I think that's an area that sounds, you know, particularly promising in terms of identifying new opportunities.

MS. GARRETT: This is to follow up on what Greg just said, and also what Youngro said a little bit earlier, and you -- you mentioned, which was that you're seeing small angel -- and what you've just mentioned right now, small angel investors pool together at the local level to invest in local companies.

But what you also said is that often that those -- those funds need to actually tap into larger VC funds. Is that what I understood?

MR. GELFER: So typically the model there, what

will happen is you'll get angels who will band together and do one of those initial kind of 500,000, $1 million rounds, and they will, in those rounds, you know, essentially get into the cap table. And then, for subsequent financings, they will have the ability to invest at a pro rata rate.

And as those rounds get bigger and bigger, typically the angels will reach a threshold where they say, "I actually don't have the capital. I like this company. I want to stay invested." And that's when they will team up with a venture firm who can provide more capital going forward.

MS. GARRETT: Okay. So, at that point, the venture capital company is actually investing directly into the company.

MR. GELFER: Yes. Yes.

MS. GARRETT: Okay.

MS. MOTT: This is Catherine. We have quarterly calls -- well, first of all -- angel groups syndicate deals, and we're still around, so you'll get three or four angel groups that will syndicate and go around. But also, I mean, we have learned to have these -- to build these relationships with VCs, and we have quarterly calls with a set of VCs, and we're meeting new VCs all the time, but it's because we have to, if we want our company -- our company to be successful.

Oftentimes, though, that does mean they move out of town, rather than stay locally and create the jobs here where there is talent, by the way.

MR. SOLOMON: When you visited some of these areas like in Florida, have there been any suggestions that have been surfaced, have some of these dialogues about how to foster, you know, more capital formation locally, than just -- other than, you know, private-public partnerships and the things that I think we have all seen. But has there been anybody that you have heard who has identified some impediment that maybe we should be considering?

MR. GELFER: Frankly, I haven't heard anything specific. I think, you know, we've kind of touched on a lot of big ones. You know, in Florida, I thought it was interesting there was a big $1.5 billion exit, and they were asking, you know, a panelist of seven VCs what they thought was going to be like the key to growth, and almost every single one of them said, "Well, hopefully, some people from that exit will go off and start, you know, angel syndicates and start investing here locally."

So I think that, you know, there is kind of a playbook, and there are certain areas I think -- you know, Utah, like I mentioned, is when you look at the activity, it is definitely disproportionate in terms of how many people are there. And I think like it's just -- they have two strong research universities. They have a very entrepreneurial kind of mindset.

They have some local successes that have been able to recycle money, and so I think, you know, I typically hold that up as like one of the examples of, you know, an area that you typically wouldn't think of having a good VC ecosystem and kind of like laying forth a blueprint for how to do it.

MR. SOLOMON: It's interesting, you know, we've talked a little bit about this. So there are definitely pockets of capital in a region that -- in regions that are actually looking to the coasts to invest, which is -- it's sort of you get capital flagged. Have people talked about that also?

MR. GELFER: I don't hear as much as about that, but where you do start to hear it is the larger funds that are coming into play. So, for instance, in Seattle, I think -- where I'm from it's a good example of a going venture ecosystem.

And a few of the bigger funds now that have been around for 20, 25 years, increasingly when you look at the deals that they are doing they are actually going down to Silicon Valley, even though, you know, Seattle is up on that list of underfunded, and so there's Portland in between us, but, you know, those bigger funds are increasingly, to your

point, kind of going to Silicon Valley to fund those big deals as they get bigger.

MS. GARRETT: Do people have more questions for James?

MR. SEATS: Jeff, were you asking about that, or were you asking about LP capital?

MR. SOLOMON: Well, no. So I've just been -- I've noticed that there are big pockets of capital in the middle of the country.

MR. SEATS: Right.

MR. SOLOMON: They just don't seem to invest necessarily meaningful amounts of capital in the middle of the country. So if you think about the cities we have mentioned, they have significant capital resources, many of them, that would be more than enough to fund, you know, Series A rounds for companies and their own areas, but they are not.

And I just -- I'm not exactly sure whether there is an incentive structure for them to do it, but, you know, in many instances these organizations, the opportunity set is right underneath their noses and they don't seem to be necessarily doing it.

So I'll just -- you know, again, I'm not -- I don't want to pick on names, but there are -- you know, in my hometown, which is Pittsburgh, there's a lot of capital

in Pittsburgh, and there's -- there are folks -- and I know Catherine and I have talked about this -- there is huge pockets of capital that is dedicated to doing some venture financing. Oftentimes they are investing, you know, this old family money or some of the universities are investing in other areas.

MR. SEATS: Right.

MR. SOLOMON: I think there is a hope that by investing in other areas they can bring some of those areas back to the community, but there is no -- there is not necessarily a tie-in. You mentioned -- somebody mentioned Minneapolis. There is tons of family offices and great wealth that has been created in the Minneapolis area.

Yet I look here on some of your statistics, and Pittsburgh and Minneapolis are at the bottom of the -- at the bottom of the ecosystem in terms of the amount of venture dollars, as you define them, dedicated to those communities.

And I'm just -- I'm just wondering if there is a functional impediment that we can address, you know, that would foster that kind of collaboration where these pockets of capital are pooling money from the coasts, or is it just not on their radar screen? Are they only, you know, ROE or IRR focused? I just -- I don't know.

I mean, because it would seem to me, you know,

we're trying to solve it from a -- you know, from where we sit, but there is all this data that we're gathering that suggests there is capital there, there is companies there that probably need to get access to that capital, and they are not necessarily seeing each other when -- and I think that those pockets of capital could easily be drawing capital from the coasts, because, you know, I will tell you, you know, when we go to raise money, guess where we go to raise money? The middle of the country, because there is a lot of money there.

MR. SEATS: That's right.

MR. SOLOMON: Right? And then we take it to the coasts, right? That's what happens, and so --

MR. SEATS: Yeah. That's what I thought you were asking. I mean, that was the dynamic I was sort of framing earlier.

And maybe I'll just draw -- pull a thread through a couple of these things. I mean, I think to -- Bert, to your point, like the existence of the scouts by that type of program I think is evidence that there is belief in the venture industry that the talent is distributed across the country, like there is -- there is meaningful effort to go source the talent.

It's clear you can go measure -- the capital exists in those markets, and then you combine with that that it's a highly volatile underlying asset, very -- extreme variability on return profile, and which makes it potentially inappropriate for some investors. And I think all of that points to the right mechanisms are intermediaries and pooled vehicles that help bring the variability down and that help connect the capital allocators to local markets.

And then, in addition, sort of the -- that -- you know, this graph we've been looking at on the earliest stages need to be funded effectively by nearby capital. And so I think there's a lot of market dynamics that you can't change, like bigger funds make more profit, like you can't change that, right?

But I think the things that we can think about are anything that can make it easier for pooled capital formation, whatever that -- whatever form that would take in local markets, I think that's the thing. That's the ticket in my opinion.

MR. FOX: I agree with that, but the only devil's advocate thing I will throw out there is, I was sitting here thinking about him talking about South Florida, and there is a lot of hedge funds, there's a lot of private equity that sits in South Florida. So there is actually already a lot of capital allocators sitting there, and yet no one sat there and said, "Let's come up with a venture capital fund."

And so, to me, either there is -- somebody has determined the ROI isn't there, or there is some other structural impediment because there is a lot of other people that are allocating capital in that same marketplace and, you know, getting it probably from all over the country or the middle of the country there, too.

So it does kind of make me kind of curious, you know, what, you know --

MR. SEATS: My reaction to that -- and I think we'll hear some of the -- some anecdotes later from our guests, but the -- when you're managing $25 billion, and you decide you're going to put whatever -- five percent towards venture, there is only so many relationships you can manage.

There is only so many fund managers you even want to talk to, and so you self-select into the largest funds, which are not any of the ones that are in these ecosystems that are starting from zero.

And so if you're going to go raise a $50 million fund, or a $25 million fund, that would be catalytic for a local market, you sometimes -- these people won't even -- there is just a disconnect. And it doesn't have anything to do with the return profile. It has to do with the required check size, which is 100 percent a side effect of just the macro construction -- you know, construction of how these capital markets are honed together.

And so if you have to write a $50 million minimum check into a fund, what size funds are you going to talk to? Talk to billion dollar funds, right?

MR. YADLEY: There is also in places like Florida a real competing asset class, which is real estate, which a lot of people feel they can touch it and see it, and there is a momentum that is putting a lot of dollars there. Again, that's a very incomplete answer, but it's easy for people who are not already a veteran of an entrepreneurial company and has had an exit and wants to be an angel. They are just wealthy families, and that's right in front of their noses.

MR. GELFER: The other thing I'll mention -- sorry. Go ahead.

MS. MEHTA: Oh, sorry. Just to build on that, I mean, anecdotally, we have seen this in a few of our markets, you know, Dallas, some places in Florida where they are not used to venture as an asset class.

And so when I negotiate with them, you know, they are giving me like private equity-type term sheets and deal documents, and it's like making my head explode because I'm like, this is not a venture. This is not -- these are not venture documents, like you -- clearly, there is a disconnect between, you know, your risk profile between what you want to do and what you are actually doing.

And so we definitely see that where it's -- venture is just a different beast, but --

MR. GELFER: One thing I'll mention about Florida, too, when I was there is a lot of the investors who, you know, were not based in Florida but were investing would say, "I'm going to do my Florida trip because I have to hit Miami and Jacksonville, and all of these other places." And I think, you know, that's one of the reasons I like using the CSA framework as opposed to the state framework.

Ohio is another good example where it's like when you just look at statewide activity, like if you're a venture investor there, you can't cover the whole state in a way that you would be able to somewhere up in northeast where the states are just geographically smaller, too. So I think that's something that is at play in a lot of places where you would think that there's a lot of activity.

Chicago is another one where it's like the ecosystem there actually goes all the way to South Bend in Indiana, and there is like actually a much bigger geographic footprint than you would think in terms of the venture ecosystem. So I think that's just another thing to consider.

MS. GARRETT: Does anybody have any further questions for James? If not, then I'm going to thank him very much for all of the very interesting data that you provided, and thank you so much for coming to our Committee meeting today. It has been very eye-opening for all of us, so thank you very much.

For the Committee members, I have -- I think if we'd like to continue to discuss some of these issues that James has risen. We have until 11:50 to discuss these issues. So thank you, James, very much.

MR. GELFER: Thank you very much. Thanks for having me. And like I mentioned, if you all need any more data or any other follow-up, please let me know.

MS. GARRETT: Thank you.

Youngro?

MR. LEE: Yeah. I was going to -- just since we have more time, I do want to kind of put this idea. This is more of a rhetorical comment, but I think we're all -- even this conversation, we're really talking about basically, okay, like we know there is people with money or firms with money, and so how do we get those money to invest in local markets? Which is definitely a critical part of this discussion.

But I think the obvious question in my mind is, okay, well, besides that, what else is there? And, obviously, the other question is, okay, who are the people that are willing to invest in it and allow them to invest? And I think the whole point of this exercise is that there

is laws in place and there's structures in place that literally prohibit the people that do want to invest in that small town to not be able to invest because of rules and regulations.

So, I mean, and it's just a thought that I wanted to present, whether in this session or otherwise. There is very systematic things that went on here that we'll talk about, but how do we actually change? Like we talked about the regulation crowdfunding or Reg A or fund vehicles, because the people that are going to invest in Pittsburgh, and are happy to invest $50,000, $100,000, those people, like, there is zero possibility of them doing it even if they want to.

So I just want -- my reaction to this discussion earlier, it has been much more -- like there is clearly a systematic issue, but I think maybe where we as a committee can add more value is the other side of it, which is the people that are just not even covered in this discussion today, and that are people that really, really care about that community and are willing to invest in that community, understanding the risks, understanding that of course it's risky and they might lose money, but they do have the desire to do so if only they could.

MR. SOLOMON: So I guess my question is, is that a function of, you know, a regulatory impediment? Or is it

just a function of fund slows? And so when I think about how money gets raised, you know, there is many pathways. We have discussed most of them, right? Harmonization is geared towards streamlining that, and that's a great step in the right direction.

But, again, if I were sitting in a spot where I wanted -- and it was in my best -- it was in my best interest to reinvest in the community in which I lived, or to foster economic development in the community in which I lived, is there an impediment or a reason why I might not form a vehicle that included individuals or included, you know, local -- other local pockets of capital to invest?

And I don't know. Like that's what I'm asking. I think I -- we know what we know, we know what we don't know. I just don't know if -- if someone said, "Well, I'd really like to do this, except, God, there is this rule which kind of is in my way." Or have they just not thought about it yet? And, if so, you know, maybe we should have them think about it, and then if there is a way for us to be doing some things here that help to make that easier, great. But I just -- I'm worried that I'm not sure they've actually thought about that as a viable way to get reinvested. If anybody has any thoughts on that, it might be helpful.

MR. LEE: Just on that, I mean, so the answer -- I don't want to oversimplify it, but it's absolutely, yes.

And I think the accredited investment -- I think there is a prime example of that -- that limit, right? So I think it was the last session when Ross Baird talked about African American professionals in Baltimore that had whatever legal degrees, MBAs, whatever. They literally want to invest in whatever, their neighborhood coffee shop. They can't. By law, they cannot invest in that company because they're not accredited investors.

So that's a prime example of if the SEC's proposal is adopted and made into law, I think there is definitely some barrier that gets removed for people that are willing to invest in their community.

And I think the other example, which Jason talked about, and he has more experience than most, is the issue of intermediaries and influence, because like funds like what Jason is working on and what Sapna is working on, they are doing that, but they have no mechanism to accept money from people who are willing to then invest in those areas that they are focused on.

MS. MILLER: Can I just jump in because this is a prime moment for me to plug providing a comment letter? If you have thoughts on the accredited investor definition, we put out a proposal, and just so that you know, we do say that the comment period has an end date, but that doesn't mean that we shut down the mailbox. Things still come in after the fact.

Please share your feedback on whether you think the rule works as it is proposed, what changes you think need to be made, because we very much so value that. So I just want to make it -- just to reiterate as much as -- and I know that the Committee did provide a recommendation to the Commission on that topic. But it is critical that we have feedback, so just, again, as just a reminder that that is something that we have on the agenda.

We are very transparent with what we're working on, thanks to a congressional mandate, as well as just how we run as an agency. And it is something that is on the short-term agenda. So please do provide feedback on that topic, because it is one that we are actively seeking market input on.

MR. FOX: Well, just on a fact point, can I ask the staff to refresh us on some facts from that meeting? I mean, I definitely remember the conversation about the lawyers in Baltimore that are all securities attorneys that would like to invest.

And at a micro level, I don't doubt that there are people who want to reinvest in the community, but I also thought we heard a lot of facts about when you look at the definition of accredited investors, and if you change that definition, there -- I'm not sure it actually moved the

needle that much.

And if I just think about the general retail investor having a lot of their money in 401(k)'s, having a lot of not necessarily excess cash to invest, and that sort of stuff, I guess I'm just not sure -- and, Jeff, back to your question -- I'm not sure if you take your average retail investor that, a) they are going to have that much excess cash, and if they do, they are going to sit there and say, "Hey, I want to invest in my community," or am I going to pick the highest ranking fund based on Morningstar or whatever else.

I'm not -- I mean, some of them will make those choices. I'm just curious whether it's going to be enough to truly move the needle one way or another.

MR. SOLOMON: Well, so let me -- so we tried to solve a few things in our discussions, and, again, I go back to market forces. So I don't -- I think Youngro brings up a good point. I mean, there are definitely some structural impediments for individuals investing in things they know more about because they are not accredited.

And we I think provided some good guidance last time for how we should make exceptions to accredited investors, so that people who have a knowledge qualifier can get exempted relatively easy. That's an easy fix for people who want to invest some of their hard-earned dollars in

local businesses when they clearly have better knowledge on how to invest than I do.

And there is really no reason why I can invest because I'm accredited and they can't. It just -- it makes no sense to me. They are probably more qualified than I am, just based on their proximity. So I think that's one thing that we discussed.

But I was sort of more thinking of, look, what do individual investors -- actually, what do most institutional investors want? They want to partner with people who have a better screening mechanism, or with institutions that have a better screening mechanism. That's really what they want to do for the most part.

And it actually dovetails really well with investor protection, because what do we want? I mean, if I'm -- if we're advising the SEC, like I really don't want people making investments with their hard-earned dollars that -- where there is not some other entity in the room that actually is accredited and knowledgeable. There is enough risk in these investments as it is anyway. We certainly want some screening mechanism.

I think we should be focusing in on a mechanism where if there is an institution -- local institution where they are willing to establish a vehicle to invest locally, out of their endowment, out of their pension fund, out of

their family office, or whatever it is, that they should be feeling like they can add incremental dollars to that pooled vehicle from local investors, because I think there is an attraction on the part of local investors to partner with local knowledgeable folks.

I think the impediment to that, if I'm sitting in their shoes, is I don't want the -- I don't want the liability. Like I don't -- I'm happy to give you the opportunity, but I really don't want to open myself up to, you know, being criticized, because a bunch of these things are probably going to fail.

And I don't know how to -- I don't know how to bridge that gap. I would think that a big part of the reason why people don't want to individual investors as a part of their pooled investment vehicles is because there is liability associated with that. And we know there is going to be failure.

And, I mean, we see it in public markets all the time. Every time there is a -- you know, an IPO or something that goes awry, you know, everybody shows up looking for where the fraud is. And most of the time there isn't fraud. It's just, I don't know, bad management, right? That happens in these earlier stage investments.

And so I'm just trying to figure out, how do we create some new structure in which we can have a sophisticated individual, family office, institution, who is incentivized to invest locally and take other accredited investors, and that might actually be -- I don't know if that's a new vehicle or if there is rules that allow for that that -- some mechanism where we can create that because it's more obvious to have locals invest locally I guess is my point.

MS. MOTT: This is Catherine. Can I say a few words, please?

MS. GARRETT: Catherine, real quick. We have a -- Catherine, this is Carla. We have a speaker from the audience who has been wanting to ask a question, so let's let her go first, okay? Thank you.

MS. MOTT: Okay.

A PARTICIPANT: *13:23:15

A PARTICIPANT: Thank you. You'll hear from us this afternoon, but one thing that hasn't been mentioned is not just venture funds who have this problem, but also he mentioned debt funds. There are now revenue-type funds. There is a lot of funds dealing -- looking for markets that are beyond venture, because venture is just a small, small set.

So we're talking about venture here, but that's like five percent or less of the total companies. And that structural problem is, we all are limited to 99 investors in

our funds.

So even if we had someone who wanted to invest $50,000 in my regional fund, I can't take them because if I want to build a fund that's of the size that I need two people on my team, we've got to build to a certain size, I've got to fund those guys, I can't even afford PitchBook actually because our tiny little fund needs people, you know, to manage the fund.

So we can't take a 50- or $100,000 investor because the math doesn't work for 99 investors.

MR. LEE: I agree.

MS. GARRETT: Catherine?

MS. MOTT: I agree with that point as well. Thank you. Thank you. I agree with that point that was just made, and I think that could move the needle locally as well, if we -- like right now, the legislation expanded back to I think it's 250 LPs, but they capped it at 10 million. So that doesn't work.

But I think there's a lot of things we can -- that are going to happen here that will move the needle. That was the question is that, if you looked at angel investors, they are small in number but they're moving a needle. They are getting companies off the ground.

And the more you can grow that pool, whether it's through, you know, changing accreditation or even looking

at, you know, being able to make it easier for finders, one of the things -- that entrepreneurs don't have the network to find people, to fund their companies. They are not running in those circles.

So I think if we would take a look at finders, I think the Volcker Rule will make a difference. I think all of this together will move the needle, and I -- I just want to make -- I am just replying to someone who had the question of whether or not this would all move the needle.

If we looked at, again, we have to provide I think the harmonization and other things to make sure that we are -- we have new company creations happening, and it has been falling off for a number of years. And this is a pretty critical point.

So nothing starts out big. It starts out small, and a lot of these small things are going to make a difference and move the needle.

That's my two cents.

MS. GARRETT: Thank you.

Martha, can I ask you a question? Can you give us a little bit of background, or Julie, on the 99 investors for maybe those of us that aren't quite as familiar with it?

MS. MILLER: Happy to. There is a limit on the number of investors that you can have in a venture fund, which is 99. There is a small fund exception that allows

you, as she was mentioning, to have up to 250 investors in a fund, but the size of the fund is capped at $10 million.

MS. DAVIS: And just to follow up on that, because I know we will hear some jargon this afternoon, there is two different ways to be a -- and I should really let Jessica do this, since it's more her area than mine. But you can be a 3(c)(1) fund, and that's where that 99 cap comes in. And in that fund, it's usually almost always accredited investors.

You can also have a 3(c)(7) fund, which has qualified purchasers, which is a higher level. That's like a $5 million inventory. And those are the big funds, are usually 3(c)(7), and there is an unlimited number there but they do have to be qualified purchasers, which is a much higher threshold than accredited investor, which is the -- so that's where the 99 -- you start to hear about the 99 investor, and that's in those funds that have accredited investors, not qualified purchasers.

MS. GARRETT: Thank you.

MR. SEATS: I'm going to react to Jeff's question, which is I think a good one, which is, really, I would recharacterize as, how much -- how much opportunity is there to iterate on the regulations versus it's some other issue? And it is in many -- I think the driving factors are a lot of the "some other issue" things, and it's worth sort of talking about them and understanding what they are.

And venture capital is often described as an apprenticeship business, and so I think the phenomena that you -- that was described in Utah, the reason why that happens, it's not that the talent is not there, but if someone has not been exposed to how it works, it is a knowledge gap.

And so I think -- I think that's actually a big, big factor in cases where the regulations are not preventing pooling of capital, they are not preventing this flow of money, but the knowledge of how to do it is what is a barrier. And I don't know what the -- I'm not sure what our role is to play in that, but it certainly is the dynamic in many markets.

An example, I mean, I was an entrepreneur. I sold my business to a company based in San Antonio, Texas. When I moved to San Antonio, it was already the eighth biggest city in the U.S. or something, and at that moment in time it had two venture-backed companies in the whole city, and zero professional investors and no VCs.

I would even say if your definition of "angel investor" is someone who has made more than one angel investment, it had zero angel investors. And so there was no organized capital of any type.

And when TechStars opened an office there, like we were an example. The people got to see what it looked like.

It demystified it, and now there are funds that are there. They are small funds, but like the way to picture the progression is people go raise $5 million funds, $10 million funds. They could use their qualified venture capital definition to go raise those small funds. I think it is valid for sort of that level.

And I think the thing that maybe we could think about is what are the -- how do we decrease the barrier to those types of funds, because that's how people cut their teeth, get comfortable with the asset, and start to walk that chain and they build -- they raise larger funds and larger funds. But it is very, very unlikely that someone will start from zero with no experience and understand how to navigate all of this stuff and go raise a fund using a 3(c)(7) exemption. Like that is never ever going to happen. Like you have to -- you have to be in the world, right?

MR. SOLOMON: So later on today we are going to talk a little bit about some of the exemptions for venture, and then that's a big part of what we're going to talk about. And so maybe I'll just put a marker down.

You know, there is -- in order to register the exemption, the 20 percent for venture fund registration, you know, maybe we should be looking at parts of the portfolio that are, you know, meant to be invested locally or outside of the major metropolitan areas as a way to get in -- like

maybe those investments don't count towards your 20 percent exemption, or maybe investments -- I know we're going to talk about investing in other funds locally, but there should be some mechanism where we can incentivize it, because this is what I see happening, right?

If we were to launch a venture fund, or anybody launched a venture fund, and they go to the big pot of capital that is sitting in the middle of the country, generally, the conversations are happening like, we're happy to take your, you know, money. We've got a track record.

So, you know, the pension funds and the family offices and the endowments are falling all over themselves again in Fund 4 or Fund 5, right?

But then those very same assets -- okay. Maybe you're aware of some of the best companies that sit in their region, but I'm not -- there's certainly no mechanism for them to really show those companies into their venture funds. I mean, it's sort of -- the venture fund will see anything, but there's no -- and it's sort of like, yeah, show me what you've got.

But there is no mechanism there for the capital then to track back to those places, and that's why -- I'm just trying to think it through because, you know, again, hard to -- that's just a market function. That's not a regulatory impediment. It's just a market function.

MR. SEATS: Right. But I think -- I don't know that you'd want to color that capital would have to sort of restrict that -- you know, to -- I'm not sure that that's exactly the mechanism, because Rise of the Rest is a totally different structure and I -- where the actual fund is somewhere -- is here and you're seeding funds that are in local markets.

And I think maybe more the phenomena to lean into is the scout phenomena, like -- and a way to think about funds and funds investing is it's just a formalization of that, right? Instead of having an angel investor have to get to a level where they are making a significant enough investment to have pro rata that I am interested in tracking and whatever else, like you're giving that person a million dollars to invest in a diversified way in a local market, and enough of -- a vote of confidence that other local investors are willing to put their capital alongside you.

And then you are also, in effect, mentoring them because now you are -- you can teach them how this industry works, and that's the way to sort of genetically spread the coastal understanding of how this works into those markets.

MR. LEE: And I think, Jeff, just to add to that because I think -- I mean, I agree with both of you guys. There is clearly a macro dynamic that we can't change, right? It is what it is. But I think what Jason is saying

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is even if you build that ecosystem of mentorship and leadership, I think the point is, even if you get to that point it's going to be hard to find capital for that, let's say, $500 fund because the people with capital as -- for all of the reasons discussed, like literally is not going to talk to you, right?

So you have to find the capital from other people, and I think in that context the regulations can absolutely make a huge difference, right? To I think Catherine's point, yeah, and Robert, of course, it's not going to change everything overnight, but, you know, I think even if it makes incremental change, that's critical to show progress.

You know, as another example, we just talked about venture capital exemption. So, I mean, we are assuming this local capital is equal then to venture capital and it's not. I think the lady previously talked about venture capital is very, very specific. In fact, the venture capital exemption that the SEC is talking about, it limits what capital you can actually deploy into.

So if you're relying on the venture capital exemption, you cannot invest in debt. You cannot invest in anything that is not intended to be this growth capital in the traditional sense of venture capital. So if we're talking about local businesses, we all know they are not going to be kind of ventures to high-growth companies. They

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might literally be restaurants and bars and gyms, and so on.

So all of that is to say I think we should separate the definition, at least the understanding of venture capital, with let's just call it local businesses, because under the common-sense understanding they are not going to be the same type of capital.

However, I think there are ways that we can absolutely improve and organize the laws to facilitate better capital formation once these macro trends you're talking about has been addressed in the form of mentorship and guidance and knowledge based on this, and so on and so forth.

MR. YADLEY: And just to pick up -- Jeff, you were asking about the accredited investor. I mean, the funds and the pooled vehicles, that is very promising and we're going to spend the afternoon talking about that. Accredited investor definition is part of Reg D, which works -- the slide that has the two big circles, right? 506(b) and registered offerings. I think the purpose is great. I'm glad the Commission moved forward with this initiative.

Add more people. Keep the limits the way they are, add for sophistication and knowledge of a particular deal, because a lot of the local business is -- Youngro, and we all know this -- and whether I hadn't heard the -- Jeff's term "scout," but I'm working on a deal now with a serial

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entrepreneur who has successfully taken companies public. He has plenty of money. He is an investor in a venture capital fund. This happens all the time. Venture capital fund said, "We've looked at this company. It looks pretty good. Too small for us. Too early for us. They need 4-, $500,000."

You may want to look at it. It is small enough that he is -- my client is going to do it himself. He is thinking that in 18 months it will be enough to do a real round. But these deals are small enough that, sure, he can ask one of his friends, "Do you want to put in $100,000 here?"

But, structurally, creating an environment for a fund that's going to have a bunch of people invest $10,000, the company is moving too fast for that kind of money. I mean, these are angel investments, but I think one thing we can do is look at the staging of this, and can we get sort of aggregates of investors, which could even under some circumstances include unaccredited investors, earlier in the process. But at the very beginning, savvy people, people who are known, I don't think we need a ton of structural changes to help those companies sort of see what they can do.

And at the high end, the information that James provided, there is plenty of money. But there are two or

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three stages along the way where the small investments from people -- I agree with what Catherine said -- of course, finders, it's just that's something whose time came a long time ago and we need to move on that.

MR. SOLOMON: So we're going to actually bring this -- did you --

A PARTICIPANT: *13:37:26

MR. SOLOMON: All right. So we -- very robust conversation. You know, Carla and I were looking at it. We thought, oh gosh, maybe we might not be able to fill all the time between, you know, 10:30 and 11:50. Obviously not the case with this group, which is awesome.

There is just -- there is a lot to take away from this, and I think some of it will continue into the afternoon session. But now I believe we've got Commissioner Lee. So I'm going to turn this back over to Carla who will do the introduction.

MS. GARRETT: Yes. Hi. I think we have Commissioner Lee, who is joining us now by video conference, and she is in the SEC's Denver office. And she'd like to provide some brief remarks to the Committee, and thank you very much for being here.

COMMISSIONER LEE: Thank you. Thank you, Martha, and thank you to Carla and the Committee for having me today. I'm sorry I'm not able to be there in person, but I am glad to be able to participate by video. So thanks to the staff for helping arrange that.

I will be very, brief, but I didn't want to miss the opportunity to commend this Committee for its important work. I have been here for most of the discussion this morning, and it has been profoundly interesting. I particularly appreciate the real-world experience and expertise that each of you brings to the issues that are faced by small businesses, and I very much respect the balanced approach I have seen in your thoughtful recommendations.

For example, I, and many others, support your recommendation regarding the accredited investor definition to index the wealth to thresholds for inflation going forward. And I also think that it may make some sense, as you have discussed, to expand that definition to include certain types of finance professionals.

This Committee's thoughtful approach is also reflected in today's agenda. As I said, I've been listening in on the informative discussion -- first the data, and then the discussion. I was especially intrigued by the in-depth exploration of how to drive capital into the lesser-served and local markets outside of the coasts, and I encourage you to continue that as I know you will. That's a worthy cause.

So I will also mention that the discussion brought

to mind a past proposal by the Commission to make some adjustments to Form D in order to increase our visibility into these private markets. And we haven't completed that rulemaking, but I'd be very interested in your views on this, should you decide to take a look at that, and on other ways that the Commission might help make more data available to inform our approach to small business capital formation.

And then, finally, I am very pleased to see that you are going to be hearing from Pam Gibbs from the Office of Minority and Women Inclusion after lunch. We know that efforts to increase capital must also address the structural issues faced by minority and women-owned businesses. We saw some data on that this morning. We know there is still work to be done, so I'm very glad to see the Committee recognizing those challenges.

So I want to thank each of you for your time and your expertise. Please know that it's valued and appreciated. And with that, I will let you get back to your busy agenda, so thank you.

MS. GARRETT: Thank you very much for joining. We very much appreciate your comments.

At this point in time, I think we can go ahead and break for lunch. We will reconvene the meeting at 1:15. If you are participate by webcast or phone, please note that it will be stopped during lunch and it will start again at

1:15.

So thank you.

(Whereupon, at 11:54 a.m., a lunch recess was taken.)

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

MS. GARRETT: Welcome back from lunch. I hereby call the committee meeting back to order. I am pleased to recognize that we have the Maryland securities commissioner, Melanie Lubin, here with us today. She is here from NASAA, which is the North American Securities Administrative Association. And, Melanie, we are very glad to have you visiting with us today. Thank you.

The first thing we are going to do is we are going to kick off with I would like to introduce Pam Gibbs, who is the director of SEC's Office of Minority and Women Inclusion. The SEC's Office of Minority and Women Inclusion is sometimes called OMWI. And it heads up the agency's efforts on all matters related to diversity and management employment and business activities at the SEC. Pam was named the SEC's first OMWI director in January of 2012. And prior to the SEC, Pam was the director of the Office of Diversity and Inclusion at the Commodity Futures Trading Commission. Before that, she spent 18 years at the U.S. Department of Labor, where she started as the trial attorney in the Civil Rights Division and was later acting deputy

director for program operation in the Office of Federal Contract Compliance Programs and director of the Equal Employment Opportunity Unit in the Employment Standards Administration. We are very happy to have her today. And welcome to the meeting, Pam.

MS. GIBBS: Thank you very much for inviting me. I see I need to edit my bio and take 18 years out.

(Laughter.)

MS. GIBBS: Somehow that makes me feel very old now that I hear that.

But no. Thank you again for inviting me. You know, I have been OMWI director for a while. And, just as way of background, these offices, there are 22 of them in the financial regulatory agencies that oversee diversity. And they were established by the Dodd-Frank Act. And I like to describe my office, really, as three buckets and which I have added a fourth bucket just so that you guys can sort of understand generally what we do as an office.

So, basically, the three prongs of what we do is workforce diversity, suppliers diversity, and diversity as it relates to our regulating entities. The fourth bucket that I will talk a little bit about a little bit later that connects me, I believe my office function and mission to the Small Business Advisory Committee, is integrating diversity into all aspects of the SEC's mission and operations.

So, first, workforce, just a little bit about workforce. The SEC is we are making much progress as it relates to diversity, demographically, age, generations. We are diverse. We do a targeted research, targeted recruitment strategy in terms of outreach to engage around occupations that the SEC hires.

And we have a very good I think the biggest asset that we have relating to workforce diversity is our affinity groups. We have nine affinity groups at the SEC, and they are very active. In fact, I just came from a book discussion in advance of this meeting on Just Mercy by Bryan Stephenson and where the chairman of the agency and many senior officers were there. So we have a big community around our affinity groups.

And then there is your targeted outreach that we do. And that is where sometimes we partner with offices and we do advertisements. So I am not going to go into the weeds on our workforce.

The next component is supplier diversity. That is where the statute says that the SEC has to increase its utilization of minority- and women-owned businesses in its operations.

So when I started at the SEC, so we contracted about a half billion dollars of our spend is around a half billion dollars in the use of contractors. Of course,

the biggest spend is related to IT. So when I got here, we spent probably we are spending maybe 21 percent on minority- and women-owned businesses. And with the combination of the partnership between my office and the Office of Acquisitions, I am pleased to say that that has ranged over the last couple of years from 30 percent to 34 percent. So that has been a big win for us at the SEC in terms of how we utilize minority- and women-owned businesses.

The third prong are our engagement with our regulated entities. So I am sure all of you guys know that we have a large percentage of regulated entities. We regulate probably in excess of 25,000 entities.

So what is the role of my office in how we engage externally? So the statute is fairly specific in terms of what it says. It says that my office is to develop standards to assess their diversity practices. And I am pleased to say that over the last two years, my office, the SEC, has been collecting diversity data from our regulated entities. So we started with the largest entities that we regulate. Those are entities in excess of 1,000 individuals where we collect their best practices. And so if you get an opportunity, you can go out to our website and look at the diversity assessment report. Basically, it is asking our entities to assess themselves. Do you have a chief

diversity officer? Do you hold your managers accountable? Is it tied to bonus pay? How much spend do you use with minority- and women-owned businesses? Are you transparent? And then we ask them to provide some demographical information.

So we have done this two years along with the other FIRREA agencies. And we are making progress. So the first year we received probably out of 250, 300 assessment reports that were sent to our entities, we received roughly 16 back. But those 16s are your big entities. So they represented 47 percent of the workforce in the regulated entity space. So we are continuing.

That is the hardest part because, you know, the statute never mandated for us to do this piece. So it is all voluntary, and it is not part of our examination process. But I think that we are making progress in how we relate to our regulated entities. And if, at best, we get out of this process, not their form but, rather, them complying and using this form as a template to assess themselves, then I think most of the OMWI directors would be satisfied.

So now let me talk a little bit about the fourth box. And that is how I work with Martha, who has been so excellent. She in herself has transformed the agency. She has high standards. She makes us all comply with these high

creative standards around engagement in outreach. So it has been a complete pleasure to welcome Martha to the agency. And so she and I, our office, from day one have partnered on outreach events. I am particularly looking at minority and women entrepreneurs, particularly those that may not be as sophisticated and understand all of the components about what you guys do. So we have teamed up in New York. We have teamed up in Omaha. We have teamed up a couple of other places, but we have done some really great events targeted specifically to minorities and woman. And it has been really good as an education process.

You know, when I think about how does diversity embed itself into this committee, I think the biggest thing is about education. You know, you cannot educate enough small businesses around capital formation. I think so many businesses still do not understand completely access to capital, the rules around access to capital, particularly those that I think about that I engage as part of the contracting process that are government contractors. So this is an area that I continue to want to work with Martha on in terms of conducting outreach from middle America to southern America to north, wherever we can reach people to educate them about the rules and regulations and the good things that the SEC is doing around capital formation. So that is really in a nutshell.

And we do work with one of   and that fourth bucket is the bucket that really is trying to integrate diversity into all of our components. So, in addition to teaming up with offices like Martha's office, to engage small businesses, we team up with the investor advocates' office and the Office of Investor Education to do financial literacy and education. We have a great program that we are hosting hopefully sometime in April out at one of the mega churches in Prince George's County, where we will be hosting two panels. One will be on financial education. The second panel will provide small businesses information about Martha's office and access to capital. So we really are looking forward to that presentation that will take place in April out in Prince George's County.

So I think going forward, one of the things, you know, you can tell me how you would like for me to be helpful. I think if there is a way that I can be helpful, I want to continue to work with Martha's office to really pierce down and drive down diversity and access to capital, reaching truly small businesses that are minorities- and women-owned around access to capital, explaining to these businesses what that actually means.

MS. GARRETT: Thank you very much. We really appreciate you being here today.

MS. GIBBS: Do you have any questions?

MS. MILLER: Can I add in one note before we go to questions? And one thing that I think is so important about how we have partnered together   and I appreciate you coming and joining us today, especially with everything that I know you have going on right now. As we talk about   and we have had a lot of conversations with our OMWI colleagues about general   when you look at workforce, it is a lot of the same dynamics that we look at and reflective of the data that we were talking about this morning about capital being concentrated with repeat players. And the investors tend to be those who have already had a successful exit. And that creates really interesting challenges across demographic lines that our office is very focused on. And I know it is also a focus of Pam's office making sure that those opportunities exist, whether it is a supplier that needs capital to scale to get to the point where they could actually take on a contract with an agency like ours or potential workforce and those who have the experience and skillset that could ultimately join our agency and bring wonderful perspectives.

So a lot happens behind the scenes that most people don't get a chance to see outside of the agency. And so this is just a wonderful opportunity to shine a light on the wonderful work that you are doing. So thank you very much for being here.

MS. GIBBS: Thank you. And I think the thing that cannot go unnoticed   and this is what I have to deal with   workforce and supplier diversity is also acknowledging that barriers exist in trying to figure out ways to address those barriers that may impede, you know, certain groups getting jobs at the SEC, certain vendors being blocked from getting contracts here, the same way as small businesses being blocked to access to capital. So, you know, as we think about our work, I think it is also important to think about, are there ways that we can address adequately the barriers that may be blocking access to capital, other issues, too?

MR. SOLOMON: Is there an easy way to get the best practices? I mean, I know I am just surfing the page. And I am embarrassed to say that I never surfed the page before. But it looks like you got a lot of information since the Dodd-Frank era. I assume you have. But have you put out, you know, best practices or if regulated entities or maybe some of our constituents want to access, you know, the information, is there an easy way to do that?

MS. GIBBS: It should be on sec.gov. We report each year at the end of March our annual report to Congress. So that is where we report on all of the agency's actions, from workforce, supplier diversity, mission-related work, and information related to our regulated entities. In

addition, on the OMWI, Office of Minority and Women Inclusion, page, you should find a diversity assessment report. Have you seen

MR. SOLOMON: Yes, I see that. I just didn't know if   I see the actual form to fill out.

MS. GIBBS: Yes. Right. So usually we compile the data in aggregate form in our annual report to Congress.

MR. SOLOMON: Okay.

MS. GIBBS: So that is where we report out each year the results of our survey, the findings that we see and the trends that we see in the industry.

MR. SOLOMON: But you didn't publish a best practices or basically since you see all of this data, have you given advice on maybe ways for regulated entities and other constituents to really make positive differences in their own enterprise?

MS. GIBBS: We try to. When I say, "we," the other FIRREA agencies. We have hosted two financial diversity summits, one in New York and one in Chicago, where we invite all entities collectively to come in and talk about diversity. We talk about the form. We answer questions from our regulated entities. And we provide them with some base information about how we are doing in aggregate. So we are trying to host these forums throughout the United States where entities can come in and ask the regulator, you know, "What can I do better? How can I do better?"

MS. GARRETT: Yes, Steve?

MR. GRAHAM: Thank you, Pamela. Just a couple of things. One, in terms of what you do in the overall, you know, set of objectives that your office has, could you tell us how you measure success? And, then, you know, sometimes diversity is in the eyes of the beholder. I guess one way this might manifest itself is oftentimes when we talk about diversity, it is just women and minorities or women and people of color. And people of color kind of encompasses a lot of people. And my question is, what do you do to differentiate between women and African American, et cetera, because, as we know, the problems and issues confronting these groups are not always the same? And one size doesn't necessarily fit all. So how do you address that?

MS. GIBBS: So what we try to do is develop benchmarks. So we use different benchmarks to measure, you know, are we moving in the right direction? So what I have tried to do is set two benchmarks for the SEC. One is the civilian labor force data of 2010. That is the census data. That is the broadest that one can be in terms of trying to reach the data because it includes everyone. And then we come back down to look at the more specific data. And that would be the federal benchmarks. What do the other

government agencies look like demographically? So that if everybody is above those benchmarks, that means we are doing well. If they are not, if there is one group, two groups, what we try to do is be targeted in our outreach to make sure that we are fair in terms of providing access to everyone.

But you are right. It is not always easy in terms of particularly with an office name like mine. You know, if someone had said, "Well, Pam, I dream of Jeannie. What could you want?" I want my name, the office name, to be changed because we are very inclusive here at the SEC. We define diversity very generally and broadly, which means that we go beyond just race and ethnicity and gender. So the way that we define it is much broader than maybe the name of my office would give us credit for.

And you asked about performance metrics. So over the years that I have been here, we have gone back and forth. We have a base of some small performance metrics. You know, are we conducting outreach? How many people from the outreach actually got jobs? So we do have a set of performance metrics that we use internally with the different offices to measure our success overall and for me as a director, you know, to determine, is this the best way forward for the agency. I am pleased to say that right now, we will be developing and issuing hopefully in the next

month the first SEC-wide strategic plan on diversity and inclusion. And I think we are at the right place, meaning that I have been here for a while, but we have never been at this right place where everybody was on board or supported having a strategic plan. And so now everyone will understand the message going forward as it relates to diversity and inclusion.

Did I answer all of your questions?

MR. GRAHAM: You did. We can have a broader conversation, but we don't want to take up the afternoon.

MR. SEATS: I guess one I guess quick comment or maybe question, the so I am a venture investor managing funds. And so a lot of the way I look at the world is through that lens, but when I think about diversity and inclusion sort of in the startup world and entrepreneur side, it feels like there is a and this was a little bit in the PitchBook data that we saw earlier. It feels like there is a little bit of a demonstrated link between the diversity and the people making the investment decisions relative to who gets funded. I don't know if you are tracking that, I mean, the regulated entities of the three things that you are tracking. You know, is there work done to track sort of the decision-makers who are allocating capital towards startups and small businesses?

MS. GIBBS: So the short answer is no, but it is

an area that I would put into that fourth bucket. I am pleased that we brought on Robert Marchman, who is our senior adviser on diversity and inclusion, who spent I will just say over 30 years at FINRA, to help us look at diversity asset managers and to work with the office, the Division of Investment Management, so that we can figure out how we can pierce into that space because I go to a lot of events, one in particular, the National Association of Securities Professionals, which is a minority group of asset managers. And they are always talking about the barriers that they face in terms of being I guess an allocator, a consultant. And so one of the things that under Chairman Clayton's leadership that we want to focus on is to get OMWI more embedded into some of the activities that IM is doing related in this space.

So I think I answered your question. So we are getting there. We are not there yet. I don't collect that type of information yet.

MS. HANKS: What resources or networks are you using in order to identify who are the minority and women entrepreneurs who need to be made aware of the opportunities that exist here?

MS. GIBBS: So we have what I call vendor outreach, open house. So we have two things. One, we develop a calendar each year of specific areas where we want to go in terms of targeting particular vendors and particular organizations that we want to educate about the contracting opportunities at the SEC. But then we have an open house once a month here at the SEC where I think it is posted to sec.gov all vendors are invited to come into the SEC to learn more about our operations, what contracts are up for bid. They can tell us about themselves so when we go back to do market and we store that information to a database so that my office along with the Office of Acquisitions can sort of partner around. That is more open, meaning that it is not just about being a minority- and women-owned business. It is about being a disabled veteran-owned business. It is about being an 8(a) contractor. So it is a little bit more broader than just being a minority- and women-owned business.

MS. HANKS: I was thinking more in terms of the entrepreneurs who use the rules that Martha is an advocate for, you know, how to find a small business who might need to raise money doing crowdfunding or something else but doesn't know that is even a thing.

MS. GIBBS: So we are working with Martha. We follow Martha's lead. And we tell her what the concern is. And Martha helps us to identify places. And, then, I have a great staff that has a little bit more expertise than I do in the VC space. And so they are always extremely helpful

in identifying how to get us to that grassroots type of VC.

MS. MILLER: I will say, just piggybacking on that, when we talk about when she says we work together, just to give some example of that, OMWI has a fantastic reputation and network through a lot of the outreach that they have been doing for years. And so some of the things that we will do are saying, you know, for example, "We are going to go to Atlanta. We have this idea. What do you think about doing an event that reaches, you know, alumni of HBCUs at the Atlanta University Center around homecoming, where we know they are going to come back in town?"

And then we work together. And we bring our respective strengths to the table, and we put on events. And we collaborate in ways that make it where we could reach far more people using our different strengths because our office is uniquely focused on capital formation. And they have a lot of different other focus areas. And so I think that our partnership is what makes those types of outreach really successful, but that is just an example of how we go about approaching that.

MS. GARRETT: Thank you very much.

MS. GIBBS: Thank you for inviting me.

MS. GARRETT: I would also like to welcome Commissioner Roisman, who has joined the meeting. Thank you for coming today.

COMMISSIONER ROISMAN: Thanks. Well, I apologize for not being able to make the earlier sessions. I really do appreciate all of the people who come in and obviously on the phone as well and to Pam as well for all of her great work on this. I look forward to following up more on today's morning conversation and look forward to this next panel. Thanks again for having me.

MS. GARRETT: Thank you for being here.

Jeff, would you like to introduce our next set of speakers?

MR. SOLOMON: Yes. Great. Thank you, Carla. It is good to see you, Commissioner Roisman. Thanks for joining us. And thanks, Pam. Really very helpful.

So as we move to the next topic today, I just want to remind everybody that we are in creative thinking mode. We had a great conversation this morning that really allowed us to exercise our creative muscles. I think this afternoon, we are going to focus a little bit more on local capital availability for early-stage companies in the role of regional funds.

Matt Cook, I want to acknowledge a few SEC staff who also joined this discussion. Matt Cook, our senior counsel at the SEC, Investment Advisory Regulation Office, Division of Investment Management. And to the extent the committee discusses funds, Matt can provide some technical

clarifications on questions about the Investment Advisers Act and exemptions from the Investment Company Act or SEC-related rules.

The discussion this afternoon will delve further into a few of the funding gaps the committee has discussed, challenges faced by businesses in different sectors, availability of funding from the hotspots on the coast, and challenges from minority-owned businesses and access to capital.

I am going to introduce the speakers. And hopefully you have had a chance to read a little something about them, but they are all quite distinguished about taking some time to make sure that you understand who they are. So first is Darnell Smith, who is the founder and CEO of MOJO. MOJO is a creative consultancy firm that specializes in digital transformations, bringing creative marketing, marketing technology, and operations, product development, and strategic communications solutions to a long list of big-name clients. The company has offices in New York, San Francisco, and Cincinnati.

Darnell has over two decades of experience in marketing and strategic brand management. Prior to founding MOJO in 2014, he was a senior principal at Infosys serving as part of the core digital transformation practice leadership team in multiple areas. Darnell will share his perspectives on seeking capital as an entrepreneur and how he ultimately built a company without investor capital.

Darcy Howe is the founder and managing director of KCRise Fund, LLC, based in Kansas City. Congratulations.

MS. HOWE: Thank you.

MR. SOLOMON: Kind of miss that. Good for you guys. Yes. She will be doing the first co-branded deal with Patrick Mahomes.

(Laughter.)

MR. SOLOMON: Again, we are all in. Just I know we are not supposed to say that here. Sorry. We are not. We will talk later.

(Laughter.)

MR. SOLOMON: Based in Kansas City, KCRise Fund is a co-investment fund, which invests with institutional VC partners in the early-stage companies with a significant presence in the western half of Missouri or in the entire State of Kansas. Launched in 2016, KCRise's first fund of $19 million is invested in 20 companies in the region. Prior to her current role, Darcy was a founding member of Merrill Lynch Private Banking and Investment Group of Merrill Lynch in Kansas City. She is a 20-year veteran angel investor and has been a regional leader in the entrepreneurial ecosystem developing connectivity between funders, entrepreneurs, and advisers.

John, I am going to make sure I get your name right. Sorry. McIlwraith? Did I get it right?

MR. McILWRAITH: Perfect.

MR. SOLOMON: Okay. Good. John McIlwraith is the cofounder and managing director of Allos Ventures. Allos is a VC firm with offices in Indianapolis and Cincinnati and focus on investments in early-stage technology companies in the Midwest. Allos raised its first fund in 2009 and just announced the closing of its third fund at $52 million. John started his career as a lawyer representing VC firms. He moved into investing and has since been involved in a variety of early-stage venture initiatives throughout the Midwest.

And, then, I want to also announce that participating by phone is Poorvi Patodia, who is so before turning it over to this panel, I wanted to ask Poorvi if she can actually share some of her experiences here. They are particularly relevant as a minority female who has successfully raised capital for her plant protein snack food startup in the Boston area. And then we will go back to the panel.

So, Poorvi, thank you for dialing in. And we look forward to hearing from you. You are on.

MS. PATODIA: Sure. Hey there. Yes. So I think I have met some of you guys via the phone, but I am the

founder of Biena Snacks, and I am on the committee. And Carla and the team had asked me to speak a little bit about the challenges I faced in raising money for my company, Biena.

So to give you a little bit of context, I have raised just over north of $15 million for the business. It has been raised across 3 major rounds, starting with the seed round that I did in 2015. Then I did a Series A financing in 2017. And most recently, in August of '19, we did our Series B financing. So I think some of the things that the committee has been talking about today certainly rang home for me and were some of the challenges that I faced.

In thinking through the three financing rounds that I have done, I do think the number one challenge that is common across all three of them is who should I be talking to or who can I connect with. And, you know, that is speaking for that fundamental challenge that we spent a lot of time talking about, which was connecting the entrepreneur to a potential group of VCs or angel investors.

But just to talk you through a few of the different challenges that I faced in the different financing realms, starting with the seed round, as I am sure many of you know or may be aware, during seed round, especially as a

first-time entrepreneur or founder, I was starting from scratch. I knew nothing. And now when I talk to other entrepreneurs and founders who are looking to raise capital for the first time and they are coming to me asking for advice, you know, one thing I talk about is to ask and understand the answers for your business to really, really basic questions of I call them the five W's, the why. Why is really your why as a business but relating that also to the VC or the angel investor talking about the type of opportunity or business, how you are approaching the market, what is unique about your offering. Going on to the who, which is, as I mentioned, who should I be talking to; the what, what should I be talking about, how should I position myself and my company to the angel investor/VC; the when; and then the what. And the when and the what is all about, you know, when do I need these dollars? Why am I out here raising money? And what are these dollars going to be used for? What milestone am I at today? And what milestone is this going to take me to in terms of scaling the business?

And so, you know, the seed round for me was really about learning how to fundraise and what that really meant. I very quickly also realized being based in the Boston area and today we spent a lot of time talking about the challenges of geography as it relates to fundraising. And I know Boston is frequently mentioned. And, you know, I saw it in the numbers. There is a lot of capital raising that happens in the Boston area. But leading a natural food company, I quickly realized that all the people you know, there are many, many investors in the Boston area, but I basically realized that, you know, a very, very, very small percentage of those people were relevant to my business.

So, you know, I am fortunate to know many different types of investors in the Boston area. And I went out and I set up meetings with different people. And I quickly realized that if you are a tech investor or you are a consumer investor, you are investing in a consumer space, but you are focused on B to C. You know, these businesses are just very different than my business. And so a tech investor may not feel comfortable with realizing that he is talking to a company. Here she is talking to a company that carries physical inventory or goes, you know, sells its product through wholesale and distributors, which is fundamentally a different business model than technology. And so I think for me, what I quickly realized is that I can certainly spend a lot of time networking in the Boston area. And, as you guys know, there is a lot of money to be raised and available capital in the Boston area, but I basically learned that what really mattered was the sector that I was in and being able to find people that really understood natural food and beverage and that were willing to make that

more excited about that space.

And then it was also when I first connected with my legal team that I still work with today. And I ended up working with a boutique law firm based out of New York that really specializes and focuses in natural food and beverage. And that was probably one of the best moves I made, even though I didn't realize it at the time. And, you know, I did weigh it quite a bit because as an entrepreneur who was self-funding the business, I went out and raised that seed round. You know, even just looking at the hourly rates, what my lawyer charges made me think, you know, three times about it. And but it was actually the right move. And now I advise founders that this is an area that you should not skimp dollars on because it is so critical to understand terms and get all of your documents right.

So that was just a little bit about the seed round. I mean, I think Series A and Series B financing obviously, you know, is very different than raising your first seed funding or angel funding. I think what characterizes those is that you have I think for me especially, I have had a real business by then. We were generating revenue. We were starting to become well-known within our industry within certain groups of people. And so I had some of that credibility. I had also started to build out a board around me and around my company that was full of

people that were heavily connected within the industry. I heard somebody earlier today talking about that, about just how much of fundraising today is based on connections. That is definitely reflective of my experience, both in the Series A financing and the Series B financing.

So I will just stop there, but I am happy to share more at another time as well.

MS. GARRETT: Thank you, Poorvi. This is Carla.

What would you say was a couple of your biggest challenges that you faced in maybe getting your seed round or the Series A? Finding the investors? The time it took? What were a couple of the big challenges you faced?

MS. PATODIA: Yes. I mean, I do think finding the investors was the number one challenge across the board for every round that I have done. And, again, some of it is about sector. Some of it is about I do think the biggest thing is the sector and the focus and then alignment between the investor and the company, whether it be about the mission or whether it be about the industry and the category, et cetera. So, I mean, right there, I knew. I sat down with an investor. And I was explaining really basic things to them about how a natural food business works. I learned over time that that conversation probably could be cut short for the benefit of both parties. So I do think that.

And, then, I think the second piece is from the entrepreneur's perspective, I do think once you get deeper into the fundraise process so let's say that you have got a number of interested parties and you are having various stages of discussion. I do think the legal aspect of things is another area that I had to learn very quickly. And, again, thankfully I ended up working with an incredible legal team, but going through my first term sheet and really understanding what are the terms and what are the rights that I am giving away seeing one way, but as you read into it, you realize or you need somebody to kind of play out scenarios for you as to what can happen when these different terms go into play. So I think those are probably two of the biggest challenges.

MR. YADLEY: Poorvi, this is Greg Yadley. Thanks for joining the meeting today.

Just picking up on what you were just talking about your legal team and as a lawyer, thanks for the advertisement do you recall any specific securities law impediments that you had in any of those rounds, things that your lawyer said, "Ah. We can't really do that because"?

MS. PATODIA: I mean, I will tell you the biggest one being the accredited investor. And, again, I know that that is something that this committee has spent some time thinking about and talking about. You know, there are people that want to invest in the business. Maybe there is something about food that everybody can relate to it, but I think the accredited-investor piece has come up multiple times for me at different rounds. So one way it has come up is exactly as you would think right? which is that the definition is preventing certain people from investing in the business but otherwise would love to be able to invest in business.

But the second way that it came up that I did not expect because of a number of other rules, which is that as the leader of Biena, I firmly believe that all of our full-time employees should have equity in the business. And it is a philosophy I have about how I run the business. It is about alignment. It is about getting everyone to think like an owner.

So we have also had employees that wanted to participate in our round, our fundraisers. And it is because they believe in the business and what we are doing in there on the inside. And they see the potential. And so multiple times I got back to our legal team and said, "Is there any way I can get these team members into the round because they really want to participate?" Again, it really came back to that definition of the accredited investor. So that might be another way that it it was just kind of a different way that it impacted us that I didn't expect.

MR. YADLEY: Thank you.

MR. SOLOMON: Thanks, Poorvi.

I want to make sure we give our panelists a chance. I am going to ask you to try to keep your comments, at least initially, to five to seven minutes so we can foster a conversation. We will start with Darnell. I know, so full disclosure, Darnell and I work together. We are one of the companies that Darnell has really been helping a lot with our communications and digital footprint.

I know you and I have talked, both professionally and personally. You want to be known as the best digital company, not just the best minority-owned digital company. And I think that there is a lot in that statement. Yet, you have faced some unique challenges as a minority business. And I look forward to hearing your thoughts.

MR. SMITH: Yes. So I will be quick so we can have a but thank you to the members of the committee for having me, obviously honored to be here as part of this panel in hopes of sharing my story will have a positive impact on the dialogue needed to inspire continuing evolution of policy as it relates to small business and their capital.

So to help frame this story, I think you need to know a little bit about me and my company. I was born and raised in Milwaukee, Wisconsin. I grew up in a blue-collar

family. While we had our fair share of struggles, like anyone else, we were solidly middle class.

As I reflect back on it, I now realize my parents probably basically worked themselves to death to provide for my brother and I. So it is not lost on me today as to why I am sitting here. So I want to give a quick shoutout to Alex and Elvira Smith, who I guarantee you before today had never logged on to the SEC website but are now there.

(Laughter.)

MR. SMITH: So both my grandfather and my dad were small business owners. They scraped together whatever they could find, and they opened up a couple of neighborhood bars right in Milwaukee, Wisconsin. My dad had a full-time job as an activity therapist and, seemingly, somehow worked both second and third shift right? to keep the business afloat for the better part of 30 years. And I remember when I got old enough to recognize kind of the toll it took on him, I said to myself, "Gosh, there has to be a better way to do this."

So as I sit here today in this forum discussing this, essentially the same challenges are here as 30 years ago. I recognize that I have lived a charmed life and I have carried this brute-force mentality with me throughout my career, which has served me quite well and why we have been able to kind of do this in lieu of being able to raise

capital.

So I was lucky enough to have had the opportunity to attend the University of Notre Dame. I had to sneak that in there. Go, Irish! And, like many of my peers, I was exposed to a whole new world.

After school, my career path took me all around the world working in marketing and advertising, technology, consulting, and corporate strategy. And it was this path that really culminated in me having the idea to start MOJO. I firsthand saw the struggles that companies were having, both large and small, that ultimately impeded innovation and growth, kind of what I referred to as like a graveyard of ideas. So I knew there was an opportunity for a more intimate approach to solving these challenges, and that led to the birth of MOJO, which quickly became a family affair as my amazing wife, Stephanie, is a cofounder. And so it truly is something that I live and breathe 24 hours a day.

We define MOJO as a creative consultancy. You might ask, what is that? We basically exist to unlock value within organizations as it relates to delivering what we consider irresistible experiences, products, and services to both external and internal audiences, which is a point that I will get to in a second. As you can see by the map, we have offices in New York, California, Cincinnati. And, then, we have remote employees who work in the great State of Kentucky, North Carolina, and Massachusetts. So we had the pull of the coast, but we also recognize talent is very prevalent in all parts of the country.

So in order to do what we do, we bring together a multi-disciplinary team of SMEs that are equipped to handle these kind of big and hairy challenges that get presented to us. And a lot of times, much larger organizations have spent a lot of time trying to figure out stuff. But what you realize is through the red tape of all of that, like a lot of times solutions get buried under process. And what we try to bring to the table is a small group of highly functioning individuals that are really adept at taking big problems and distilling them into simple solutions, so strategists, creators, designers, technologists, ethnographers. The list goes on. But we bring together these teams to really try to solve problems.

We are organized around three verticals, and this is important to understand so you can see the breadth of how we see things. We have a creative and design organization. Right? And we have consulting and business services, and we have ventures. Our creative vertical really focuses on helping organizations take a customer-centric approach to creating and communicating their offerings. This spans from helping large financial services firms educate and transact on retirement products all the way down to helping the

fastest-growing bourbon in the United States commercialize, so everything in between. So we see a lot of different things across many different industries.

Our business services and consulting arm is really what we consider is focused on the plumbing of company and what we consider the people process in technology. And this is where effectiveness and efficiency really come into play and how can we help companies operate in a way that they continue to be growth engines and they thrive in this hypercompetitive landscape.

Last but not least, our ventures arm leverages all of these learnings we get out on the playing field. And we use our skillset in support of very early-stage ventures, primarily women and minorities. And this is where I journey along with the stories of others, crystalize the challenges that are real and present for small business entrepreneurs today.

Really quick, just to crystalize that, there are three types of funds we work with: multinationals that are trying to adopt a rapid prototype, fast-fill mentality, and they want to be the disrupter and not the disruptee. So it could be a ventures arm. I know we talked about that earlier this morning. A lot of these Fortune 500 companies have very specific venture arms that they stand up. We also work with mid-tier challenger firms, who don't have access

to the same resources; and obviously the early-stage company. And we have done it for a nice list of clients that most of my peers would kill me over.

All of this we have done with zero dollars, not one penny of outside capital. And, you know, for us, we had to take something that was a frustration and basically turn it into a badge of honor. Right? Like we took the fact that we were having such a hard time raising capital and we had to flip that and say, "You know what? We don't need capital. We are going to do this on our own." And I think about my peers in other businesses that go through this and how hard it is to make it through that and how many of them don't ever make it that far because they cannot access capital.

So we are part of the statistics. We are part of that 83 percent I think the number was mentioned this morning, right? that has not had access to formal capital. Four out of five businesses I think it is. That is us.

So now that you know a bit about me and my company, let me dive into the areas that I have experienced, the greatest challenge when it comes to access to capital as a small business owner. No doubt you have talked extensively about these things. But hopefully my experience will be additive to that.

The first thing is the sector, right? The fact that the core of our business is service-based essentially rules out VCs. I think my co-panelists will agree that in order to survive in their space, there is a very narrow playing field which they have to adhere to. And if you are not I heard the word "unicorny" thrown around this morning. Good luck with that. Right? So that really limits our playing field to the private markets and banks.

And, you know, one of the lines I always love hearing from a VC is, "I think you are amazing, and I would love to invest in what you are doing if you could only bring me" X. Right? And I have heard that so many times it's like I finish the sentence, you know, for the VC.

So that leads us, again, like I said, to the private market and banks, which are really our only options. And these sources know the limited opportunities we have in this sector. So, as you can imagine, this is clearly reflected in the quality of offers right? they are willing to put on the table. And knowledge of any alternative sources to capital is certainly not readily available to an entrepreneur and proactively communicated to the larger and small business community. So sectors is one.

The second piece is the minority and women angle of this. Right? Several published reports that were well-documented, additional challenges that businesses of our type face. So, for the sake of time, I won't rehash that except to say that as both a minority- and woman-owned business, we are certainly not immune to any of this, even despite our success.

I always tell the story I had a recent situation with a peer who has a similar business, who happened to a nonminority. And we had a potential source of capital in common. What was told to that person versus what was told to me was so vastly different that it made me wonder like, do these folks think that we don't talk as an entrepreneurial community? Right? Kudos to this peer, right? He actually secured funding from this place but decided to go in a different direction as not to support that way of doing business, right? And this is just one of many stories that I could tell you from myself and peers who have come across this.

So last, but not least, and kind of tying it back to the local and regional aspect of what we are doing, geography has certainly been a huge challenge for us. I can best sum this up by a quote a youth basketball coach once said to me, like in order to grab a rebound, it is probably best that you are in the paint. And that is really true, at least from our perception, right? Everything is set up perfectly for me to live in Cincinnati. My wife's family is from there. We have an office there. We have clients

there. And yet and still, the tug of the coasts is so prevalent that we still kind of refuse to move in that direction, just because we know proximity is super hard to have access to capital in the first place. So to move somewhere where it is even harder seems very daunting.

So the good news is that living in San Francisco, I have seen peers that are starting companies that are starting to migrate right? to the areas that we have talked about, the Denvers; the Chicagos; the Austins; and even to some extent, you know, the areas that my co-panelists represent. But, yet and still, there is still this tug of being on the coast that is hard to overcome, especially if you want to have proximity to things that, you know, could potentially change your business.

So, in closing, I am inspired to see this committee foster meaningful discourse around the subject of access. While I am no policy genius, I do know that the complexity of regulations and prohibitive costs of trying to gain an understanding of what is possible is, again, very daunting. And it is something that as an entrepreneur, you are more focused on keeping your business alive on a day-to-day basis than you are trying to become an expert in policy. So I am glad that I have a chance, some area to step back and actually try to think about things that could help the situation.

You know, I hear things of crowdfunding and creating asset classes that will close a gap in terms of between debt and equity and redefining accredited investors, but I have to tell you for most entrepreneurs, that discussion, you know, kind of goes over their head. Right? Again, they are worried mere about, how do I keep my business afloat on a day-to-day basis. Right? Especially when you have employees that you are responsible for, families that you feel responsible for, the anxiety of that alone will give you many sleepless nights. And so worrying about capital is almost secondary. You have to adopt this brute-force mentality that "I am going to get it done, no matter what" because people are depending on me. And that really changes the playing field and the ability to scale as a small business.

So I will shut up now, but, you know, thank you for having me and, again, look forward to continuing being a part of the conversation.

MR. SOLOMON: Thank you, Darnell.

Darcy?

MS. HOWE: I think an interesting thing that we found out over the lunch break is that because I asked Darnell. I said, "I just talked to a VC, who said on the West Coast, that they had 100 percent turnover in their technology team in 1 year. In Kansas City, we don't have

that. People really stick around." And Darnell said he had the same problem. So it is interesting that there is a talent, we are seeing talent coming from your part of the world back to KC. We literally have a backtokc.org bringing that talent back to our region. Okay.

I will be quick. So why are we activating the untapped potential of the region? Because I have been an angel investor for many decades. I have been an asset manager for many decades. So I know well-to-do people. And I understand early-stage investing pattern recognition.

So in my retirement from Merrill Lynch, I said, "Okay. Well, I will do something for our very slow economy in Kansas City," where we weren't growing as fast as even cities like Indianapolis, where John is; Nashville; Denver; et cetera. And so we are just connecting the dots between investors and companies created in the region, which, by the way, our average founder is over 40 years old, slightly over 40. So these are people who want to stay in the region. Their kids are in school there. Their employees' kids were in school there. They don't necessarily want to move somewhere else. And 80 percent of all of the jobs, as it shows on my screen here, in our region is because somebody who is already living there creates a business.

This gives you an idea of our fund metrics. This is a combination of Fund I and Fund II. But mostly I want to show you what our investor group looks like. In Fund I, you will see it is 18 percent corporate, 45 percent high net worth, 24 percent family offices, and 12 percent donor advice fund.

Interestingly, our local community foundation allowed their donor-advised families to say, "Yes. You could use the KCRise Fund, instead of the S&P Fund or your pooled funds or whatever else." And that is actually our largest investor because five of our families chose to use the donor advice fund. But you can see how little that is, how little capital we have raised. And I am a venture fund. So people, they don't know how to pattern-recognize venture very well in our region, but they know how to pattern-recognize debt funds. And there are now funds that have come up that are revenue models and other debts. So that would actually provide capital to a broader group of entrepreneurs, not just high-growth technology-type companies, which is, by the way, why Darnell he is a service-based company for the most part. And that is not the model for venture. So there has got to be capital in other ways.

For us to try and build a larger fund because it is really clear we were only 2.2 percent of each of the virtual companies in Fund I, we are trying top be more like 5 percent because, again, venture math is you want each one

of your companies to try and return the fund. So you can't do that unless you have a little bit larger pot. But for us to get a larger pot, we are not getting the institutional money yet on endowments. So we can go through some of the systemic challenges of that in a moment or after we speak.

So my way of trying to do the math so that we could create a larger fund was to go to corporations. So you saw from PitchBook, you can see in Fund 2, corporations now are a much larger percentage. We are seeing this out at our market. The S&P 500 companies are out in the Midwest. Where are the customers for all of these entrepreneurial companies? They are out in the Midwest. So it would make sense to be born out here. It would also make sense for the corporations to invest in that technology and innovation that is happening in their own backyard.

And this is our most interesting statistic I think. So our funds have only invested $12 million at this point. And, yet, since KCRise Fund has been in these 23 companies, they have raised $282 million, of which 76 percent of it is from out of the market. So we are actually net capital importers, a very important function for our region, not just our little fund but that we are bringing capital so that those entrepreneurs who want to build their business and raise their families, that our community can do that.

And, frankly, I am kind of agnostic because in Kansas City, this is not the way most families of wealth have made their money. They have made their money in more industrial ways. And so we are going to import the capital from places, which is why Rise of the Rest Fund is such a great partner to us because they are very good fundraisers. We are birddogging the deal flow for all of these venture funds around the country. We are by design created as a co-investment model so we don't have local bias on I might love that particular online auto auction company, but until Rise of the Rest decides they want to invest in it because they have seen all of the others that are out there, that that is a win-win that we are bringing in that smart capital who have seen other deals in other parts of the country.

This just shows you we have co-invested with 41 firms. Look at that, even the coast. What do you know? I have got to say when I do LinkedIn things, that $282 million, I posted that on LinkedIn. I had 23,000 views. And the least number of views were from California. I believe California still doesn't add it for the most part.

And this just gives you an idea of where our sectors are in the Midwest we are seeing. It makes sense. Transportation logistics. We are in the middle of the country. Right? We have got Sprint there, IOT, Big Data. GulfTech is interesting that that is becoming more prevalent

in our region, trying to move it here.

A PARTICIPANT: That is your last slide.

MS. HOWE: Oh, was that my last slide? Oh, there you go. I will stop there.

MR. SOLOMON: That is super helpful. You are allowed to if you need to get out early today to get back for the kingdom parade.

MS. HOWE: Thank God it is tomorrow or you may not have seen me here today.

MR. SOLOMON: Oh, I know. I said if you need to leave early to get back to Kansas City, don't miss that.

So, anyway, John?

MR. McILWRAITH: Yes. And I will be even shorter. So I am a VC. Obviously if the bio was correct, I have been in the business through Jones Day in a prior fund and now Allos for 35 years, all in the Midwest. So I have got a pretty good window on what has happened over the years, in particular what has happened to try and solve capital formation, capital availability for startups and funds. In fact, in 2001, Michigan was a backwater. And some people there that had small funds asked me to join what was created called the Michigan Venture Capital Association to solve the problem in Michigan. I was the outside board member from Ohio because Ohio had a huge amount of capital funds. We had Primus and Morgenthaler. They said, "We want to be like

Ohio. Please come to Michigan and help us." Twenty years later, almost 20 years later, Ohio is a backwater. Michigan is a shining example. And just they keep trading places. Indiana is now up and coming. We have a new fund of funds, the next-level fund, but the same thing. It is Groundhog Day to a certain degree over the last 35 years. And I have watched it.

A couple of things, observations, from this morning, which was super helpful. It is like a firehose. We sat back there listening to this thing. We have thoughts.

The Volcker rule change that you are about to make, fabulous. What happened, the Volcker rule came out. It gutted Midwest Funds because a lot of the local funds in Ohio and elsewhere had banks. Was HR part of their capital structure? And when they went away, they are like, "Oh, it is hard enough to raise the fund. Now you have just taken a third or half of my capital away? I'm done." And so you saw a lot of firms exit the market. So bringing that back is hugely important.

The other thing, data is fabulous. And I think the SEC report that was reviewed this morning, that is awesome. PitchBook data is generally good, but everything is local. Venture capital is local and whether it is in definitional terms or things like in Ohio, I will look and

say, "Well, Ohio has got a lot of capital." There are two funds that have got a billion dollars of capital. So, all of a sudden, the numbers have changed dramatically. In one fund, they might make three or four or five investments in Ohio. They are a national firm. There are a number of companies in Ohio and the Midwest that need capital, a number in the five, six, seven hundred, right? So

MR. SOLOMON: John, can you hold on real quick?

MR. McILWRAITH: Yes. Sorry.

MR. SOLOMON: The mike isn't

MR. McILWRAITH: Sorry about that.

So when you have got this data, you have got to be careful, watch things that skew the data and to make sure the data is really capturing what is happening locally. We have seen that over the years. In Michigan, we created the Michigan venture capital report. You can see it online at the MVCA, wonderful wealth of knowledge for what is really happening in Michigan. We did the same thing. I was the founding chair of Venture Ohio. Straight out of the gate, we said, "Let's get the data and make sure we can complement what PitchBook and Pricewaterhouse put out."

A little bit about Allos. And let's see. I've got the clicker here. Yes. I am not going to go through the whole slide, but that is Allos at a glance, 3 funds, over $100 million of committed capital. And, like Darcy's

fund, we have capitalized over $600 million of co-investment in those companies. We only invest in the Midwest. We are an early-stage-focused fund. That means

MS. HOWE: There is a reason in the Midwest, by the way, John. We have got to talk.

MR. McILWRAITH: Part of the Midwest I think it says up there. And the way we chose our space, early stage is very hands-on. It is hard for coastal firms to do early-stage because they don't want to fly out for board meetings. They can't meet with the companies in between board meetings. We chose that region that is our map because it was places we could drive to in about four hours. And we could meet with those companies whenever they needed attention.

And, by the way, back in 2009, when we formed Allos, Don Aquilano and I looked around and said, "There's a wealth, there's an increasing number of startups being formed in this region through public-private partnerships and angel activity, lots of things happening." And, meanwhile, the early-stage venture funds that existed in the early 2000s are going away. They have either gone on to be growth equity funds, like Primus or River Cities, or they have gone out of business because of the Volcker rule and other things that impact the funds. So there is a shortage of early-stage capital. We saw it back in 2009. And we

started Allos to try and address that shortage.

And, Darnell, we focus on non-unicorns, companies that sell at $100 million. We will make a fine return, and our OPs will be very happy with Midwestern companies that sell for $100 or $200 million. We have had several of those exits. We like unicorns, but we realize they are not going to be the norm in the Midwest typically, at least until we get the flywheel spinning.

Let's see. Other things. We are one of the most active funds in the region. We have recognized that Indiana is the most active fund the last two years. And it is a

MS. HOWE: We are the most active fund in Kansas.

MR. McILWRAITH: Perfect.

MS. HOWE: Yes. There you go.

MR. McILWRAITH: Yes. We should co-invest.

Next slide. So we thought this would be helpful to the observations I have in terms of challenges. Allos I 2009 and 2010 fund. It actually was a $22 million fund. I will get to that in a moment. But you can see the vast majority of our money came from individuals. And that is because we were too small for institutions. Institutions want fewer managers. They want to put $20 or $30 or $50 million to work, but they can't be more than about 20 percent of the fund. So if you are trying to raise a $20, $30, $40, $50 million fund, you won't get general

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institutional money. You might get fund to funds that have a mandate to invest in your region. You might get an endowment that wants to help support the community. But the core of institutional investors are probably not going to invest in a $25 to $50 million fund. And that was our experience. And so we raised it mostly from individuals. And you can see most of those individuals committed less than a half a million dollars. The 99-investor rule will come up. I will talk about that in a moment. The progression once we get a track record and once we had some exits and had something we could show, you can see we started to move more down the institutional path. But individual investors for now a $50 million fund, our most recent fund, that is a key part of our capital base. And there are things we can do I think, the SEC can do to improve the availability of capital for funds like ours and smaller funds, which are important to the ecosystem.

This just shows these corporations at the top are not those are not LPs, but people within those organizations are LPs. And they are the ones that are investing $250,000, $300,000, $400,000. And it is a wonderful resource for our companies because we get to access those corporations in terms of potential customers, due diligence, and the like. You can also see through our representative co-investors we have pulled capital from the

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coasts, Sequoia, Benchmark. Again, they will eventually come to the Midwest, but they want the companies to be de-risked. They want them to be a little larger. And they really don't want to come to more than four board meetings a year and sometimes less than that. So they welcome a local presence that can be the lead investor or the co-lead investor in Indianapolis or Cincinnati or the like.

And, then, finally, just a list of our portfolio companies. We are B2B software. So, to Darnell's point, we don't do service investments. We don't do consumer. We don't do food. We are very focused, as most funds are, B2B software for enterprise. And what that means is we need more venture funds, more diversity of venture funds, to fund the kind of companies that are service companies or food companies or consumer product companies. And that is coming, but we need to find a way to have the regulation support that capital formation.

And, then, finally, the two big issues we see and I think it has been talked about a little bit before the 99-investor rule is a big deal. We could have raised for this recent fund, the $52 million fund, probably another $10 million if we could have gone beyond 99. I mean, we had lots of interest, people who wanted to invest $100,000 in the fund. We turned them away because we said eventually we are going to have a numbers problem. And so we just said,

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no, we have got to keep to our $250,000 minimum. So that is an issue.

And the other issue that we should talk about a bit is general solicitation. In these ecosystems, there is lots of interest from folks who want to invest in funds or in startups. There is a lot of confusion about what a general solicitation is, particularly now that you have the internet and social media and a way to disseminate information in a way that feels general. But in our case, we went to our lawyer for our last fund and said, "Hey, we would like to send an email out to the 3,000 people in our database that we have. They are friends of ours."

And the lawyer said, "Oh, if it was like 200, that is probably okay, but 3,000, that feels like it is wrong."

MR. SOLOMON: It is all in the feel, right?

MR. McILWRAITH: What is that?

MR. SOLOMON: It is all in the feel

MR. McILWRAITH: Yes.

MR. SOLOMON: because there is no

MR. McILWRAITH: Right. And so she convinced we couldn't do it. And, meanwhile, I am a lawyer. So I understand it and can have the debate. My two partners are going crazy, saying, "Wait a minute. I'm sending other funds sending these emails out, posting things on LinkedIn, articles in the newspaper. And, yet, you are holding us to

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a higher standard."

And I said, "Well, it is because it is uncertain, and we are going to be conservative when it comes to things that might bump up against what could be considered a general solicitation." And, much like the rule that changed the 99 number to 248, it limits you to $10 million in capital. That is really not a help to the venture funds. Nobody really wants to have a $10 million fund. It is just there is not enough income to support one person, let alone a team.

When it comes to general solicitation, 506(c) helped, but the other problem is and there is some confusion about this, and Julie and I talked about this most of the lawyers out there thing that you have to get that tax under 506(c), you can do general solicitation through credit investors, but you can't rely on self-certification. So you can't rely on the subscription agreement. You have got to go get a balance sheet or a tax return or something. The likelihood that we are going to and we chose not to pursue that because it is hard enough to get the investors engaged. If you said, "Oh, now, by the way, we are not going to rely on your signature. We need to see some financial statements"

MS. HOWE: "I don't trust you enough," yes. It is a relationship business, "I don't trust you enough. I need to see your bank statement."

MR. McILWRAITH: That is friction. And so we said, "No. We are not going to do a general solicitation." And I checked before coming here today. That is a big deal. There is a lot of confusion. And most people are not using it because they are afraid, either because of their lawyers or friends or whatever, to use it.

And this business, much like the startup-financing world, is very inefficient. It is very hard to there are investors out there. They want to invest. They want to find product. Connecting with them is very much a one-off process because you can't do things that might start to look like a general solicitation.

MR. SEATS: John, have you thought about doing a parallel 337 fund to separate out any of the

MR. McILWRAITH: Yes. We did that.

MR. SEATS: Oh, you already did that?

MR. McILWRAITH: Oh, yes.

MR. SEATS: Okay.

MR. McILWRAITH: So if you think about it

MR. SOLOMON: So just so everybody understands what you are saying, you know, you can create parallel feeder funds where you have qualified purchasers, which gets you around the 99 limitation, and you have a parallel fund that is actually for credit investors so you can aggregate

more than 99 investors, you just keep your accredited investors to the 99. You have got a parallel fund that makes co-investments alongside of your accredited investor fund. That is

MR. McILWRAITH: Absolutely.

MR. SEATS: And, I mean, I am aware of

MR. SOLOMON: We do that all of the time, by the way. It is for the same exact reason when we are raising money.

MR. SEATS: I am aware of a vehicle that has got a I won't say the name of it, but it is a big investor group. And most of their membership are people who have over $5 million in invested assets. So they are all QPs. But they raised a venture fund that is over $100 million with like 500-plus LPs or something.

MR. McILWRAITH: Those are QPs.

MR. SEATS: Because they are all QPs, yes.

MR. McILWRAITH: Yes.

MR. SEATS: So it is a different, a totally different, dynamic.

MR. McILWRAITH: QPs, they aren't quite unicorns, but those are a little harder to find, particularly in the Midwest.

MR. SEATS: Yes.

MR. McILWRAITH: They are out there.

MR. SEATS: Yes.

MR. McILWRAITH: And, again, without things that are

MR. SEATS: It is hard to find them.

MR. McILWRAITH: Yes. And the thing about our fund, we had lots of again, we had a lot of $250,000 investors come in. We knew there were more out there, but we also knew we were going to have a numbers problem in the accredited-investor fund.

One last quick example. I talked to somebody on the flight in or before the flight today. Somebody in the Midwest about to raise a new fund desperately needed unbelievable contacts that they are very well connected in a region that needs a fund. And I am talking to the person that is helping them because he has been in the industry as long as I have. And he says, "Wait a minute. General solicitation and 99. Okay. Those are two things."

They were about to they knew they couldn't put something in the newspaper saying, "Hey, we are about to raise a fund" because that is probably a no-no, thought we ought to talk about that. So they said, "So we are going to do an email out to our network."

Their network is probably 8,000 people, right? And they are all people that want to support this organization. And I said, "You had better go talk to your

lawyer about that because that is a gray area."

He goes, "I am glad I talked to you. Now I am frustrated. And please let me know how your conversation this afternoon goes."

MR. SOLOMON: Tell them you came to watch it until you got it all fixed.

MR. McILWRAITH: Yes, exactly. I said, "It may be a little slower than that."

MR. SOLOMON: I want to just first of all, I want to thank you all. We are going to have a little bit more discussion, but I want to make sure we are we have one more presentation to listen to, but before we get to that, we want to make sure we have some dialogue about it and some questions and answers, again mindful of time. So we are probably going to leave this section to maybe 10 minutes, 10-15 minutes because at the end, we have got to wrap up and make sure that we actually do some recommending. So we want to make sure we leave enough time for that.

So any questions for the panelists or discussion points or if you have got some other things you want to say?

MS. GARRETT: Bert?

MR. FOX: Well, I wanted to go back to a point, well, I guess both to John and Darcy, but I think Darcy brought it up, you know, first on this co-investment idea and bringing in folks. You know, this morning we heard on the PitchBook data miles from investment and that sort of stuff. Yes, I guess I am curious. How hard is it to get the money to come in from the coast if you guys are actually providing introduction or not? Can you talk a little bit more or both of you about that?

MS. HOWE: Well, our model is we can't invest unless there is because we don't lead rounds. I would say the West Coast is the hardest because they believe they know everything is out there. But I think it hasn't been difficult. If the entrepreneur is raising, let's say, in the $4, $5, $6 million range, the hard part is getting to that part. Where they need capital in our part of the world, frankly, you could do really well on a million dollars. We have got to fund entrepreneurs have raised only a million or two million dollars who already have a million dollars of revenue. That is unheard of. They laugh about that on the West Coast. They are like, "Well, we have got a $50 million valuation on $1 million." So I think the bigger challenge in the Midwest or noncoastal places is those early dollars.

And what we found as a co-investment model, we are co-investing more with fewer brand-name VCs because they are writing smaller checks. The big brand VCs can't write smaller checks. And the Midwestern entrepreneurs need somewhere between, let's say, $100,000 and a million for

their seed A. And those checks are mostly in other small funds. So we will bring in and we believe that good governance is you get institutional money and sooner because the angels are wonderful investors, but they are not that great at good governance. So, you know, they price internal rounds, and they do stuff that is really dumb for companies long-term. So by bringing in other institutional investors who write small checks, that is I think the key. And that is where I think the coastal guys just can't do it because their math doesn't work on writing small checks.

MR. McILWRAITH: And they don't want to fly out to Indianapolis for a million-dollar investment. And so we invest in Series A rounds typically. Two million dollars is part of a $3 to $5 million round. West Coast firms just aren't going to do that. There are some exceptions, and we have seen it. ExactTarget, which was founded and launched and successful in India, the founder of that, Scott Dorsey, can pull people in Indianapolis through his brand. But, generally speaking, the funds on the West Coast and the East Coast want to wait until a company gets to about $4 or $5 million in revenue. And the round size is north of $5 million and usually closer to $10 million because then they can get enough money to work to justify taking one of their precious slots and their board seats and putting time into it.

MS. HOWE: And to speak to your other problem, which is the not problem but the opportunity where folks in a region want to invest in a region and it is not just the $50-$100 thousand checks, it is actually the institutional people who want to. But if they have an unnamed Boston consultant who is their consultant who says you don't know who that is, do you? who says, "No. They are a first-time fund" or "They are not a $100 million." And I get it because they spend the time to do the diligence. They need inventory to spread out amongst their clients.

And so our land grant institutions who want to invest in our fund or others locally or big endowments who want to invest in our fund, their consultant is telling them, "No. You can't do that."

MR. McILWRAITH: So IE Foundation is an investor in our fund. We may be one of their only or few investments in the Midwest. And they are reducing the number of managers and focusing more on the coast and more the big funds recommended by this unnamed Boston firm. But they invested in us because of our track record and because they believed in us. And they have now committed our most recent fund in a larger amount. But that is almost unheard of because of what you just said. You know, their investment amount is about half of what they normally commit and maybe

a quarter. And they really don't want a lot of managers. They just like funds, want fewer investments. The LPs, the institutional investor, want fewer managers.

MR. SOLOMON: So I think there is something in here that we should probably consider also that you mentioned, which is really first-time funds and first-time fund managers. That is not necessarily an impediment that is specific to regional funds. It is actually specific to any fund that gets formed. And it creates, really, a moat or a fortress around capital. So those who have been successful just get more money because they have shown successful track records. It makes sense logically, but it also adds to some of the problems I think we are seeing around the free form of capital.

We just did a fund that is not a venture fund. I hope by saying this and putting it into the record, I am not violating the general solicitation rules, by the way, but we just did a fund that closed on $208 million. It took us 18 months to do it because first-time fund and in an area of ESG sustainability, not well-known. So it was almost like first-time fund. We want to put money in this area, but we actually don't know how to put money in this area. And the two anchor investors in there don't write checks that small. So we had, really, three major impediments, and it took us you know, we are big, and we can throw a fair amount of

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money at it relative to both entrepreneurs. And it still took us 18 months to raise the money because of some impediments.

I just think we should draw a distinction here a little bit between what we can do to facilitate it, but sometimes first-time funds are just facing impediments that have nothing to do with the regulatory framework. It is just the challenge of advisers or consultants who might be doing that.

MR. McILWRAITH: Well, I guess the only exception I would say is and, again, I look at J. D. Vance is raising a first-time fund. He has been a manager before, but this is his first fund. And he basically acts as West Coast capital and others. And he has already had a

MR. SOLOMON: So I guess if you have a New York Times bestseller, that might be the exception.

MR. McILWRAITH: Exactly, or Mark Kvamme with Drive. But in the Midwest, if you are not Mark Kvamme and you

MR. SEATS: Well, they are first-time funds, not first-time managers. That is the

MR. McILWRAITH: Yes. Yes.

MR. SEATS: yes, because they can be double.

I want to emphasize this because you hit this point, I think, but it is a big one to me, which is that

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your explanation of, okay, well, $5 million in revenue or above is sort of the you know, because they want to write a check that is this big because they want to yadda yadda, and it is because they want to guard their slots.

MR. McILWRAITH: Right.

MR. SEATS: Right? And so what that is a reference to is the portfolio construction of these investors, which is 100 percent dictated by how much time the partners have as individuals, which is the dynamic which is driving why as these funds raise more and more capital, they don't increase the number of investments. And when you can't increase the number of investments, the only thing you can increase is how much you invest, which pushes you to later stage and bigger checks and oversized rounds and whatever else.

And so that is the dynamic that is playing out in the capital stack, which is why when you look at the market numbers, more capital doesn't equal more on-the-ground innovation of ownership, whatever else.

And so, you know, I think for us just to have really crisp focus on it, my belief is that if you are not creating new fund managers, you are not changing that dynamic.

MR. McILWRAITH: Absolutely.

MR. SEATS: Because a fund itself is effectively

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investing in a static number of companies in variance of how much money they are managing.

MR. McILWRAITH: Just a quick example in that we

MS. MOTT: This is Catherine. Can I comment something?

MR. SOLOMON: Sure. Go ahead, Catherine.

MS. MOTT: May I comment on something?

MR. SOLOMON: Yes. Go ahead.

MS. MOTT: Every year, I am invited to the Grosvenor emerging manager conference and to the Texas teachers emerging manager conference. They define emerging manger as someone who is raising $250 million and worked something like 4 to 8 years with a major fund. So when we think about how major institutional investors look at emerging managers, it is very difficult. They are from Kansas or from Cincinnati or from Louisville, Kentucky, you know, where you are focused regionally. It is very, very challenging to meet that definition.

And when you also think about those who raise big funds in I think somebody brought this up earlier in California or Boston, it is people who are cast out think Marc Andreessen cast out and get kind of and he has got a $400 million name, you know. So what we need to address is, how can we modernize our rules so that the

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middle of the country can successfully raise money in a way that they can spread their risk across several companies, protect their pro rata share to the point they can, and be able to prove their worth to raise another fund and get to the point where when they go to Grosvenor, they are an emerging manager and they will get $20 to $30 million. But in the meantime, we are not addressing this problem of how do we address the middle, that, you know, this is it, the flyover state. That is the key thing here.

MR. McILWRAITH: So two things, not quick but two things you could do. On the 99, the rule you passed that allowed you to go to 249, that take 10 million to 100. I don't know. Ten is just not relevant. I mean, maybe there is some relevance in how that became to be, but if you talk to people in the industry, they are like, "Nope. Nobody wants a $10 million fund. So it is not going to help." So 100 might be I mean, I don't know how you pick 10, but if you made it 50 or 100 million, that would allow these funds that want to grow to be 25, 30, 40 million to not worry about the 99 rule. And that will remove friction.

And on the general solicitation, if you could find a way to take 506(c) and go back to what you know, there is this concept of principal. You either have the hard evidence of their accredited-investor status or there is a principal process where you know the person and say, "Well, I think he is worth $5 million or whatever," if you could find a way to just go back to self-certification and say, you know, somebody says, "Signs make the paperwork more stringent in terms of what they fill out," but if they sign and say, "I am accredited based on these definitions" and make that the standard for 506(c) and allow that level of general solicitation, that would improve not only fundraising for funds. The startups have the same problem because they are worried.

Like demo days, I mean, people go to demo days. They don't know those people. And they are told, "Oops. You cannot talk about fundraising at demo day" when that audience is sitting there saying

MS. HOWE: They have got checkbooks. They have got checkbooks.

MR. McILWRAITH: Yes. And most of those people are accredited and they want to invest, but there is a mismatch.

MS. HOWE: And the last solution I would have is on the fund-to-funds side. If I don't know what the impediments are for fund-to-funds, I don't see very many of them very interested in what we are doing. I don't believe it is in the investors' best interest for us to raise $100 million fund on a highly focused geography, but I think that is our special sauce is we know that deal flow in that

region better than anybody. So whatever the impediments are for fund-to-funds, I think that would help a lot. It would help the institutions. Our own land grant Kansas State says $75 million is our minimum. And they recognize that because the fund has to be a little bit larger, they are missing the kinds of things that are being built in the State of Kansas that would help them to have economic prosperity, you could have more students there. They would like to, but they can't because of their size restrictions as well. So I think fund-to-funds could really help.

MR. McILWRAITH: That ties to the 20 percent rule, which I think is part of the that is another thing that could help for sure.

MS. MEHTA: Is that a good segue?

MS. GARRETT: Yes, that is a great segue.

Thank you very much. I mean, I just want to kind of it sounds like there are funds out there, a lot of funds. So you are not having a problem actually getting money into your funds. It is problems on caps that are restricting the amount that you can get, would you say?

MR. McILWRAITH: Yes. But it is also increasing awareness. So you think about this general solicitation. Had we been able to send comfortably, we can send an email to the people we know, the 2,500 people in our database, and not worry about that being a general solicitation, I know we

would have gotten a bunch more $250,000 investors from that. And, you know, think about it. Ten of those is $2.5 million.

I mean, our partner, we sat around and said, "We know they are out there, but the way we find them is through one-off introductions because it is a very inefficient market."

MS. HOWE: And it will take me a year and a half to raise $20 or $30 million. It takes

MR. SEATS: That is on the accredited-fund side. For the QP parallel fund, that is the dollar size, the mismatch with the LP base.

MR. McILWRAITH: But we can't do a general solicitation of QPs.

MR. SEATS: Yes. Right. Yes.

MR. SOLOMON: I mean, general solicitation rules are murky. So I think that is an area where we could probably address that. They are definitely murky like, you know, we looked at LinkedIn posts.

MR. SEATS: Yes.

MR. SOLOMON: So I want to announce that, you know, when we did our first close on an ESG fund because that was a pretty remarkable thing to say, people were like, "Oh, no, no, no, no. You cannot announce that at all."

MR. McELWRAITH: And just real quick, the

challenge we face, most funds have a first closing, and then there are 12 or 18 months to your final closing.

MR. SEATS: That is also true

MR. McELWRAITH: The moment you have a first closing, you want to put out news of your closing so you get deal flow, not LPs. You just want to be able to tell the world, "I have funds to invest."

Talk about a sticky process because now the press wants to talk to you about your fundraising they read your Reg D file. And you are like, "I can't talk about that." And then you run the risk that they might say something that you didn't say to them.

MR. SOLOMON: So we are publicly traded. Say, "We are publicly traded." And so I would like to tell our shareholders that we closed on a $208 million venture fund or a $208 million fund, first closing. It is still opened."

Today is probably the first day I can talk about it because it made its first investment. Literally as we were sitting here, we pushed a press release. And people were like, "Oh. Oh. Wait a minute. They actually raised the fund, and they are making investments? When did that happen?"

MR. McILWRAITH: Right.

MR. SOLOMON: And it is all because we didn't want to be in a position where we blew the general solicitation rules. I totally agree with you.

MR. McILWRAITH: Great. Great.

MS. HOWE: Carla, it is really hard to raise money out of our

MS. GARRETT: Okay. I understand.

MS. HOWE: It is really hard.

MS. GARRETT: The money is there. It is hard to get it.

MR. McILWRAITH: Right. Right.

MS. HOWE: Yes. It takes a long time. And you are just

MR. McILWRAITH: Very inefficient.

MS. GARRETT: That was the point I wanted to clarify. I think

MR. McILWRAITH: Or in Darnell's case, the money, really, it wasn't there. Right?

MS. GARRETT: Well, Commissioner Roisman would like to talk real quick.

COMMISSIONER ROISMAN: I'm sorry. And I know my comments are going to be far less valuable than Sapna's, but I do just want to take a moment to recognize I really thank you very much, all of you and Poorvi on the phone as well, for providing this like insight. I think this is a great example of why this committee is so incredible. There are

so many people rooting for exactly what we are trying to accomplish here, which is provide answers and clarity for businesses going through the process. I think you are a great example of explaining a situation that was, as you said, your badge of honor. Yet, you have been successful.

I think everything we talked about is actually through the lifecycle of pretty much any business. You have started your own shop. You raised your own capital. We have the next stage, which is the venture capital, right? You guys are saying we should expand and, you know, help it out because that needs more oxygen in the fire. Then you would have discussions of public companies and what they need to do. But it is important to remember that everyone goes through this cycle right? and to help those that had come after you that have the same struggles that you did.

So your funds, which are great, doing an incredible job in the Midwest, think about companies such as Darnell's and Poorvi's, how they can benefit from your wisdom from potentially long-term your investments, even though they may not be the size that you want right now.

And also think about new asset managers. I mean, this is a point that Jason makes. I think that is a very valid point. You know, there is a limitation on the ability of managers to take the time and provide their insights and

expertise to these companies. We have to somehow fill that gap.

But these are all important points. And I don't want it to become paralytic because there is a confluence of different things that have led to the current situation. But you have identified some helpful points for us to take back what we as the SEC can do in order to potentially help grow the funds that you guys have access to capital and hopefully push down some of these barriers. There may be things that we just don't have control but we should know about. Maybe we can partner up with other agencies and things like that to, you know, have Martha and her team kind of follow up on. But I think it is really important to continue this dialogue and after today's session provide us three or four things that are issues and three or four solutions. At least from my perspective, I think that would be particularly helpful.

But, again, I really do appreciate all of your insights and your help on this. And to the extent that you guys want to submit comments on things that we are currently doing, I will certainly find that when I review. Thank you.

MS. GARRETT: Sapna, we would love to hear your story of Revolution's Rise of the Rest. And we would love to hear how

MS. MEHTA: Happy to. And it dovetails very well

with discussions that have been happening after lunch and even before lunch. So, as you all probably know, we have Steve Case. We have a series of funds in different stages of a company's lifecycle. And our youngest one is our seed fund, Rise of the Rest Seed Fund. It's a $150 million seed fund, you know, raised with relative ease because it was a great mission that people could get behind. And we had already laid the foundation through these bus tours that we do throughout the country.

So I know you know members of our team. And a part of our competitive advantage is that we know managers like you guys. And so a lot of coastal VCs like don't really know how to go about finding gems that are not near them, like in middle America, or they are not willing or able to put behind the resources needed to do that.

So we raised this fund pretty quickly, and we deployed the money faster than we had thought we would. And we are getting around to raising our next fund. And what we wanted to do is have a hybrid fund where we could do fund-to-fund investments and direct investments because in our view, like we saw that after making these, you know, deploying two-thirds of the $150 million, leaving the rest for reserves, but after deploying that money, to really get the flywheel effect going, we need those regional money managers as regional funds to invest in the companies in their own backyards. Like they know the people. They know those entrepreneurs well. They know the network. They know the community. They know those industries. They are the ones with the deepest roots in those communities. And we rely on people like you to source a lot of these deals for us. So it is a mutually beneficial relationship.

And we didn't want to compete with what you do. We wanted to piggyback off of what you do. And so that was the thinking, that we were going to deploy maybe over half the fund and funds like yours and then reserve a smaller percentage for direct investments.

However, when we started going down the path of how we would do that, we knew the constraints. But when we really started doing the math and thinking of what it would mean for our organization to do that, we ran into some hiccups.

So just as background, with Dodd-Frank, there came an exemption for venture capital. So everyone else has to become a registered investment adviser, so private equity funds, hedge funds, but there is this VC exemption. However, if you are over $150 million of assets under management, there is a multipronged test that you have to satisfy in order to be an exempt reporting adviser.

I am going to go past this because I think everyone sort of this is just some background. And some

of the policy reasons I think for creating the venture capital exemption is because SEC and Congress wanted this money to go directly to the companies, rather than towards compliance costs. And so that is something to keep in mind. So when you are looking at potentially having to be an RIA or if you want to be an exempt reporting adviser, there are certain things you have to do. So you have to represent yourself as pursuing a venture capital strategy.

There are certain leverage limitations. So, really, you know, it knocks out a lot of like LBO strategies. You cannot offer your investors redemption or similar liquidity rates. So that eliminates most hedge funds.

And the other prong that I want to talk about is that you can hold no more than 20 percent of your total capital commitments in nonqualifying investments.

Yes, I have different talking points than slides. Yes.

And so in talking about that 20 percent prong, so what are nonqualifying investments? So these are things such as secondary transactions. So in order to make let me say the inverse of it. So 80 percent of your investments have to be in qualifying investments, which are direct investments in private companies. So that eliminates fund-to-fund strategies. That eliminates secondary transactions.

That eliminates any investment in a public company and a few other ones that we won't delve into here.

Just to rewind a bit, so a lot of people are like, "Well, then, why don't you just register? If you want to pursue these strategies, then what is the harm in registering?" So we had these numbers that NVCA had provided. And they did a study. And they came to the conclusion that it could cost eight times as much for a fund to become a registered investment adviser, rather than being an exempt reporting adviser. And so when we started going down this path of what it would mean for Revolution to become an RIA so we have 137 portfolio companies in our first fund.

So that is a $150 fund. We write small checks. We tend not to lead or take board positions. And a lot of these are very early-stage companies. So when we were first talking to our auditor, they did not even want to do it because it is not worth their time. It just becomes something. It is very impractical. So what we ended up doing is we do income tax-based accounting for this fund. So we do not do GAAP accounting. If we were to become an RIA, we would have to do GAAP accounting. And so we would have to go back and all 137 of those companies, we would have to you know, we worked it out finally with our auditor. And they gave us an estimate. And it would be

three times more expensive to do our annual audit.

And that is just the annual audit piece because then you have the other compliance components. So we would probably have had to hire two more people on our team to manage the ongoing compliance regime that is associated with being an RIA.

And then you have to hire outside vendors and software programs. So there is like the custodian issues that you would have to comply with. There are various outfits that help you become an RIA. And one of the more we haven't discussed it here, but one of the biggest barriers was the advertising rule. So, I mean, we are a marketing machine and not being able to talk about our investments, I mean, we were on 60 Minutes and touting a few of our investments. What we were trying to do is shine a spotlight on these companies to draw interest to these companies and to these areas. And with the advertising rule, we would not be able to do that. So we would not be able to really tweet about any of these companies. You know, maybe it is okay to say something very factual, but like with no color attached to it.

And so these things and the other thing about this rule is that if one fund becomes an RIA, you have to look at the integration rules and then all of your family of funds. So our other Revolution funds would also have had to register. It is one thing to say that and then the cost that it will be, but if you really think about it, some of it would come out of your management fee, like if you are hiring additional staff, but a lot of these are going to be fund expenses.

And our LPs don't want this. They were fine our accounting. They are fine with the level of reporting we provide them. They would rather us show a higher IRR. They would rather us put this money towards our investments in these companies. And so, really, it didn't make sense for us to do.

And so we could have done it with the 20 percent. We could have just restricted ourselves to doing 20 percent of the fund. But we just felt like it would send wrong signaling because then it is like, well, which funds are you selecting for that 20 percent basket? It wasn't worth the headache involved.

You know, it does get a little complicated doing a hybrid fund, but we had managed to work through a lot of those issues around fees and carry and all of that structure. But it really was the legal impediment, which is why we did not pursue that strategy.

MS. GARRETT: Sapna, just to be clear

MS. MEHTA: Yes?

MS. GARRETT: the strategy you did not pursue

was creating a fund that would have invested in regional funds?

MS. MEHTA: Correct.

A PARTICIPANT: As well as

MS. HOWE: And all of the regional funds that were associated with them were begging because we knew Steve Case is a marketing machine who can go out and raise money. And we were having a hard time raising money. None of us who went to his summits had ever raised more than $30 million 3 years ago, when he first started doing that. So we were really hoping and disappointed, frankly, when they didn't do

MR. FOX: I guess I want to be

MR. SEATS: Also, the thing just to point out is that, in essence, what you are talking about here is pooling small regional funds so that the capital allocators can write bigger checks to people who are better at raising money. I think of it like sort of connecting the dots of the system. Right?

MR. FOX: So I just want to make sure I understand, not an attorney. So is it purely from the 20 percent rule? Is it that you couldn't do direct investments and the fund-to-funds or you can't do the fund-to-funds, period?

MS. MEHTA: We could do up to 20 percent of our

total capital commitments. So if we have a $100 million fund, we could do up to 20 million of that in fund investments. But that 20 percent basket, you have to keep in mind also covers any secondary transactions. So you would want to leave room in there for

MR. SOLOMON: As well as any public investment?

MS. MEHTA: Yes.

MR. FOX: So you couldn't have just a fund-to-fund, period?

MR. SOLOMON: No. You have to be a registered investment adviser.

MR. FOX: Okay.

MR. SOLOMON: Right.

A PARTICIPANT: Can I say something else?

MR. SOLOMON: Matthew is actually the expert on this.

MR. COOK: I am a staff member on this. I wouldn't say expert.

MR. SOLOMON: In this room, you might be the expert.

MR. COOK: Maybe. Just to conceptually the way you started off is great. I mean, the first slide, in particular, sort of showed the context in which the venture capital exemption arose, which was their prior exemption in Congress for basically all private fund advisers. And then

Congress in Dodd-Frank said, "No, We want all advisers to register, but we don't want venture capital advisers to have to register. So we are going to create an exemption for them." That exemption then became a question of, what does it mean to be a venture capital fund and a venture capital fund adviser. And so the SEC came up with a definition that showed. And part of the decision there really if you read the release, which you may not want to do, back in 2011 was basically saying for venture purposes, the SEC was interpreting Congress' intent or what Congress intended to get at by saying the goal here was to get funds from the investors into one fund and then the fund direct investment equity issued directly by a portfolio company, that they interpreted the exemption to mean. And so the idea was to be a venture capital fund, at least 80 percent would have to be that activity.

And then there were a bunch of comments. And the proposal was slightly different from what was ultimately adopted. But the basic premise was 80 percent is to be that and 20 percent is for any other piece of strategy you want to do, which would include the fund-to-funds and would include secondaries. But every time the Commission considered a potential tweak to the overall definition, rather than do it on an individual or piece-by-piece basis throughout the general approach, was look to the 20 percent basket and if that be everything that doesn't meet what we thought Congress meant by being a venture capital investment.

MR. LEE: Just clarifying, the 20 percent also includes nonequity investment, so debt investments, revenue-share agreements. You mentioned like, for example, where if you don't know after all the show that you went through, you don't want to sell equity. You just need a million-dollar credit line. You know you are going to pay it back in a year. These venture funds could not meet that financing to you.

MR. McILWRAITH: They could make it within the 20 percent, but the 20 percent

MR. LEE: But for all of the reasons and even for your do any of

MR. McILWRAITH: So no. But Indianapolis, so High Alpha, the guy that founded ExactTarget created a venture student. Now he is a $100 million venture fund, big fund for the Midwest, wonderful asset for Indianapolis. I think one, maybe two of his investors are out-of-state coastal firms that put money in his fund. So they used part of their 20 percent. And they are now spending time on a regular basis in Indianapolis looking at the portfolio companies that this fund, High Alpha, has invested in.

So it works. It is not something we would do. We

are too small. We would be a recipient, and you would be a recipient. But the impact on the Midwest it could be anywhere, but we come from the Midwest is dramatic because now, all of a sudden, those coastal firms say, "Hey, I do want to spend time in the Midwest because I have my local firms, and I have got to look through one." And the 20 percent just inhibits that.

MS. MEHTA: That is exactly right. And it is also that we talked earlier about coastal funds not wanting to do a lot of direct investments because of the time

MR. McILWRAITH: Right.

MS. MEHTA: and attention it takes. However, if you find a good manger, you don't have to put in the time and attention because you are entrusting this fund to do that for you. They are sourcing the deals, and they are doing that for you.

MR. McILWRAITH: Then they come in with larger. So when those companies grow, they need that growth capital around. Now these funds are teed up. They know the companies well. And they come along and say, "Terrific. Now I am bringing $10, $15, $20 million to the table in rocket fuel for these companies." So it is a big issue.

And the secondary piece is a big issue, too, because you have got these companies that know there is investors or at least early investors that want to get out.

And the big funds would like to take them out. If I am a big fund and I want to put $20 million to work and the company only needs $10, I am either going to figure out another way to get $10 million to work or I am going to walk away.

Now, if I am the company, I might say, "Well, I have got some of my early-stage investors." They would sell out at five times or three times the return. The 20 percent rule impedes these bigger funds from putting more capital to work in Midwestern companies. And so they stay on the sidelines because they just can't get enough capital to work.

MR. SOLOMON: So I want to make sure. There are a couple of things in here. First of all, I want to make sure the committee understands that a lot of these recommendations are actually recommendations from a broader report that the NVCA put out. So while they represent a lot of what Sapna and Jason have experienced in their own funds, this is not just them coming with ideas.

This is actually a subsection of a recommendation from a white paper that came out from the NVCA, which I would encourage the committee to look at. This is the relevant parts. I think we discussed this. This is the relevant parts for this committee, but there are some other things in here as well the NVCA is arguing for.

One of the things we talked about, though, is because you can't invest, as a venture fund, you can't invest, in public companies other than through this 20 percent exemption. In the last seven years since the SEC has guidance around this, what has really fueled the growth of biotech investing is actually something that we don't talk a lot about because it is a market convention. And that is partnership.

So in 2011, 2010, let's be really clear. It isn't like the venture community and the public investors really were having much conversation. They weren't. They didn't really like each other that much because there's always arguments over what these things are worth. And so you would have the venture community saying like, "I'm not going to let the biotech cabal price my portfolio."

And you would have the public market investor saying, "Well, we are not going to let you sell everything to us at an IPO" at some value and then we get left holding the bag.

And so a bunch of us got together in the industry and just started fostering communication and dialogue. And out of those dialogues came the concept of crossover investing. Particularly I think crossover investing in biotech is very unique relative to the other crossover investing we have seen. And that is where public company funds, mutual fund companies, by and large, and other hedge funds, '40 Act registered companies, are investing in private securities in a round just before the companies are likely to go public and and it is an "and" statement the venture funds are also investing at the IPO additional capital. That combination of having public market traditional public market investors investing privately allows them to get access to value creation for their shareholders, which, by the way, most of which are retail and individual shareholders. So that the venture capital firms are giving up a little bit of value to introduce their longer-term shareholders. And then at the next round of financing, which is the public round, and in many subsequent follow-on rounds, the venture funds are putting up incremental capital because they recognize there is still value to be created from the companies. They are using that exemption to do that in many instances. And it is chewing up a lot of their because these companies, if you go from a $200 million company to $400 million company to an $800 million to a billion, 2, which is what you like to see, you almost by definition have to be polluted. You may want to own more of those companies.

And so one of the things that NVCA is advocating for is the ability for public investments, particularly in biotech, where there has been some success, to be exempted

from this 20 percent bucket provided that the venture firm has actually made a prior investment where the companies were private.

And I would just say, you know, we talk a lot about what in regulation doesn't work. This is actually one place where the market figured out how to actually collaborate and cooperate. And it has really been in addition to the JOBS Act, I think the number one reason why we have seen so much capital flow to these companies is because there has been a partner I am not saying they always get along, but they get along a heck of a lot better now when both are putting money at the same time. And we just want to make sure that that gets recognized in some of these exemptions.

MS. GARRETT: I would like to thank our speakers very much for coming today. I would like to use the rest of this time, actually, for the committee members to discuss what we have heard and what we have heard from the speakers and also think about how we would like to have our next committee meetings follow up on a lot of the points that were raised today because we have raised a lot of different issues that are all great. And I think they dovetail great into the next committee meetings. So thank you very much for coming. Thank you. We really appreciate having you here.

MR. FOX: Hold on, Carla, real quick, before Darcy and John leave.

MS. GARRETT: Okay.

MR. FOX: Would you echo the thoughts on the cost of becoming RIA? That is a nonstarter for you as well.

MR. McILWRAITH: If we were I mean, we know about that. And yes, you

MR. FOX: Okay. Just want to touch.

MR. McILWRAITH: your registered investment adviser.

MR. FOX: Just want to confirm it.

MR. McILWRAITH: Okay.

MS. HOWE: Having come from Merrill Lynch, also I know there was a fund-to-funds. A lot of folks thought that was expensive. You are ripping off the retail investor and all of that. Actually, in this case, I think it is helping the retail investor to be able to invest because otherwise they can't invest in our funds in a small amount.

MR. FOX: Okay.

MS. GARRETT: Thank you very much.

And I would like to now open it up to the committee. And we have 15 minutes. So I think this is a great time to put on the table some of the different ideas that we have discussed today, topics that you would like to see on the agenda for upcoming meetings. Sapna and I know

we -- you know, you talked about the venture capital operating exemption. If we don't come down to a recommendation today, which maybe we all need to digest all of the information that we have received today because we have received a lot of information, if we come up with agenda topics for the future, that would be useful.

MR. LEE: I would make a suggestion. I was wondering if it is possible next time if we can really try to focus on the most pertinent. Like the most direct problem is probably the best way to phrase it, which is still basically how do we ensure more capital to Darnell or Darcy or John, right? I think that is an easy way to kind of think about today's discussion.

I think the PitchBook was great. And I think somebody mentioned maybe there is a better way to slice that data to get more specific data on regional funds and regional investment. I think that might be really helpful to focus specifically on, really, how do we get more capital to the Darcys and the Johns of the world because I think when we look at like when we step back too far, the problems become really big. It is kind of difficult to kind of equate the problems that Darcy and Darnell is having versus the Blackstones of the world that have different problems that they are trying to solve.

MR. SEATS: Just to explicitly sort of connect those dots, I mean, this is not a recommendation. I think Jeff was correct in framing what shared was a subset of some of the NVCA's recommendations on the VC modernization. But these three things that are left on the screen, that is as close to what a recommendation is out of the sort of content there. And to be explicit, that first item would directly impact John and Darcy. That is basically the formalizing of the Scout program to allow large coastal firms to put capital into small, regional funds for deal-flow purposes, that is a behavior that they already want to do but are averse to because it hits against the 20 percent

MR. SOLOMON: I would go even further than that, which is to say I just don't see a difference between if you are a venture firm that only invests in other venture firms, I just don't see why that doesn't qualify you as a venture firm.

We can definitely do the exemption bucket. We should do that. I think that is a good recommendation because we certainly want to if we are solving for this idea we have capital at the coast and knowledge regionally. And we can create a transmission mechanism but for the fact we have some, you know, I don't want to say arbitrary but some regulatory constraint. I believe it was there for good reason, but we can now say 10 years hence almost that it maybe is doing something that it wasn't intended to do.

Certainly like we saw at Dodd-Frank, it hadn't even dawned on me until you mentioned it, John, that, of course, Dodd-Frank decimated the middle of the country as it relates to venture because it stopped all the banks from being investment managers. You know, again, we talk a lot about the law of unintended consequences when it comes to brute-force regulation. I am not opposed to Dodd-Frank and its concept. I think it was a necessary thing that had to happen here, but let's face it. Legislation is not a nuanced tool.

And here with regulation, we can use regulation and maybe amend regulation to get to what we want to get to and I would say go a step further after hearing today. No reason why we can't have maybe if you are just a venture fund to invest in other venture funds, why are you not considered to be a venture fund? And, you know, maybe start from that and then and see where we go from there.

MR. FOX: I guess I like Matthew's take on that because I can imagine if I am a fund complex and I invest in I have a venture capital arm and a private equity arm and maybe just a hedge fund arm and, you know, I am like, "Well, gee, let me raise some more money" and I invest in some other hedge, you know, venture funds, fund-to-funds. And I go into the SEC and say, "Well, gee, now 51 percent of my activities are investing in venture funds. Maybe I should

qualify and I shouldn't be an RIA, even though a sizeable part of my business is not in venture funds." You know, it just seems like there is some does it have to be 100 percent? Does it have to be I don't know.

MS. MEHTA: I mean, let's get

MR. FOX: Yes.

MS. MEHTA: Yes. There are still other prongs to the test to leverage.

MR. FOX: Yes, I know, but

MS. MEHTA: So I do agree. And, I mean, going back and reflecting on Jeff's point, I get the idea that we want these dollars to go directly into companies, but now that we have had time to assess what the impact of that has been and how the money is staying on the coasts and it is all part of an ecosystem. So you have to have the companies, the entrepreneurs. You have to have the funds that are going to invest in those entrepreneurs. You need the investors that are going to invest in those funds in order to make the whole thing go.

And so I agree that there should be some change in whether it is exempting it altogether, exempting the fund-to-funds investments altogether, or putting some parameters around it. You know, I am open to whatever ideas other people have, but I do think we need to take a more holistic approach and see the whole ecosystem for what it is and be

able to address the issues that are affecting a lot of middle America.

MR. SOLOMON: So one of the frameworks I would say and I don't know if we want to work this into some of our recommendations, but I see this framework happen all of the time where we just have a problem, a market convention problem, where the bigger people are, the bigger they have to look at investments. That is something we have heard today, right? Kansas, State of Kansas, can't invest in a local fund because the pension fund is too small. Right?

We face this problem all of the time in the public markets, too. Right? We now have multi-trillion-dollar asset managers who can't look at small cap stocks because you can't invest enough in them. This is a problem. So what have we done? What has the market done? Market has actually figured out how to allocate capital to capital allocators. Right?

So I would argue today's biotech investor again, we look at that as something we know a lot about at Cowen, but it is also a good example of how a market figures it out. A lot of the bigger funds today are investing in management teams that they can then allocate capital to various clinical programs. You know, historically biotechs invested in one clinical program. Now they invest in 10 o 20. Why? Because investment managers have to allocate that capital to somebody who can better select them. It is a very similar analogy here.

So venture firms would like to allocate money to people who are better at allocating it regionally with more specificity. And they would do it if they could. So we have, again, other market conventions in which very large asset aggregators are figuring out ways to get to smaller, more purposeful investments that are venture-oriented. We should use that rubric as a way to think about designing regulation to foster that same move. It is always helpful to see that markets do figure this out and capital actually does flow that way when it is unimpeded. And I hope that is helpful as a framework maybe as an analogy or a way to think about it.

MS. GARRETT: I thought that was very helpful. Do other people have items or are you

MR. FOX: Well, that makes sense to me. It also struck me that today was the multiple times in the meetings so far that the you know, this rule around solicitation, general solicitation, has also come up as well. And so maybe we can ask the staff to have, you know, maybe some of the attorneys here maybe help provide some more background on the background of that, how the staff here actually thinks about it and maybe some background on how we got to there and maybe for the next meeting as well.

MS. MEHTA: How many hours do you have?

MR. SEATS: But even more accurately, the thing that I heard wasn't the fact that we are limited in solicitation, but we are uncertain

MR. FOX: Right.

MR. SEATS: -- about how we are limited.

MR. FOX: Yeah.

MR. SEATS: So even if it was a higher restriction but more precise --

MR. FOX: Right.

MR. SEATS: -- it would probably help the market.

MR. FOX: Yes.

MR. YADLEY: Well, there is definitionally and then also the American Bar Association comment letter on general solicitation and the deregulation of offers and that whole thing. There are different ways to go at it, but certainly the lack of a definition now. But how meaningful does it need to be as we try and harmonize the exemptive schemes?

MR. McILWRAITH: Can I just add one thing to that? Sorry. I agree with that. But the thing about -- you -- under 506(c) you allow a full-blown general solicitation, right? I know a fund out there that is advertising, like, because it can. Because it's going through the step of getting the documentation to show they're accredited. To me

it's not trying to define general solicitation. It's figuring out how to better define what you're trying to -- you know, why you need that extra step to prove they're an accredited investor. Because if you know they're an accredited investor, you can sell them as many as you want, subject to the 99 Rule. And you can do it through general solicitation, right? Is that -- I think that's the way that the rule works. So what struck me as odd is you know, I got to go through all this friction to get a tax return, when I know this person is an accredited investor. So I -- I don't know that I'd focus on trying to define general solicitation. Because I think that's -- you said it. How many hours do you have? Is there a way to make it more tied to the traditional rules on an accredited investor?

MS. MILLER: And so I also want to point to I know we talked about this a little bit with the harmonization concept release, as the committee. And there4 was a lot -- we had a lot of really thoughtful comment letters in the file about this very topic. And so it is something that we have heard really good feedback on. And I know that the committee, the subcommittee that had met previously talked a good bit about the issue.

I actually wanted to bring up one thing as we get close to time for adjournment. I know that folks have travel reservations. And that is a topic that we touched on

a little bit, which is around the size and scale of funds and being able to cover. You know, somebody mentioned that $10 million will cover one person's salary I think was something that someone said earlier if you are a fund. And I just wanted to highlight a great program that EDA, the Economic Development Administration, has. And they teased it publicly last week at an event that I was attending. And I asked the director of the Office of Innovation and Entrepreneurship, Craig Buerstatte, over there, if it was okay if I mentioned it today. And he said, "Please do" because they want people to know about it. And that is a grant that supports operating expenses for smaller and regional VC funds, in particular, are very attractive candidates. So I flagged that because there are resources and programs like that that are available. That will be something that launches very soon.

So if you are silent for email blasts and make sure that you are looking for it, that is the type of thing that can really help. But it is only helpful if you know to apply. So I bring that up because it is germane to this discussion and wanted to make sure that I flagged that that was something coming.

MS. GARRETT: Any other items that people would like to discuss?

MS. MOTT: This is a question, if I could, please?

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MS. GARRETT: Sure, Catherine.

MS. MOTT: The 99-investor, 250-investor rule is in legislation. Is there anything we can do here as a group to you know, can we send a letter to Congress or is that totally inappropriate considering that we identified the issues that this creates for the middle of the country, where the capital is needed the most.

To address it I know that, you know, I did not get a chance to mention it when I testified before the Senate Finance Committee last March. I was limited in stump minutes, but I think it is a big issue for middle America and I just want to know if there is anything we can do as a committee.

MR. YADLEY: I think we are an advisory committee to the Commission and the advocate probably, although we talked about at the last advisory committee. And we went on record saying some of the same.

MR. SOLOMON: Well, I certainly think that everybody can do this. So whether or not we can speak as a committee, I am not sure. I don't know what the rules are around that. There is always that funny stuff between the Executive Branch and the Legislative Branch that I don't profess to understand. But each of us has carried with us in our bios the fact that we are members of this committee. When we show up on Capitol Hill for our times, we will see

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members of the House Financial Services Committee and Senate Banking and Finance. And they will know that we are there and our involvement here. So I would strongly suggest that if as part of your routine, you are seeing these members of Congress, that you advocate for that.

They are absolutely looking for interesting ways to improve capital formation. I mean, the push for JOBS Act 2.0 and JOBS Act 3.0 because of the success of JOBS Act 1.0, they are open and listening. And I think there is a handful of things in here, if they require legislative action, we can certainly get our heads around it, even if it is not a formal part of this committee.

MS. MOTT: Thanks. I didn't think there was. I was just asking. I was just curious. Thank you.

MS. GARRETT: Thank you for the question. And I think that

MR. SOLOMON: I just have one question, actually, for you, Carla

MS. GARRETT: Okay.

MR. SOLOMON: which is just, you know, last time when we were going to put forth formal recommendations, we kind of circulated them to the committee. And then we had a committee call. Is that sort of you know, we are not going to get a chance to draft anything formal today? Is the idea that, you know, we should all think about these

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things and then maybe we will circulate some food for thought and then get this group back together again, see if there is anything formal that comes off the back of it?

MS. GARRETT: I think that what we have done today in terms of brainstorming and coming up with what the issues are has been very useful. You guys could tell me if you disagree. But at our next committee, we could do as Youngro suggested, which is start to figure out how to get the money to Darnell and the other people, Darcy and John, and maybe come up with recommendations at the next meeting so that everybody has time to digest everything that they learned today if the committee is on board with that.

MR. LEE: Yes. I just meant specifically because I think some I mean, I love this committee and what it is doing, but when we have really, really big examples, it is hard to focus on the small application. I think that is our job, right? We are the Small Business Capital Formation. I think we can literally talk about Darcy's circumstance for three hours if you want to, still not get the so, if possible, if that is maybe a focus of the future meetings to really hone in on the issues of let's just call it small funds or small businesses because I think when you bring in necessarily big, big money managers or big investors, it does have a different framework. That was my personal opinion. Obviously I am not the only voice here.

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MS. GARRETT: Stephen?

MR. GRAHAM: Yes. I would be kind of inclined to go in the direction that you seem to be describing. I think it has been a great discussion. I think we have learned a lot. I think there are a lot of things now that we are just kind of thinking about. And I think we would go away and kind of let things kind of percolate some more. But it probably makes sense for you guys to begin to formulate what the recommendation might look like and, you know, have those drafts and kind of the supporting discussion of bullet points to basically serve as a way to facilitate formulating and considering a recommendation for the next meeting.

MS. GARRETT: Okay. Thank you. The next meeting is May 8th. It is in Boston. And I think that is a great idea that we can work on that. And we can talk about these issues at the next meeting.

So, on that, I will say thank you very much. And the meeting is now adjourned.

(Whereupon, at 3:31 p.m., the meeting was adjourned.)

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PROOFREADER'S CERTIFICATE

In the Matter of: SMALL BUSINESS ADVISORY COMMITTEE MEETING

File Number: OS-0204

Date: Tuesday, February 4, 2020

Location: Washington, D.C.

This is to certify that I, Christine Boyce (the undersigned), do hereby certify that the foregoing transcript is a complete, true and accurate transcription of all matters contained on the recorded proceedings of the investigative testimony.

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REPORTER'S CERTIFICATE

I, Beth Roots, reporter, hereby certify that the foregoing transcript is a complete, true and accurate transcript of the matter indicated, held on __2/4/2020___________, at Washington, D.C., in the matter of:

SMALL BUSINESS ADVISORY COMMITTEE MEETING.

I further certify that this proceeding was recorded by me, and that the foregoing transcript has been prepared under my direction.

Date: 2/4/2020

Official Reporter: Beth Roots

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