UNITED STATES SECURITIES AND EXCHANGE COMMISSION

SEC SMALL BUSINESS CAPITAL FORMATION ADVISORY COMMITTEE MEETING

Tuesday, August 13, 2019

9:36 a.m.

President's Fitzgerald Boardroom

4th Floor of the Mike and Josie Harper Center

Heider College of Business

Creighton University

602 N. 20th Street

Omaha, Nebraska

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Mike Pieciak - by phone

PARTIPICANTS(CONT.)
PANEL ONE:
Matthew Swartz
Bill Korn

PANEL TWO:
Charles Crain
David Maley
Mike Raab

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PROCEEDINGS

CARLA GARRET: I would like to confirm who the members are -- for those of you on phones --

Thank you to Creighton University for hosting us here today. They have been gracious --

I would like to introduce --

We're going to wait for a minute --

(The Committee waited for audio visual technical difficulties to be resolved.)

CARLA GARRET: Well, I don't need to call the meeting to order again because I've already done that, and we've established that there is a forum. And so I wanted to thank Creighton for hosting us. They have been great and have been very gracious in everything that we're doing here today.

Here is a brief overview of the agenda items for today's meeting. In June the SEC requested public comment on ways to simplify, harmonize and improve the exempt offering framework to expand investment opportunities while maintaining appropriate investor protections and to promote capital formation. The harmonization release is quite comprehensive and large enough to take up multiple of our committee meetings.

And so today what we will be doing is focusing on developing a framework for this committee's work recommendation on harmonization release.

Today we will also be discussing regulation SX related to merger and acquisition disclosures plus accelerator filing definition. These two rules apply to public company disclosures and are timely because the SEC has just proposed an amendment to these two areas, and the public comment period has just ended. As the SEC staff and commissioners deliberate on how to move forward, the committee can provide perspective on how the proposals would impact small businesses. And what we are hoping today is if we can provide actually recommendations to the Commission on -- on these two rules.

I would like to mention that for members of the Committee who don't work -- regularly work on public company reporting requirements, your perspectives on these issues are still very important and future committee meetings will likely have much more focus on private companies and exempt offerings. Please note that Chairman Clayton -- Clayton and Commissioner Purse will be joining later in the day, likely around lunchtime.

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expand investment opportunities while maintaining appropriate investor protection and to remote capital formation. The harmonization release is quite comprehensive and large enough to pick up multiple of our committee meetings. And so today what we will be doing is focusing on developing a framework for this committee's work and recommendations on harmonization release.

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Please note that Chairman Clayton -- Clayton and Commissioner Purse (phonetic) will be going later in the day, likely around lunch time --

Now, I would like to introduce the SEC staff with us today. We have Martha Legg Miller who serves as the SEC advocate for small business capital formation and she is a member of the committee. Thanks, Martha.

And we have Julie Davis, senior special counsel in the SEC office of the advocate respondent of capital formation and has been incredibly instrumental in everything for today's meeting so thank you very much.

Also we have Bill Hinman, who is the director of the SEC business and corporate finance committee. Bill leads the division responsible for, among other things, drafting SEC rules and forms regarding the office security leading the rules --

The committee heard from Bill about recommendations of small businesses at the first meeting.

(Inaudible.)

If you have a point to add a question, please e-mail Julie, and Julie will relay them to us. Thank you.

I will start today with our first agenda item is SEC formatization.

Since our May meeting -- oh, I'm sorry, I -- I was in the middle of introducing Bill.

I'm sorry.

It's worth noting that Jennifer's policy office is different than Martha's advocacy office. Jennifer is with the policy office that takes relief in drafting the full release of the offering and to draft the harmonization concept relief. And as I was mentioning to those this morning, thank you very much. That it is why it is a relief, so thank you.

Thank you everybody for traveling to Omaha. Our first agenda item today is SEC harmonization law and relief. Since our May meeting the SEC has published a request for public comment on ways to simplify, harmonize and improve the offering framework.

The concept release provides a thorough overview of the current framework for exempt offerings, and requests comments on a broad list of issues.

Simultaneously the commission will release the staff report on the impact of Regulation Crowdfunding on capital formation and investor protection, looking back at three years since the effective date of Crowdfunding rules.

Before discussing how this committee wants to approach this opportunity to provide its strategic input, Bill and Jennifer will provide us an overview of the concept release and the harmonization effect.

Bill. Jennifer.

WILLIAM HINMAN: Sure. Thanks very much, Carla, and thanks from Core Fin to Creighton University hosting us today and Martha for organizing this, and I really want to thank the committee for coming to Omaha to provide input on these important rule makings.

The first one we were talking about is a concept release, the harmonization concept release, so in itself, it's not at the rule-making stage yet, we're really seeking input, and this committee's input will be incredibly valuable. The private placement market is significantly larger than the public offering. Last year I think it was about 2.9 trillion of dollars raised in the private placement market versus 1.4 trillion in the public registry market. So it's an important space, and it's one that we hadn't really looked at in a very comprehensive way, and so this concept release is intending to do that and to get input on a whole host of issues, as Carla mentioned, particularly whether we can bring the rules together in a little bit more cohesive fashion.

Since 2012 we've been adding some private placement exemptions, the Jobs Act, added Crowdfunding, we've expanded Reg A, we've added Reg A plus, and then Reg A has been itself expanded for public companies to use as well. And as we've done that, we haven't sort of thought about how do these all fit together. One of the other things that we have looked at a little bit, but we haven't really done any real rule making on is the current definition of a credited investor. And that definition obviously plays a very important role in how our private placement exemptions work. The credit investor obviously is allowed to invest in a lot more wider range of private placement options without limitations, and we hadn't looked at that group to see if we have the right group there and are doing the right thing in terms of investor protection, as well as making something that's easy to work with and is useful in terms of capital formation.

Just so the committee knows, as we approach the harmonization release and thinking about what we can do in a very broad way to bring all that together, we will probably try to bite off the accredited investor definition first. Right now it's on our regulatory agenda for late in the year, and we expect to deal with that.

And I think that will actually make the harmonization exercise a little easier because then we'll know this is our group of accredited investors, or, you know, there's some good ideas out there around how to change that to broaden that some, to look at sophistication of investors a little bit more carefully than we have in the past. Numbers haven't been adjusted for a while, so we'll have an open mind in how to approach that field of potential investors, and we'll try to get that done before we tackle, okay, now that's that group of accredited investors, we also have unaccredited investors who participate in some of our private placement exemptions, let's make a rational field for them to both participate in. The chairman has really emphasized capital formation generally, and the smaller investor's access to private opportunities beginning -- you know, going back to where I began with the size of the relative markets. There's a number of interesting opportunities in the private space that if you're not an accredited investor today, you have very limited opportunity to engage in those opportunities. We are, and through the concept release, looking at is that appropriate, is there something we can do to facilitate the smaller investor having a more diverse range of options.

One of the things that Jennifer will talk about in a little bit more detail is that we've actually invited our colleagues and investment management to think about, you know, investment vehicles and how smaller investors may participate through an intermediary to get more access to some of these funds. Right now the universe of private funds and funds that engage in some of this 2.9 trillion market is somewhat limited to credit investors for a host of reasons, some of which are investment management division rules, and we want to work with them to think about as we change our rules is there something that could be done in the collective space to do what the chairman has suggested that we might want to be thinking about, which is making more opportunities available for more folks.

So that's something to have in mind as you're -- you're thinking about commenting here as well as, you know, the -- the credit investor point.

Jennifer has done a tremendous amount of work on the harmonization release. I just want to recognize that. I think -- we're at a Jesuit university. I think the theme is men and women built for others, and Jennifer was built for that release. I mean, she has done a fabulous job, and I really appreciate what she and her team has done there.

If you read it, and I congratulate you if you do, it's a long comprehensive basically treatise on what goes on in our private placement space. And with that, I'll let her speak more about that because she's the best informed person I know about about the topic.

Jennifer.

JENNIFER ZEPRALKA: Thank you, Bill. Thanks very much. I need to give some credit back to the other members of my team who worked so hard on this release, Enura Shower (phonetic) and Jenny Riegel. Jenny will be here later. They did a lot of the drafting all by themselves, so I want to thank them as well, not take all the credit for myself.

Just to talk a little bit more about what's in the concept release to launch your -- your discussion, it is a -- it is big -- a big document. And I hope you'll get a chance to read it, or at least read sections of it that you're most invested in, but it -- it broadly reviews all of the available exemptions for -- from the registration requirements of the securities laws that are used for capital raising. We -- we stayed away from most live the resale exemptions and the Rule 701 that we're focusing on capital formation here. It covers quite a bit of ground, and includes a lot of questions to explore whether there are overlapping

exemptions that create confusion for issuers that are trying to figure out the most efficient way to raise capital, whether there are any gaps in the framework that might make it difficult, especially for smaller issuers to find the right exemption from registration, and we were asking a lot of questions about whether we've got the right exemptions for each stage of their business cycle. So, you know, does our framework work for anyone from in the garage to on the verge of going public, and we want to look at concepts like integration to determine whether we can and should do more to allow issuers to transition from one type of exempt offering to the next, and ultimately to a registered public offering if that's what's appropriate for that company.

There are sections on each of the capital raising exemptions, so the private placement exemption in Section 482 of the Securities Act, Rule 506(b) and (c) of Regulation D, Regulation A, Regulation 50 -- or Rule 504 of Reg A, the Intrastate Offerings 147 and 147A, and Regulation Crowdfunding.

So as you flip through the release, you'll see there's a section on each of them, we give some background, we ask questions about how we can improve each of those exemptions. There's a -- the first

section of the release talks bigger picture, general questions about how we can improve the framework across the board, and then it goes into those more specific questions about your exemptions. That discussion for each of them has been informed by a lot of feedback from the public, including prior advisory committees, prior forums, comments we've received, conversations with market participants. So a lot of the concerns that you may have are probably already sort of acknowledged in the release, but we'd love to hear your feedback on -- on what we can do about those issues.

For example, in the Regulation Crowdfunding section we ask a lot of questions about whether we should be doing something to the offering limit, whether we should be allowing special purpose vehicles to use the exemption, things that, you know, have been coming up over and over again.

In the Rule 506 section we talked about verification of accredited investor status and whether there's anything that could be improved there that would make that exemption more attractive, whether additional clarity is needed around the idea of what -- what is general solicitation, that sort of thing. So too many questions to go through here, but as -- if you -- if there are sections you're particularly

interested in, I would recommend that you read through just the sections you like.

There are also -- as Bill mentioned, there's a significant section of the release that talks about the accredited investor definition and questions about the rules, who -- that limit who can invest in certain offerings. It's pretty binary right now for the most part so, you know, you're either accredited and you can invest or you are not -- a non accredited, and then your opportunities are much more limited. So we asked bigger picture questions about how we should approach that, whether it's appropriate to expand the universe of accredited investors or have some other way to allow currently non accredited investors to invest in more private placements or exempt offerings, and we -- we want to really probe on whether it's appropriate to look at something other than just the wealth of the investor in making that determination, so there are questions drawn -- a lot of it draws from the 2015 staff study on the accredited investor definition. We've gone through that in great detail in the concept release, and we ask a lot of questions about whether we should revise the financial thresholds, whether we should look for a different measure of sophistication, investment experience, testing, you know, there's a million choices there and we would love to get more feedback.

Most of the comments we're getting on the concept release right now -- I shouldn't say most, but a significant percentage of the comments we're getting on the release so far are focusing on the accredited investor definition. It seems to be a topic that is of great interest to the people who are reading the release.

As Bill mentioned, we teamed up with our colleagues in the division of investment management to examine whether the commission should expand issuer's ability to raise capital through pooled investment funds, and whether retail or non accredited investors should be allowed greater exposure to growth stage issuers through that type of fund. There's a lot of advantages to that if we can figure out the right way to make the rules work because of course there's some advantage to having a diversified portfolio, and funds may be a way to do that.

We also worked with our colleagues in the division of trading and markets to look at secondary trading of securities that were initially issued in exempt offerings, and we asked a lot of questions to see if anything can be done with the resale exemptions to

facilitate secondary market liquidity in non registered securities.

So as -- that's the very short version. I could talk about this for an hour, and obviously there's a lot of information in this release. We tried to make it digestible by breaking it up into smaller bites. So each section can be read and commented on separately, and the comment period is now open and runs until September 24th, but of course we'll continue to take comments after that point as well depending on when the committee can -- can get back to us on anything of interest.

I think that's it.

CARLA GARRET: Thank you, Bill. Thank you, Jennifer. Um, it is quite a release, and we thank you for that.

Um, before we kind of jump into how we develop our framework as a committee on how we want to approach the harmonization release, just kind of big picture. I didn't want to talk about what we think might be useful for the full committee to consider and whether there are discrete topics that we think subcommittees might be able to dive into for this release.

One way -- you know, I was picturing it with Martha and Julie was that we might have for the full

committee if there's a topic that's of interest to everyone, that there's kind of a consensus on, we could all as a committee hear from different panelists and -- and that would be a full committee agenda item If we thought that there was a discrete topic, for instance, maybe it is how to sell securities over the Internet, which would encompass Crowdfunding, 506(c), Reg A, maybe we look at a subcommittee for something like that

And the other thing I would just like to mention is that I am, you know, really in favor of looking at the whole exempt offering framework as a whole The first 30 pages of the concept release really do talk about each of the different exemptions I have a chart here that I can barely understand as a security lawyer I think it would be a great opportunity We're in a unique situation right now as this committee to just take a step back and look at if we were developing the -- the exempt offering framework from scratch what might be our recommendations

And on that, I am -- Jeff had some comments, and then we'll open it up to the committee to talk about the ways you'd like to approach this

MARTHA LEGG MILLER: And if I can jump in quickly before Jeff Since we got off to a little bit of a bumpy start with audio, which it sounds like we're in

good shape now, I did want to add in a lovely standard disclaimer that we give at almost every event you've heard anyone from the SEC speak at, which is any statements made by SEC staff or commissioners or any speakers from the agency or their own perspective are not necessarily reflected of the perspective of the entire Commission. So I just wanted to add that lovely disclaimer, and so that we can skip that in future notes from staff for the rest of the day.

CARLA GARRET: Thank you.

JEFFREY SOLOMON: So I would just say my views are just my views, and not the views of all my colleagues at Kalin.

So I think there's -- first of all, the framework that Carla has laid out I think is a great one. If we're going to function, I agree with you, sort of figuring out how we break this down because it is an amazing document, but it took me and my team quite some time to really break down where we wanted to lean in and how we wanted to think about it. I think there's a natural place.

Certainly looking at the accredited investor as it relates to investment vehicles is one whole area that when you think about the two sides of capital formation, right, the investor side and the company side I think a natural break would be able to think about things from the standpoint of attracting capital from an investor side, and then really the raising the capital, if you will, from the company side. And so one of the things I'd like to propose is that we actually look at at least two very different -- because they are very different things to consider when -- when we're looking at this, and so that would be my -- my -- my first suggestion, and I didn't know if anybody wanted to address that, but to me that's a natural break point, and then we can figure out how to go from there, but that would be my suggestion.

CARLA GARRET: Okay. Thank you.

Do other members on the Committee have suggestions and thoughts on the harmonization concept that they'd like to talk?

(Ms. Hanks indicating).

CARLA GARRET: Hi, Sara.

SARA HANKS: Yeah. Hi. I just wanted to raise one point with respect to the breaking off discrete pieces because I think that one of the things I love about the concept release is it looks at everything as a whole and says how does all this work together, and I -- I worry about, I mean, this committee and its predecessors have been very much in favor of expanding

the accredited investor definition.

One thing I worry about, though, is if you look just at the accredited investor definition, you've got the possibility of distorting the whole process, and what I mean by that is my guess from practicing in this area is that if you did -- if you took some relatively small tweaks around the definition of accredited investor, especially around the sort of who's sophisticated, you could take the -- you could increase the investor -- accredited investor potential pool by, I don't know, maybe 250,000, 500,000 people. It doesn't seem like a lot when we're talking about 12 percent of the households in the states being -- being accredited, but only about a half a million of anybody who is accredited actually invests in Reg D offerings, and so making a relatively small tweak to the accredited investor definition could increase by 100 percent the people who could invest in Reg Ds, which makes Reg D way much more attractive. It's already a lot more attractive than registered deals, more attractive than Reg CF, more attractive than Reg A, and so what you're doing is you're saying, Let's make this the more attractive to the issuers, and then you're leaving behind all of the retail investors. And I know the chairman has been concerned about that. This is

one of -- investing and securities is one of the two ways that you make money, that you have wealth. The other being real estate. And so I do worry about there's going to be these whole bunch of people who are going to left behind -- be left behind, which is why I love the idea of pool investment vehicles being a possibility to ex -- to expand that, and make Reg CF/Reg A more attractive, but I do worry about if you spin off, that is a discrete thing. You've just skewed the whole -- you've changed the facts on the ground.

JEFFREY SOLOMON: And so I actually think you're 100 percent right. This has to be integrated, and the great thing about this is it's actually called harmonization release, which is awesome, so we should -- if we're going to split it and take a look at it and do deeper dives, I think we have to come back together as a committee to make sure it all works together 100 percent, otherwise we can end up with some real distortion, and I agree with you, that's not -- that would not be the goal. We kind of defeat the whole idea of harmonization, but I just think if we're -- for -- for me, for example, I am -- I -- I don't do this every day.

We have people in our organization who could really go deep in both sides of this,

and I'll be drawing on a lot of their expertise in order to make sure that we're -- you know, as we think through all the unintended consequences. And I just think to me it's just -- it seemed like there's a natural break point, but I agree with you. I mean, between sort of cap -- dealing with investor issues, and then dealing with issuer issues, but if -- but we have to bring that back together again, or we could end up with a very skewed and un -- again, unintended consequences like the one you highlight, which would kind of be -- it would be -- it would defeat, I think the whole purpose of -- of being balances, so I totally agree.

CARLA GARRET: I also agree with you. I think that the pulled investment, I think looking at the Crowdfunding Reg A, 506(c), looking at the vehicles where non accredited investors, even with an expanded definition of accredited investors are able to invest is incredibly important, and something that this committee can provide valuable input on.

JASON SEATS: One quick reaction. I am wondering almost if maybe there's three things to think about. The first is the definition of the -- who those pools of investors are, and then the other two are related to activities around them. One is the activity of going and raising pooled capital, and the other is the activity of going and raising new issuer company capital, and so -- and so -- and the suggestion to start with the definition of accreditation makes sense to me that maybe there's actually three things there, and putting the work into the definition of the investor pools, who these people are, like maybe -- maybe that is a thing by itself, and then you have two activities.

Because one is defining people, and the other is defining behaviors, right?

CARLA GARRET: Yes, I agree. I do. Because we do have to define the two -- there are at least two different buckets of investors, and there may be more that -- that you define, and then you define whether or not they are -- which way they are investing.

JASON SEATS: Yeah.

JEFFREY SOLOMON: So one of the things that we talked -- that we've talked about is actually along your line of -- of three. You know, any time we talk about capital formation, at least in my firm, we talk about three different constituents. And actually, when I presented it to the -- to the investor Advisory Committee, or the investment management, the investor Advisory Committee a few years ago, I always look at

investors, companies and intermediaries. And obviously we do a lot of intermediary work, and -- and so I -- there is -- there are ways to create good incentives, and not so good incentives for intermediaries to act certain way. I think one of the things we look at here as you -- as you enable different pockets of capital to get access. Almost invariably they are going to come through an intermediary.

And they -- they -- unless they go direct to Crowdfunding, which they could do, but even there, the Crowdfunding site is effectively acting as an intermediary. And the truth of the matter is, intermediaries can -- if they do their jobs, they screen for high quality. They should be screening for high quality, and -- and so that actually creates -- when you think about most of the way the capital gets formed, the very majority of even professional investors, they look for an anchor, right, and then they'll come in around an anchor who they think might be smarter than them in a particular area. And so I think one of the reasons why a lot of investors get crowded out is because they don't actually get access to the high quality deal flow. They just -- they don't -- they never see it, and it all gets -- it all

gets angled towards accredited or super accredited frankly at best. And so if we're going to think about this from an investor standpoint, I think creating pooled vehicles that intermediaries can then articulate to their -- to their constituents is actually a great way to bring it back to the appropriate function for screening. And -- and we've talked a lot about this. Reg G and private placements are not the favorite ways to go to retail investors because you've got K-1s and a bunch of tech stuff, and so almost invariably intermediaries don't like to deal with them, and it -- and it knocks out most of the retail distribution in -- in the country because private placements mean K-1s, and K-1s mean delayed tax filings, and you end up in a bad spot.

So if you look at where a bulk of the money has actually been raised, and we just talked about this actually earlier, it's been through interval funds and registered investment companies, and there's a bunch of rules in there that actually preclude earlier stage investing.

And actually because they never -- the rules and the 40 Act never really contemplated this idea of being able to have a mass affluent or high net worth individuals access private investments or capital

formation, just -- they were two completely different rules.

It was much more towards publicly traded vehicles and mutual funds. But if we could figure out a way to again look at -- at some of the existing 40 Act areas and make those easier for intermediaries to essentially screen and sell to high net worth, all of a sudden you really democratize that capital raising function again, and we almost have to think about Reg D. Getting away from Reg D in some capacity and private partnerships because it -- I just will tell you, most intermediaries won't even -- won't even touch it at the mass affluent level. Not even high net-worth level, but not even the mass affluent level, or the -- or the -- or the retail level, so it's just something to consider.

CARLA GARRET: Thank you, Jeff. Robert?

ROBERT FOX: Yeah, I've been sitting here listening to this conversation, and I've been trying to think about -- you know, I -- I keep hearing as a non attorney, you know, we -- we talk about Reg D and those -- you know, all these terms, and, you know, it seems like we're talking about existing frameworks and how to improve them. Part of me wonders are there some principles that maybe we should focus on first,

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right? You know, first start with a blank sheet of paper. Are there principles we should focus on first that would be kind of -- maybe set the framework for rule making. And when I think about a lot of these standards, it seems to me that a lot of them were created from an investor protection mindset, right? Something probably happened that they took advantage of somebody, you know, either an intermediary was, you know, not acting at the best interest or, you know, somebody got swindled or somebody lost money or something like that, and it seems like that's where a lot of these issues have come from, at least from my perspective. And I am wondering if it wouldn't be better for the Commission -- or for the Committee to maybe think about some of the principles of investor protection, right, that would go -- that would kind of filter through the definition of accredited investor, or some of the other rule making. You know, if we can think about some of the things that would balance -- you know, what are the principles that would kind of govern that and could balance the need for appropriate capital raising and investor protection. If we could come up with that, it seems like that would provide a framework that a lot of things could be built off of, and I -- and I think that that echoes both the

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intermediary point that Jeffrey was talking about and, you know, the definition part that you're talking about, but it just seems to me that that may be something if others agree, that the Committee can maybe think about because I feel like without that we're just kind of tacking, you know, Well, how do we improve Reg D or how do we improve Crowdfunding, or whatever it is, and I'm not sure that that -- that may be an incremental improvement, but I'm not sure that that's a wholesale improvement.

CARLA GARRET: Yes, Youngro?

YOUNGRO LEE: Yeah, I'd like to suggest, if possible, us -- this committee taking as practical position as possible, knowing the realities of rule making, and not just with the SEC's level, the legislative level. And the reason I say there's twofold. One is we talked about harmonization, and like Jeff talked about, it's very, very difficult for mainstream investors and companies to invest in companies to access that and intermediaries don't even try because it's so hard. So the elephant in the room, in my mind, is kind of the whole point of the harmonization, which is there -- there is regulation Crowdfunding. There has been three plus years of operation. There has been a track record. That's

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what the SEC spent so much time writing on. And as you guys saw, the AOIYP release that our -- the Committee of Online Investment Platforms have -- have -- have submitted and said throughout this committee. That's it, like so -- so we're not -- I guess from a -- I am overly simplifying, but instead of trying to come up with maybe a brand new suggestion on harmonization -- and maybe this is what Sara was referring to. We have a track record, just like a credit investor definition is a very specific thing that the SEC is looking at, which I agree with to make changes. There are very specific limited changes you can make to regu -- Regulation Crowdfunding today immediately that will -- that will very much expand the data points, the usage and everything else that I think will be more helpful, so that would be my first personal, and in a -- from my perspective obviously as the -- one of the very few portals that are operating this kind of industry, just focus on what's actually possible and what -- what's there today.

And then the second bigger point of this is I know that previous committee has spent a lot of time and effort in all of this. My understanding was essentially none of it was acted upon, or -- or was addressed by the SEC. So it's a very direct point,

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maybe a question to the SEC because I would like to understand what is constant. Right? Like if the -- if the answer really is, That's great, all these things is great, but really a credit investor is that and needs to be worked on, that's fine. I can -- I can personally kind of even set aside the Reg CF changes, which -- which I think are very easy, relatively speaking, and just focus all in on the credit investor so that we can give the most helpful advice and feedback on that specific point rather than us trying to come up with, again, a lot of different things that after another year of doing this, frankly nothing is going to happen.

CARLA GARRET: Thank you, Youngro.

I actually agree with both -- both of you, Burt and Youngro, which are we could actually do both if we wanted to as a committee. There could be a focus on the various practical specific changes to certain of the rules, like Crowdfunding or Reg A or other 506(c). There could also be that the committee does look at the big picture, and at the principles of -- of investor protection, and we couldn't -- can do both if that's something that the committee is willing to do, and something that they are interested in doing.

That would be something I would be interested in doing I would be interested in hearing what other people think because I think both are very important And I do think that the -- as I read the Crowdfunding release, it does look like you have really thought about some of the recommendations that the prior predecessor committees have -- have provided in the past, and hopefully those are in the -- you know, they were put into the -- the harmonization piece

JENNIFER ZEPRALKA: They were The Crowdfunding relief study kind of was an overview of what's been happening in -- in the use of Reg Crowdfunding since adoption We -- we didn't include specific rule-change recommendations in there because we also were incorporating those concepts into the concept release We were hoping to gather a bit more information from the public, and then would incorporate those ideas into a real proposal in the future I am not promising which ones we would look at, but that's the idea is that we -- we didn't want to have sort of competing documents here, so, you know, that they kind of flow together if you read them to -- the Crowdfunding section of harmonization along with the report, they -- they work together, and then we're hoping to continue to take the feedback there for a future that will change

ELAD L. ROISMAN: Sir, and, look -- first of all, again, I'll echo this later, but thank you all for -- for coming here. And, look, this discussion already is very helpful because it goes to show the different perspectives you all provide and -- and bring given your diverse backgrounds. I think everything here said, even though it may seem -- have been a little bit in a different direction. I think they're all valuable. Look, we're going to take your input because you guys have unique perspective and background, and the reason you were formed as congress determined that you guys were an important input, this committee has important input in terms of our agenda and what we're trying to do. To the points about like how can we improve the private markets, but at the same time be cognizant that if we improve the private markets, it may have an impact on the public markets is something that we're constantly thinking about. I don't think that we should stop that because I think we need to work on both on tandem, and I think anything we do in one will have an impact on another, but we should think about that as we kind of draw out our agenda.

To Youngro's point, like, you know, I personally would love any input you have. Even if it's simple,

that's great. You know, do I have a sense of timing? I don't. I don't control the agenda, but that being said, it will filter through us, and we will try to get that out as soon as possible.

To Burt's point about investor protection, that's something we take on every single day. That's how we function. That's part of our core mission/mandate. Whatever you guys provide, I assume it will be within the constructs of your -- your mission, your -- your statutory mission, your bylaws, your charters, but also through the lens of, you know, what would be helpful for us to kind of fill our job. And don't worry, we'll -- well take a look when we also make a termination through the lens of how does it facilitate cap formation, protect investors and maintain fair, orderly and efficient markets.

So I think this is already very helpful because you guys have identified kind of the key players and the key themes. If you guys do take this one, I think you'll provide a really valuable input for us in terms of what steps we can later take and what the division will do, so, um, I have really been heartened by this kind of conversation, and -- and look forward to anything that you will do.

CARLA GARRET: Thank you.

WILLIAM HINMAN: Carla, can I just underscore that a little bit? Just from our perspective in Core Fin, it's really valuable to hear from this committee what small businesses think of this, right? From the investor protection point is a good one, but what we really are looking to this committee for is the practical experience of small businesses in the US, trying to use our rules. You know, these private placement exemption rules apply to everyone, large companies as well, but many of them use 506 repeatedly. But from a small business perspective how are they working. You know, is access to the retail investor -- you know, Tremors made the point that access to retail investors would be useful from their own perspective, that that's a useful thing for Americans to be able to invest and have that growth opportunity. But from a small businesses op -- business opportunity, is it something that you're actually looking for? Is this something where the cost benefit is worth it? You know, Jeffrey made some points about the difficulties of -- of getting into the retail market to raise capital of significant amounts. Is that something from this committee's perspective you want to see us pursuing more of?

As you use the private placement exemptions, is there a natural progression from some of the smaller exemptions where you're raising less capital to the larger ones, or is there something there that we're missing? You know, are the amounts that are -- are currently available for the different levels of offerings the right amounts for smaller companies?

I think all those things -- you know, as an organizational theme for the work that we get from you would be really useful, to have that idea that this is what small businesses are looking for as they're using our exemptions, and in what has been highlighted in the release.

JEFFREY SOLOMON: So I would be curious to know, you know, when a small business goes to raise money. I mean the ones that come to us are probably a little bit bigger and have already done a few offerings, so I -- I will just say I don't have a lot of understanding of when a small business says, I want to go raise money. Have they even thought about how they would go about doing that from a regulatory standpoint? My guess is probably not, so they ask their attorney, and their attorney gives them the advice on the best exemption to utilize. And can we just level set, is that generally how it happens?

HANK TORBERT: Yes.

JENNIFER ZEPRALKA: Yes.

HANK TORBERT: Yes, I mean, it's -- as the president of a small business, I will tell you the answer is very simple. This is a very complex -- very complex situation. As a small business, we would not necessarily consider some of these things because one of the costs -- the amount of investors we actually have access to, the disclosure requirements, it may be too much versus a very simple debt equity raise, which is -- and also, as you look at the accredited investors and who we have access to, I think it's too small. If we can just make minor tweaks to the existing system just to allow for us to reach just a smaller group of people. For all small -- smaller businesses, that could be a significant change if I'm making any sense. Just a small tweak could mean millions, perhaps hundreds of millions of extra dollars that are available to a small business, and so if we could look at that -- but in terms of how we view the world, a lot of these are just too expensive for us from an accounting standpoint, from a legal standpoint, it's just too much.

WILLIAM HINMAN: One other big idea that's useful here that's being asked for a comment on in the release that would, I think, simplify things for

smaller businesses somewhat is the idea that should we be relating offers? You know it's one big idea that reaches across all of -- main -- basically all of our exempt offerings today. Do we need to regulate offers, or do we want to just regulate the sale making sure that folks have sold to the -- to the right group. Because if you do that, then it makes it so much easier to reach out and to use the Internet, to use social media, use different ways that people use today to find people, you know, more broadly, but then you just limit the -- the regulation of to who you're selling to. He ultimately has protections around that.

That's a big -- one of the big ideas that's in one release. It's one that, you know, your perspective thinking about that from a smaller business's perspective and the friction of trying to avoid a general solicitation of an offering. That would be pretty useful for us to hear from you on.

CARLA GARRET: Uh-huh.

HANK TORBERT: Could we form a special subcommittee on this specifically, if you will, to -- to review this, the framework for this particular part?

CARLA GARRET: I'm sorry, is that you, Hank?

HANK TORBERT: Yeah.

CARLA GARRET: Okay.

HANK TORBERT: I said, Is it possible? I mean, we were earlier discussing if we should break into smaller groups, if you will, whether it's investor protection or whatever the case may be. But if there's a way to -- especially from a small business standpoint if there's a way to form a small committee that would look at some aspects of this, if you will, that he's discussing.

CARLA GARRET: Definitely. I mean, that's what we're here for is to -- to set up what is this committee interested in. We're all going to be interested in different things.

HANK TORBERT: Right.

CARLA GARRET: I mean, some people are going to be looking at one way, some people are going to be looking at other ways to raise capital for small businesses, and we can -- for people that are interested in focusing on one, you know, kind of unique topic --

HANK TORBERT: Okay.

CARLA GARRET: -- we can definitely put together a subcommittee on that.

HANK TORBERT: Okay.

JEFFREY SOLOMON: I actually have a question. I actually -- I read that in the release, and it seemed like a really big idea, and then I will just say it's something I've ever contemplated looking at the offer versus the sale. I did -- I never really -- I never really thought about it because I always viewed they all -- when there's an offer, there's a sale. And, I mean, I kind of view it as one together. And so I just would be curious to get a little bit more color on some of the things that you're thinking about and where we can potentially get pushback. I hadn't really thought about it, but it seems like an interesting idea, I just -- I am not sure how that works.

WILLIAM HINMAN: It's certainly the 506(c) exemption, right, where you can do a general solicitation offering to anyone, but only sell it to accredited investors. It's sort of that concept taking that more broadly than just one particular rule.

506(c) raises some interesting issues around verification of have you told to the right people at the end of the day. But that's -- that's the general thought is we are less concerned -- we would be less concerned with who you -- who might see the offer as

long as you end up selling to the right folks, whatever that criteria might be for that exemption, so --

JEFFREY SOLOMON: Would that encompass things like integration? So I think one of the big challenges that we always face again as an intermediary is we need to go -- there has to be a beginning, a middle and an end before you can start the next round. And the realty is, you know, when we're talking to companies, like, you know, they are always talking to investors who may come in this round or next round, or they may -- it's -- it -- it's a continuous process that we actually have to, you know, make sure that it begins and middles and ends before we start the next process, but that -- and so would this also in your minds encompass like rules around integration and how to relax those as well?

WILLIAM HINMAN: It will raise integration issues. One of the other things that you saw in the release is that we do ask some questions around integration, and the kinds of difficulties that you're -- you're highlighting. So to the extent you did have less regulation of the offer for some of the rules or for, you know, a wide range of the rules, there would be some interesting integration issues because every offering would be more widely known, and

so how do you draw the lines between them, but that's one of the things we're asking for. I mean, again, we need it here at the outset. Is this something that's actually attractive to smaller businesses, is the idea of having to limit themselves in how they communicate and making sure they're not engaged in a general solicitation at the front end something that's really burdensome and is creating real problems or maybe it's not? Maybe they know how to do a private placement without, you know, how to find their investors.

So we're just asking the general question, is the regulation of the offer, as opposed to the sale something that's problematic, something that could be revised, to the extent we do think that, then there would be some integration things to --

JEFFREY SOLOMON: Also, I would just say we're giving advice all the time on how not to do -- how not to integrate and our clients are like, What are you talking about? Like -- so I don't even think -- again, small businesses aren't necessarily thinking about integration rules. It's usually when you get an intermediary or a lawyer involved they are like, Whoa, whoa, whoa, whoa, you can't do that.

WILLIAM HINMAN: Uh-huh.

JEFFREY SOLOMON: And here's why, and they're

like, Really? I've been talking to -- I've been talking to everybody, right, and then you -- and then you scramble to figure out, okay, Well, who did you talk to, and -- and are they all accredited. It becomes a real thicket, a hornet's nest, if you will. And so, again, one of these -- it's just something that we have to deal with on the intermediary side when we first engage with somebody and try to figure out, okay, how many people have you talked to about this. It's a -- it's a big issue that we have to, I think, resolve. So that's -- that's -- that's helpful.

CARLA GARRET: Okay.

ROBERT FOX: So I think that Bill's point on the offer is -- is probably a more articulate way of what I was trying to articulate in terms of some of the principles, that it feels to me that if this committee could focus as well on things like, hey, maybe if -- if, you know, we can still get yet, you know, things done in an appropriate regulatory context without regulated offers, are -- you know, maybe up to a certain amount, we don't have to have an accredited investor. Whatever it is, I think that there's some things like that at a higher level that if we can establish that we think that would be very beneficial to small businesses. And also to make sure we're clear, I think the definition of small businesses up -- is -- is a pretty big business, right? It's not your mom and pop dry cleaner, right? And, you know, I think -- I think that would be very helpful. I'm not trying to discount that I think that there's some knowledge that this committee can provide some very concrete, discreet changes that would also be impactful, but I feel like if we can say, Hey, overall, small businesses that would really benefit from, you know, some overarching print, you know, things here that we think if the SEC kept that in mind as they're writing the releases and got an anchor back to that, it would be very helpful.

CARLA GARRET: Thank you. Yes, Catherine.

CATHERINE MOTT: Um, I would like to go back to what Bill mentioned earlier. What do -- what do small businesses do is they respond to issues, and that varies with the stage of the company and the type of company. So if you're a start up, you're going to be dealing with pure equity, not debt or anything like that. If you're a high -- you know, high-growth company, you're going to be looking at large venture rounds and integration issues. You know, if you started out with Reg -- with Regulation Crowdfunding

and then you need private equity, there are issues around that, and that makes it hard for the company to scale. So -- but if you're a lifestyle company, that doesn't matter. So we should be looking at this from what -- you know, what the businesses need, how they need to grow and scale and how each one of these things apply and how the integration issues evolved through that process.

I just think it would -- might shed some light on how we treat some of this.

CARLA GARRET: Thank you. Yes.

SAPNA MEHTA: Just one more point on that. I know we were looking at it from the small business perspective, and not from the investor protection standpoint. That's not our role, that's your role, and you will thoroughly look at that. But just -- you know, I think going back to Robert's point it would be helpful to get a refresher on the reason for the framework for having general solicitation rules because if we're loosening general solicitation rules the offer side of it, and loosening the -- or maybe not loosening, but making more appropriate the accredited investor definition, you know, we might be taking -- the pendulum would be definitely swinging in the other direction. And also just from a company

standpoint I see it from the venture side a lot where, you know, you get a lot of -- a lot of investors on your cap table, and if you're getting a lot of investors who are unsophisticated who may not know, you know, they're like, Well, we can invest in this company, it seems like a great idea, it often ends up biting the company later on down the road when you're dealing with a lot of unsophisticated investors and you have a significant amount of people on your cap table it makes fundraising a little more difficult in the future.

So I know that's, you know, for each company to decide on their own what's best, but just something I've seen that, you know, unintended consequences later on down the road.

CARLA GARRET: Thank you. Anyone else?

JASON SEATS: I have a -- a comment. I like the idea of separating out the regulation of offerings from the sale and opening it up thinking about Jeff's comments about the dynamics of fundraising, which is what we experienced a lot. We have a portfolio of thousands, and they're -- we engage with them when they are, you know, three founders and a -- a dog in a garage. I mean, the way that they -- the way they just -- they raise money is they ask a friend, they

ask an adviser and they get good advice, they get bad advice, and we hope that they find someone who gives them good advice, but I think that they -- the indirect benefit, not the direct benefit, I think the indirect benefit comes through the intermediaries. And I think that that by opening up the offering what you're actually doing is creating a lot of flexibility for the way that intermediaries help those companies raise money. And so it -- but by itself it doesn't solve the problems, but I think it removes -- it removes one important friction point, but because it's -- you can tell that we haven't thought about it deeply, it may have some unintended consequences and/or dynamics that it will create that we don't think about.

One of which is the fact that the best companies, the ones that are in strong positions to raise capital don't market the fact that they're raising capital. And so you'll have a bit of adverse selection, which is why I think opening up the restrictions on offerings coupled with increasing the flexibility of accredited investors to put money into pooled vehicles that are intermediaries who may have the access, that a dual-pronged approach sort of makes a whole lot more sense to me than opening it up and assuming that companies are marketing themselves directly

CARLA GARRET: Thank you Okay So I think we probably should maybe end the harmonization talk right now It's -- in terms of November meeting I think we have a lot of different ideas on how to structure, and what the different points are I -- and if there are special subcommittees that we think would be useful, maybe we can talk about that offline, Martha, unless you think we should determine that today

MARTHA LEGG MILLER: We can come back with the general session this afternoon if everybody wants to just -- now that we've had a chance to float ideas I know most people like to take a minute --

CARLA GARRET: Okay

MARTHA LEGG MILLER: -- as opposed to jumping right to formulation of an idea --

CARLA GARRET: Okay

MARTHA LEGG MILLER: -- but we could use some of that if folks have specific leanings on that

CARLA GARRET: Okay Great Thank you And thank you again, Bill and Jennifer That's -- there's a -- there's a lot of um -- um, very interesting ideas for us to think about

Our next agenda item is SEC's proposal to amend financial disclosure requirements relating to

acquisitions and dispositions of businesses.

On May 3rd, 2019, the Commission released a proposal to amend the financial reporting requirements for the acquisitions and dispositions of businesses including Rule 305, 314 and Article 11 of Regulation SX. The proposed amendments are intended to improve for investors the financial information about acquired and disposed businesses, facilitate more timely access to capital and reduce the complexity and cost to prepare the disclosure.

In addition to hearing from Director Hinman on the technical elements of this rule, we're also going to be hearing from some guest speakers.

Also, I just want to note that one of the purposes of what we hope to accomplish during -- before our lunchtime is to not only hear from the speakers and hear from Director Hinman and to ask questions, but we're hoping to set aside at the end maybe 15 or 20 minutes to actually make, if we can, and vote on recommendations with respect to these rules and what our committee would like to recommend to the Commission with respect to the rules.

So think about that as we're listening to the speakers that we will be hopefully voting on a recommendation before lunch.

I'd like to introduce our two speakers. Thank you for coming today. We have with us on the left, Matthew Swartz, who is a partner at Pillsbury, Winthrop, Shaw & Pittman. Mr. Swartz has over 20 years of experience in providing legal advice to middle market and technology companies and their investors on mergers and acquisitions, venture capital and private equity transactions and public securities offerings.

Chambers and partners notes that clients praise Matt's encyclopedia knowledge of business law. Matt is a published author of securities law and SEC compliance. He is a graduate of UC Berkeley and UC Hastings College of Law. Welcome, Matt.

MATT SWARTZ: Thank you.

CARLA GARRET: We also have with us today Bill Korn --

BILL KORN: Hi.

CARLA GARRET: -- who is the chief financial officer of MTVC. Mr. Korn is a veteran technology executive with over 30 years of experience managing high tech businesses. MTVC is a provider of electronic health record software and other IT healthcare solutions.

Bill graduated from Harvard College with a BA in economics and received his MBA from Harvard Business

School. He has served as CFO of seven companies, has raised over 350 million of capital and has completed multiple acquisitions. Welcome, Bill.

BILL KORN: Thank you.

CARLA GARRET: First we're going to have Director Hinman provide an overview of the rule changes, and then we're going to have Matt and Bill speak.

If I could ask Matt and Bill because we are running a little bit behind, if you're able to limit your -- your time to about ten minutes, that would be useful. So, Bill.

WILLIAM HINMAN: Right. Thanks, Carla. And I'll limit my time just because you have two very capable speakers here, but I did want to get a little bit of an overview of the rules particularly significant for smaller businesses either on their way to becoming public companies or when they are public companies. Even small business that never become a public company, but sell themselves to the public company are affected by these rules. These are the rules that the acquirer will have to comply with after they acquire that small business, and today they're very complex. The interpretations of these rules that exist today in terms of what you have to provide in terms of background on financial statements of the companies you are acquiring are -- are not only complex, but they take up about half of our financial reporting manual in terms of the interpretations that have been issued under those rules.

So what we're trying to do with the Rule 305 and some of the related changes is to streamline that, to simplify that and to just make, you know, more sense of these highly technical rules, which you'll -- you'll hear more about.

One of the things that these rules trigger off of is whether your acquisition is significant or not, and at what level is it significant, and there's been three tests that have been used historically for that, and you'll -- you'll hear more about these. There's been an income test, an assets test and an investment test.

The investment test was not designed to say how -- how big a deal is this, what are you paying versus historically it's been your -- the amount of assets you have. We have thought about that and said, You know, how much you're paying versus your assets it's maybe a little bit out of step without -- as a measure of significance generally, that your assets may not relate to the size of your business or how significant this particular operation is, so we're revising or

suggesting to revise that to look at how much you're paying versus your total worldwide market cap. I think that's a simple change to make, it's an easier number to calculate, and I think it -- it makes more sense.

The other significance test that we're looking at changing is the income test, and that we looked at the relative income of both the acquirer and the target. And there if the acquirer happened to have a near break-even year and you looked at that as a denominator and you put the targets asset -- or income on top, that could be a very significant acquisition if you've had a near break-even year or if you had a loss -- a small last year. And so we get a lot of anomalous results, and so we're changing the income test or suggesting that we could change the income test to add a revenue layer. And so you look at both revenue and income in that component when the -- the income is not a good measure itself, and that should result in fewer anomalous situations where historical financials are required.

Another thing we're doing is how many years of bistorical financials do you need to prepare. Depending on significance, that might be one, two or three years. With the new suggestions we're going to limit no matter what the level of significance --

significance might be to a two years of historical financials. That will make it easier in many cases to prepare. We think investors are really more interested in the last couple of years, and when you go back three years, the relevance there seems to be much more limited and people are making investment decisions based on performance over the last couple of years, so we're looking at that. We're making some changes that should be particularly helpful in the IPO space, IPO companies now have never sort of integrated some of the financial statements of the targets that they've been rolling up as they get ready to go public into a public filing, and because it hasn't been previously publicly filed, we require a lot of these 305 financials for these roll-up situations.

We're going to say going forward if you've integrated that company for over a year, you won't have to supply the proformas and the historical financials of the target stand alone that IPO companies used to have to do. That should make it much easier to -- to join the public companies here.

There's some also -- there's some changes that relate to the proformas that also accompany these presentations. If you have a 305 historical financial obligation, you also have an obligation under

Article 11 of SX to provide a proforma financial status. It's basically the last full year for the two companies combined. And it hasn't been given a lot of attention by investors because it's -- it's somewhat of an -- an artificial set of numbers. It's, you know, the last year, putting the two companies combined, what would you do in terms of the accounting changes that happen and here's the result. It can be useful for analysts and -- and people certainly will look at it, but it doesn't really give you an idea of how the combined businesses will operate going forward. It doesn't cover the potential synergies of the -- of the two operations, and so we've asked for comment on whether it would be useful to have a separate column of the pro forma financials that look at management's expected synergies, or changes as a result of putting the companies together.

That's generated a lot of comment. Those synergies typically have been discussed when people talk about their acquisition strategy outside of the registered filing. The registered filing has the very dry proforma, and the rest of the story gets told outside the filing. So we've suggested some rules that would require more of that story to be told in the filing. Some people are a little bit reluctant to put that into a filing, and so we're getting comments to that effect, and we recognize that those are difficult numbers to stand behind in a registration statement. So, you know, people have been commenting around perhaps this should be optional, we've asked questions around that, but that's one of the areas that's actually pretty interesting in terms of how do those proformas become more meaningful, should it be done in the registered filing with us or should it be done in the way it's been done in the past, can we make these more meaningful or not. Do we give issuers an opportunity to do it? Do we give them forward looking? They would have forward-looking statement protections, so -- and that's just something that the committee may want to think about as well.

With that, I'll pass it over so you can hear from your experts.

CARLA GARRET: Thank you, Bill. Matt.

MATT SWARTZ: Well, thanks. Good morning. It looks like the PowerPoint that I brought will not be seeing the committee or the Commission's eyes today, but that's okay. I'll go from the -- from the pages I have. Thank you very much to both the committee and the Commission for having us. I'll -- I'll begin by saying, Carla Garret was kind enough to observe that

I've been honored for inclusion by chambers and partners in the top M&A lawyers in the Washington region. My favorite observation from Chambers about me sits on my refrigerator for all of the household to see, and I quote, Always thinks things through from a reasonable market perspective of what's fair. So I hope I can bring some of that here today.

I'm going to try to honor the request to stay within ten minutes, and the first thing I'll do is say if I had to -- well, let me speak to my experience briefly and say I'm counselor mostly to small and middle market companies. Many of them are technology companies, not all of them are. I have counseled on probably 150 exits by small and middle market companies, and I will be speaking primarily from the perspective of a seller who is evaluating options as a small business person to exit to the available buyers in the market, and how these rule changes look from the seller's point of view. Having served as a corporate director of two middle-market companies that exited and sold to public companies I feel that I've seen this process enough that I hope my perspective will be valuable.

So if I could summarize the proposed rule changes in one word, it would be Bravo. I think the small

business community, both the small business issuers and also the targets are very much in favor of the reforms that the SEC has proposed in this proposed rule change. If I had to summarize it in two words, it would be Bravo however, and I'll proceed with the -- with the however now.

Let me begin by giving you a little bit of context in the process that middle market and small companies experience when they're looking to sell. And, again, I'm speaking from the perspective of a selling company and the impact of these rules on selling companies. Small business people have limited options for exits. Initial public offerings, as I know the Commission is aware from some of its other work, have become more and more expensive. Private equity has become more and more active, different aspects of the public offering process are in different ways more expensive, more cumbersome, less available to small companies. So the M&A exit is more common than it ever was, and it was always pretty common. So I'm going to speak to what we might call a managed process, or a process led by an investment bank, not because that's the only process, but because it's one that quickly kind of illustrates what the issues small companies face even without an investment bank actually are. In a managed process an

investment bank essentially markets the target company to available buyers with the idea, of course, of getting the best price; what do sellers consider? They consider of course price, certainty to close and cultural fit with the buyer. Now what's certainty to close? Because I think certainty to close bears on the rule change that we're talking about. Of course the first question: Does the buyer actually have the money? With any public company you're going to have the answer; Does the buyer have the money? Well, go onto Edgar and find out. What is their reputation? That's typically a place where investment bankers can help. Is the buyer reputed to actually close the transactions they start, are they a reliable buyer?

And then more specifically to the rule, is there a special requirement that applies to this buyer that would threaten the certainty to close or the timing to close or the burden to close? There's other examples besides the requirement of delivering audited financial statements. For example, foreign buyers are subject to the CFIUS requirements that impose delay. And the way the investment bankers say it, delay is risk. Any time you're having to wait other things happen. The world changes, your business changes. So anything that causes a delay in closing a transaction risks closing the transaction altogether. So an audit is a risk. An audit is a diminution in certainty. So who are the kinds of buyers that are available to small and middle market companies. Private companies, investment funds, and I'll include private equity in that, and public companies, but as we all know, there's more than one kind of public company. They are small public companies and big public companies, and I think if there's a message that I'd like to convey from all of this, the small public companies are put at a substantial disadvantage as buyers of small business targets, and the reason for that is that the significance test I submit even as changed, though certainly is unchanged, impose a requirement that larger public companies won't have simply because they have such great assets, income, market cap. It takes an enormous target for those significance tests to be met.

So the rule certainly affects public companies as buyers, but I think it's useful to focus on small public companies because they're the ones who really are impacted by the significance test simply by virtue of their size, their smallness. So I have here a table that -- sorry, among the issues that are on the table when small company entrepreneurs or boards are

evaluating alternative acquirers, can you see the resources? I mentioned this. Yes or no. Yes with public companies. Is there a delay that's likely to threaten the certainty of closing. With large public companies, the answer is almost certainly no, and I'll use examples just randomly chosen, the alphabets and Johnson & Johnson's and Marriott's would take a tremendously sized target for significance tests to be met. So the kinds of requirements that the rule has proposed or has modified would impose do not apply to companies like that because it's so hard to reach the significance tests. On the other hand, smaller public companies, you'd have to be even a lot smaller than that, really to have that issue. So they're less competitive at the table when selling companies are evaluating competing offers, and I submit less likely to buy the company, and therefore because the selling company if it has options that don't involve the uncertainty of delivering audited financial statements are less likely to choose a small public company as a buyer. And I think it's a matter of securities law, but also of -- of common sense. One choice or two choices, a private company acquire, a large public company acquire don't have this burden and delay. Small public company acquire has this burden and delay.

So even if the prices are the same, a seller is likely to choose anyone but a small public company as the acquirer. So smaller public companies are just less competitive as buyers.

So I'll skip right to will the proposed rule changes make it better? Yes, but diminishing the likelihood of a significance determination with the revised rests and the burden on target companies that changes what has to be delivered. At a separate topic is the IPO process, but I think the proposed change to the rule that deals with allowing IPO companies to under certain circumstances pre -- admit pre acquisition target financial statements is probably more of a benefit to the IPO process than it is -- that it is to the M&A process, but that's another story. I still think that's a particularly good change and helpful to small companies going public.

Will the proposed changes make small public companies more competitive as acquirers? Yes, probably, but they are still at a disadvantage relative to other common buyers.

So I'll go on and say, This is a good step, but what else could the Commission do. Move farther away from the audit requirement of significant targets, meaning significant with respect to the buyer, place

more emphasis on detailed proforma information and explanation. So Director Hinman's comments about projected proforma synergies is -- is exactly what I think could be the most helpful, though I'm sure in -- in the comments that the Commission has already received the disadvantages are real took and this is what accountants call the tension between relevance and reliability. I think if you were to look at private equity buyers and asked, What are you looking at when you're looking at buying a company, I would bet that the first thing they don't say is audited financial statements. I bet one of the first things they say, and one of the first things I've observed is what do these companies look like once we buy them. Are we paying a better -- are we buying low with the hope of ultimately selling high? And so that's a proforma analysis, and the negatives of that, of course, are that the cost savings are not necessarily things that acquirers want to make public either because they're distasteful or because they are competitively sensitive. Nonetheless, that is where the investment decision is made, so I go on and say, Well, it's -- I had a bullet point in this last slide when I first drafted it saying that private equity is a competitor of capital markets. That may be a little bit more than is the case, but it's certainly true that the rise of public equi -- private equity has come just as the fall of IPOs has -- has been seen.

So I think it would be useful for the Commission, and you may already be doing this, to study the financial diligence of the competitors. Who is the competition? It's private equity funds. What do they care about? And they care about relevant information. Reliable information in the audits are good, check the box, highly reliable, always part of the Commission's important role of protecting investors, but is it relevant enough that sophisticated people make an investment decision on that alone? I submit that it is.

I am happy to discuss more. I want to respect the time limit. I want to thank you all for having me as your guest. Thanks for your service to the country and dedication to sound capital markets, and thank you for the thoughtful reform that the changes to 305 represent.

CARLA GARRET: Thank you very much, Matt.

Bill?

BILL KORN: Thank you, and I've also got some -- some slides. I'll give you all a very, very brief introduction. MTVC does fit that -- that profile of a

small company. When I joined the firm we were a $10 million company. A year later we went public. At the time that we went public we were still a little over 10 million. We bought three companies in the day of the IPO. Last year we did 50 million in revenue. This year where we're at we're projecting 63 to 65 million. And we've done 15 acquisitions over the -- the last six years, and eight of them have required us to -- to file the -- the 305 or the -- the small business version, the 9 804 financials, which are virtually the -- the same.

And so I'm going to give you some advice, you know, from -- from my perspective. I agree that these changes that are being proposed will be very, very welcome. You know, I think there's a few things that we might be able to tweak that would make it a little more useful for us. I don't know if these slides can -- can come on, but from -- from my perspective -- okay. There we go. Background.

From my perspective, the -- one of the challenges we face -- again, it's been -- been mentioned. When I talk to analysts, when I talk to investors they never ask me about the 305 financials, and they almost never ask me about the proformas. What they really want to know is how's that going to change you, what will that

do to your revenue, and more important what's it going to do to your profit and your cash flow in future years. And so I think what we want to -- we definitely want to respect getting those financials out there. We need to think about it and not spend more energy on certain aspects, and, you know, again, I'll -- I'll talk about acquisitions. You can either buy the stock of a company or you could buy the assets. We've done exclusively asset purchases.

So I'll file financials, I'll show the balance sheet of the company that I bought, but I didn't buy the balance sheet. I didn't get the cash, I didn't assume the debt. And by the way, even in my proformas after one quarter it's part of my business, so for the next two years I've done all this work to want to come up with a balance sheet, and we're not really using it. And, you know, the other thing -- that hurts us the most, I think -- and again, maybe five suggestions, this is the first of them, is that when we file the -- the financials, the good news is 74 days we've got it filed, everything is perfect. And then there's a period of time for which we need to keep refiling it every time there's a registration statement. And, you know, to me it isn't so much about is that timeframe in years or three years? Is it nine months? If we could

do this in a way that the financials were filed and the auditor's consent was evergreen, well, great, we can keep doing this for two years or if the order needs to do a consent, but the management rep letter could be evergreen, that would be okay as well.

You know, the problem that we often face is the person who represented this in the past and the seller is no longer there. And the buyer can't really represent it because you're talking about the financials before we bought the company. And I -- you know, I've had situations where an auditor keeps calling back the -- the same buyer, and he said, I left. I left a year ago. You know, I've signed a non compete, I've signed a non solicitation. I agreed I was never going to talk to the employees, I was not going to talk to the customers. Why are you asking me what changed? And so, you know, to me that -- if we could find a way to incorporate those financials without the requirement of -- of getting that representation again, that would be really useful.

So the -- the second recommendation I've got is -- is one of carve out or partial financials. And, again, when you buy assets as opposed to the whole company, you know, the challenge is you spend all this time on the balance sheet, you work on a cash flow, none of that is actually relevant because you didn't actually buy all of that. And, again, to me the -- the challenge, especially when you buy a company that's years old, you're try to get a balance sheet. Getting that opening balance sheet when it's never been done before is a big, big deal, and it's not really relevant.

A company that's done acquisitions, you do all this work to figure out how to value those acquisitions and how much is goodwill and how much is intangible. It doesn't actually matter because once it comes into our books, that all gets eliminated.

So, you know, there is currently a carve-out provision, and I've actually used the carve out financial statement rule a couple times. You know, to me I think when you're doing assets, it would be good to encourage carve-outs, and even -- you know, this probably sounds like heresy, but maybe it isn't a full financial statement with a balance sheet P&L in it and a cash flow because, again, you buy a division of a -- of a business. In some ways the cash flow is artificial because they got money from the parent -- the profits they made, went back to the parent and you spend all this time trying to figure that out, and it's not really relevant.

So, again, if you can figure out a way to do partial financials. And, again, even if they couldn't be ordered, even if they can be reviewed, if they were actually relevant, to me that would actually be more useful for the -- for the investors.

You know, on the -- on the income test I think we've had a challenge that others have talked about. You go through a period where you're showing a little bit of GAP profit, you buy a company, you're now amortizing intangibles, you're now showing a GAP loss. So at the end of the year, GAP debt income is pretty close to zero. No matter what I do as a significance test, anything divided by zero is infinity, everything is relevant.

So I think the revenue test, you know, to me, if I was thinking about the distinction between the 804 small business rule and the 305, I would almost say in a small business, make it all revenue. Because in some respects the revenue is going to be more relevant as to how significant it's really going to be in terms of the -- the business. And, you know, if you were going to do a -- a test for a bigger business under 305, again, it seems to me the -- the income before extraordinary items is what's important. And when I think about the financials of the -- of the -- of the

company being acquired, if there was impairment of goodwill, who cares? If there was amortization of intangibles, again, though -- that's another noncash expense. It doesn't carry forward, it doesn't even hit the GAP books. I would take those two out. And, again, sometimes we face the situation where I actually have to complete the audit, figure out whether the goodwill was impaired last year or the year before, then I'll know what the net income is. And by that point, now I've got to go file the financials.

It's my -- my fourth suggestion is -- is actually a -- you know, a relatively small one, and -- you know, in terms of the investment test, again, I think using market value makes a lot of sense. You know, I've heard others like I & Line, KPMG suggest using this as of the day of the -- the transaction if it's available because, again, I think that makes -- makes more sense than using the last year end.

But one thing I was struck with is that the -- the suggestions focus on the value of the common equity, and it even makes a distinction of include the voting and non voting. I would ask, why not include all equity. Often at companies, especially a smaller company, has some preferred stock, and sometimes that can be valued. If it can't, clearly you can't use it,

but, for example, if it is -- in our case is it happens to be one, we've got to prefer the trades on NASDAQ, and the dollar value of a trading each day is not dramatically different than the dollar value of the -- the common, so there it would be easy to figure out the -- that the real market value.

There are other smaller companies where there's a preferred that's convertible. And, again, you could at least say if it was converted, what would it turn into so you wouldn't completely eliminate that, and that would be my suggestion for -- for coming up with the -- the investment value.

And my -- my last suggestion really revolves around the performance. And I think the idea of including management adjustments is a good one. Because, again, today when you're the reader of those financials and you see them, I mean, occasionally I'll have somebody say, You know, Bill, is that what MTVC is going to look like when you complete this acquisition? Well, no, it shows revenue from customers who left before we bought the company so we're not going to get that revenue. And it shows a lot of expenses that we wouldn't have so you're not going to see those expenses, so if you could -- if you could put in adjustments -- and, again, I realize it will be easier for a company that's already done repeated acquisitions to be able to convince somebody, okay, I've done this enough times, you know, I know this is going to go down 10 percent, I know that. But I still think the -- the only challenge with the adjustments is going to be figuring out how do you do a comfort letter. Because at the end of the day we can -- we can convince ourselves of it. But if my investment banker asks my auditor to -- to provide comfort, you know, it's like providing comfort on the weather forecast. You can't do it, so, again, I think it needs to be clear this is management's responsibility, but I feel like if you -- if you wind up with it potentially needing to be comforted, you're going to wind up with a lot of companies saying, you know, I'm not going to put anything in because that's a path of less resistance is when somebody asks me, you know, why is the facilities expense going to go down 20 percent. I am not going to be able to prove that it will be 20. One case it was 15, one case it was 25, you know, I made a judgment, so -- so that would be my third -- my first suggestion.

So sort of in -- in summary, you know, I think streamlining 305 and streamlining 804 will make the playing field more level. I agree with -- with Matt

that there will be times where it would be easier for competitors of mine who are, you know, multi billion dollar companies, they could do an acquisition easier than me, and private companies don't need the financials. But, you know, I'd still say, you know, it's worth it to -- to just make it easier so that we -- you know, we have at least a fighting chance. I realize many smaller reporting companies don't have the recourses or the patience to deal with these rules, but some do. And, again, I think we're probably an example of somebody who's -- who's dealt with the rules as they are and we've still managed to -- to figure out how to do it. And if you can make it a little bit less onerous, I think that would be good for -- for all our investors as well as for the -- for the companies that we might -- that we might buy.

Yeah, I think the focus on how do I give the analyst, how do I give the investor the information they need, you know, that's -- that's the end reason. I mean, that's all -- the only reason anybody actually wants to see these financials is so that they can project forward. Nobody actually cares the company that you're buying or how much did it lose last year. You know, that's -- you know, investors assume you've sort of factored that into the price and you've figured

this out, but focusing on the end result is -- is good. And, again, if you could figure out how to not require that repeated consent, repeated management rep letter, that -- that would make it a lot easier, and then you could leave it out there for two years. That's, you know, not a problem.

And so, you know, I -- I echo that the -- that the suggestions that have been put forth by the SEC are good proposals. If you don't take any of my advice, things are still better than they -- than they are today, but I think there's probably a few things we could do that could make it just a little bit better for -- for everybody. And I appreciate everyone listening to us, and -- and taking our suggestions.

CARLA GARRET: Thank you very much. We appreciate that.

Do any of the members like to speak?

SARA HANKS: Just --

CARLA GARRET: Yes.

SARA HANKS: I just have a quick question because we've just been focusing here about -- on the public companies, and as I understand it, these -- these rules would affect Reg A companies, right, who would just follow the -- the rules of the smaller reporting companies.

I -- I think it would be great if Reg A companies could get a bit more of a break. I've been in a situation where we were following the -- the proforma rules for an acquisition, and when you have an acquisition of -- by a very small company of an even smaller company, the proformas just -- it's just fantasy, and after you've gone through a couple of rounds of comments, and going -- and fine tune the elim -- the eliminations, I don't -- really don't think it adds anything. All it adds is an enormous bill from the -- from the accountants, and so in my personal experience we took a bill that would have been X, and ended up being 2X because of the proformas, which is a lot for a small company, so different treatment than smaller reporting companies might be warranted there.

MATT SWARTZ: I think -- I think Bill and I both agree that that's absolutely right.

BILL KORN: Yeah.

JASON SEATS: I have a stupid question.

BILL KORN: Do ya? Well, we'll probably have stupid answers for you.

JASON SEATS: Yeah, so first of all, that was an awesome walk through. That was fantastic. I don't -- I guess -- and maybe this might not even before you all, but I don't know that I understand how the revenue test or income test is not fully redundant to the investment test. Like what -- in what cases would the investment test alone not serve the purpose?

BILL KORN: Yeah, so -- so today, at least in our situation, there are times, again, when -- when my -- when my income has been pretty close to zero, so the answer is --

JASON SEATS: Income I get. Revenue I am --

BILL KORN: -- I am buying -- I am buying somebody for zero, it's -- it's actually still relevant because if I have $1 either way, the thing has reached significance. And, you know, there --

JASON SEATS: And revenue and --

BILL KORN: -- are times, you know, that -- that -- and I -- I would agree they are from a shareholder's point of view. How much am I paying for this company, you know, that probably makes more of a -- a difference. I guess I'll -- I'll give people the benefit of the doubt that says if -- when you're finished with this acquisition, if you're going to double the size of the business, I would kind of like to know about it.

And, again, our threshold right now is 20 percent. Sometimes 20 percent for a small company means I just signed up one big customer. Well, that didn't need all

of this work, but, you know, now I've bought a little company that had that big customer. Now it does, so, you know, certainly you could -- you could argue that -- that it doesn't meet the -- the investment test, that it doesn't really matter at all.

JASON SEATS: The reason why I am asking the question too is when I think about different business models, like you're moving up the li -- you know, higher up the financial statement, which is -- makes it easier, but a marketplace business where 95 percent of the revenue doesn't flow to the next line is very different than an enterprise software company where 85 percent of their rev -- top-end revenue goes to the next line. And -- and you could end up with the exact same issue with small denominators with the revenue -- a revenue test, and you're going to be parsing the definition of revenue versus like what -- is it a material transaction or not from a market cap standpoint, right?

BILL KORN: I mean, again, I didn't take the -- I thought about this, but I didn't take the philosophy that says the -- the easier you can make it the better because from the acquirer, that's probably true. I mean, if you had no requirement, that would be really easy. And if it was -- you know, but I did try to

take a little bit of a balance. Okay. I got to protect the acquirer, the -- the company. I do have to protect the current investors, I do have to protect the -- the potential investor who is weighing whether this makes sense. You know, maybe I even have to protect the -- the seller in one perspective. So I did try to sort of balance it and not go all the way and say, oh, let's eliminate revenue and income. But you're right, there are certainly situations where something reaches the significance test in terms of revenue, but it's not really significant.

MATT SWARTZ: Right, and it's -- it sounds to me, and to extrapolate what I believe you're saying to something we encounter, you know, reasonably often, in addition to marketplace kinds of businesses, you look at, for example, hospital systems that have -- they have nominal revenue, but what they really get is insurance reimbursements, and there's a massive difference between those two things to their everlasting regret, and so it -- it's probably a fairly industry-specific analysis as to what the relevant line item is, right? Because you could nominally say patients are -- are billed $100 million, but the real revenue is what we get from the insurance company, and that's 45, so that -- that's a great

point, and I think it's probably, you know, one of -- one of the things that actually speaks to accounting as a whole, you know, in other words, does -- does -- does accounting for a software company, is it actually comparable to that of a hospital system or a marketplace business. In other words, I think that's -- that is an issue, and you raise it well. It's an issue that transcends even this rule.

CARLA GARRET: Thank you.

JEFFREY SOLOMON: Yeah, obviously, you know, again having done a lot of acquisitions like -- like Bill, you know, the -- the tests are actually quite complicated. Oftentimes we -- we have a whole team that just sits around and does the tests, and -- and -- and then we try to decide whether or not we think it's significant or not. The -- rather than sort of think about -- there's a -- when you look at the three tests it's because the rule, in my opinion -- it's because the rule has to encompass all different industries.

UNIDENTIFIED SPEAKER: Uh-huh.

JEFFREY SOLOMON: But that's -- I mean, that's sort of the basic premise on it. The changing to market capitalization from assets is -- is actually I think a reflection of the fact that market capitalization is a normalizer, you know, companies can be asset light and then they trip up the rules, or other -- you can acquire a business that's asset heavy, and all of a sudden that runs. So market capitalization I just think when you think about the rule changes, it's a much better mechanism for most companies because it's agno -- it's industry agnostic. But I -- I don't think we should be -- I mean, personally I don't -- you know, I don't think that was a stupid question at all. I will just say to you, the amount of work that we do every time we do an acquisition to figure out which tests we might get -- we might have to -- we might have to follow is not a inconsequential effort on our part. And we have an entire accounting policy team that just deals with stuff like this.

If you look at what -- what the other revisions are, though, I think the idea of, you know, sort of let's assume that companies for a second are going to be doing things that more oftentimes not are actually going to be significant like, you know, it's not oftentimes that companies are doing a bunch of insignificant acquisitions.

So the -- what I like about what's being done here is it's really looking at how to streamline that

process. I will tell you, there's a -- the asymmetry -- and I think you guys outlined it quite well, there's an asymmetry here between private equity and public buyers, and that's actually what this is meant to try and normalize that.

Private equity buyers don't really care about these -- these rules at all, so as a result they become more competitive. When you're a seller, if there's a bunch of work that you have to do in order to comply with being public, it's a cost to you, significant cost to you, or it's a cost to the acquirer, one or the other. That doesn't exist if private equity is actually consolidating. And so I think the premise here we are to consider is that this -- these rule changes are meant to make it easier for public companies to compete with the private equity bid, and -- and while we can't exactly get away from the significant tests, and nor should we, I think we can streamline that process to make it less onerous on the acquirers and therefore the -- the sellers, if you will, or the small businesses that are being acquired can run a more competitive process. That just is taking a step back and saying, Why are we even discussing this. And I -- I don't mean to put words in -- in your mouth. It -- in, you know, corporation

finance that, that's my assessment.

Am I wrong about that?

MATT SWARTZ: No, that's absolutely right.

WILLIAM HINMAN: Yes, I think that's right. I mean, there's always going to be some difference between what we're going to require versus what the private equity buyer requires.

JEFFREY SOLOMON: Right.

WILLIAM HINMAN: A private equity buyer is always going to be able to put a ton of people into that other company and do a lot of diligence and see a lot of numbers, manage projections and things that we don't in the pri -- in the public sphere ask for, right? So there's always a -- a little bit of a difference. And what we're trying to do, as you said, Jeff, is reduce the public burden so it's sensible. So going back three years we didn't think made a lot of sense. We were limiting to two. Making a significance test have fewer anomalous results is, you know, again, one of the ideas.

Your question is a good one in terms of is there a redundancy between some of these tests. We have three. Do we need three? I mean, folks have commented more about the investment tests versus the asset test. You know, those are both measures of how big is this.

The income tests are -- has its own, you know, value, I think. There are situations where you don't pay much for a company, but you're taking on the big operation just because of its loss history or something, so it makes sense to have more than one test, but do we need all three, that's something that people have been commenting on and -- and asking specifically about investment versus asset test.

But we are trying to -- to make them a little bit more streamlined. Some of the points Bill has mentioned in terms of the -- the diligence and the consent process, that's not something in our rules actually required, you know, in terms of getting those -- that diligence done through a comfort letter. That's something for the private sector to sort of work out with the auditors, you know, what can you comfort and what can't you, but we do recognize that when we do ask you to put something in a registration statement, there are generally going to be comfort consequences. We take this seriously.

Just to kind of go through the rule a little bit more in terms of some of the points you raise. The carve-up financial option is there, it's being broadened. And you said you encourage folks to use it when --

BILL KORN: Right. I've done it, and I've had auditors say I've never done this, how am I going to audit this thing.

WILLIAM HINMAN: Right.

BILL KORN: When I've done it they wound up looking like the standard balance sheet, you know, and cash flow.

WILLIAM HINMAN: Right.

BILL KORN: But to me when it's an asset deal maybe you don't actually need all those components. You really need -- here's what I bought, and so now I've got a statement of assets acquired and liability assumed, and it's not a balance sheet that balances, and there isn't a cash flow, and there isn't a statement of equity, but you know what, you weren't buying any of that anyway. So if there was a way to do that, to me I think that would be --

WILLIAM HINMAN: Well, we are broadening what's there now in terms of the carve-out financial option. These are highly technical rules, so you've got to get into the weeds, but you can -- there will be more situations where a carve out will be acceptable, particularly if the assets you're buying hadn't been accounted for separately as a segment or as another line of business. We're trying to be more liberal in

that area, just because of what you're talking about.

The revenue test that we're trying to do there is add the revenue test to the income test to use the smaller of the -- you know, whatever is less significant, that's the number you use, so I think that works the way you want it to.

BILL KORN: Right. I mean, I -- I would say that the -- sometimes the only way you really ever know how to do the income piece is if you actually finished getting financials ordered because you could sort of take what the -- what the seller said, but they haven't really done the impairment, they haven't done -- and so by -- by the time you actually do it, and in some ways, if you say I am going to take the smaller of the two results, you know, you could sort of say as long as I don't pass -- as long as I don't trigger the -- the revenue threshold I don't need to worry, but then the question might be under 804 under the small business version, do you just eliminate the whole income question completely? Maybe that's a -- again --

WILLIAM HINMAN: Right. I take your point. It's sometimes hard to figure out what the income is until the auditors have been in there for a while, so that's a fair point.

You had talked about using a pre tax, you know, number adjusted for extraordinary items versus just net income in some of these measures. That's a really interesting thing for us to get feedback on in that what we were trying to do with the income test was use an easy to calculate number, and one you didn't have to go up and sort of, you know, figure out what's an extraordinary item, adjust for taxes, adjust for different items. We're trying to use a number that might be off the face of the financials on the theory that that may be easier, but if -- if folks who are going to actually use these rules think it's better to go up, you know, the income statement a little bit because that's a more reliable number and a more meaningful number, yeah, that's a great comment to make, so --

BILL KORN: Yeah, and especially on -- when -- when I am thinking about the seller's financials. Because, again, there's -- you know, there -- there are these one-time non cash expenses, you know, that --

WILLIAM HINMAN: Right.

BILL KORN: -- something was acquired for 10 million, and it was now sold for 2 million. 8 million is going to get written off. At some point 8 million

is going to run through the income statement, but it doesn't really matter. I mean, in some respects you'd say, Let's -- let's not even figure out whether that happened two years ago or last year because -- because the timing of what had happened determines whether you'll hit the significance test. Let's just say it's -- it's not relevant. It was no cash -- it was non recurring. It doesn't affect the people in the future anyway.

WILLIAM HINMAN: Correct.

CARLA GARRET: I think Burt had some statements that you've been trying to say.

ROBERT FOX: Well, I mean, a number of -- a number of comments and a couple of -- of comments as well. I mean, a couple of recommendations.

You -- first I think the number of tests is clearly needed. I mean, just the -- you know, we could talk about the different ones, but some of the industries, I mean, you know, if we went to a pure market cap test, the IT and biotech guys would probably start screaming because their -- their lifetime is buying pre revenue companies and all of a sudden they start getting thresholds, right, or limited revenue companies. The -- the comfort letter, though, this is -- is really significant, right? I mean, I totally agree. I mean, I think our comment letter is already out there, but -- you know, from my firm, but I -- the comfort letter issue is a real issue. I mean, the -- the -- you know, Kalin, I can't imagine is going to want to do a deal without a comfort letter. And if there's -- you know, in -- in a registration statement.

So this management adjustment issue, and also kind of the non audited numbers, right, that may go into the proformas as well, which is another one of the concepts is -- is a big issue.

But the -- the thing I wanted to bring up, you know, that wasn't in my firm's comment letter, something we kicked around, though, is I know on limited circumstances the staff has allowed companies that have limited information, right? You know, hey, I am looking to buy XYZ Company, never been audited before, we can get limited information, maybe we could do carve out, maybe we do revenue and expenses, but that leads to a full balance sheet. And the staff has allowed in certain situations in the past, Hey, put that information in, maybe you won't -- you know, you'll be kind of tapped out of the capital markets for some period of time, right? You can't -- you can't keep -- keep doing that, but I wonder if there isn't some other things, especially for small businesses that

you could contemplate, you know, almost like an exemption, you know, hey, we want to do this deal, we recognize we may not be ale to go back to the public capital markets for 12 months or whatever it is, but we don't want this to be a, you know, barrier for us doing the deal. And -- and I just wonder if this -- you know, maybe that's either rule making or if it's a staff policy statement that you may be more willing to consider that. I don't know if that's something that you thought about as well.

WILLIAM HINMAN: Yeah. Just to answer that, as you know probably we have a Rule 313 of SX that people come in and they ask for exemptions from the current 305 because the 305 today generates a lot of areas where you do need relief. I don't expect that that relief process will go away.

BILL KORN: Right.

WILLIAM HINMAN: That it will continue because we'll have less of the odd things to pick up hopefully we would continue to be pretty quick in turning those situations around where people would come in and say, It's just not possible to get those financials, you know, can you give us relief here, there's the alternative of what we are going to tell our investors. We do those today, and we look at that and

we say, okay, that presentation is practical, it's what you can get, it's what you use to make your investment decision, and we will generally allow those things to go forward. We may ask them to tweak the disclosure a little bit.

ROBERT FOX: And -- and so then to me it's maybe more either educational efforts, but to Bill's point earlier, I go to a lot of accountants, right, and they say, Well, I haven't seen that before, or I don't think the SEC will ever buy that.

WILLIAM HINMAN: Yep.

ROBERT FOX: Or the attorney will say, That's just a waste of time.

WILLIAM HINMAN: Yeah.

ROBERT FOX: And so I am just wondering whether -- whether it's a policy statement you guys put out or educational efforts, but I don't think, especially if you get to the smaller end of the capital markets companies are taking much advantage of that, and I don't think that they be -- that there's enough belief --

WILLIAM HINMAN: Yeah.

ROBERT FOX: -- that you're going to actually honor a lot of those relief requests.

WILLIAM HINMAN: Again, it's -- it's a very good

point. We, for the last couple years, have been publicizing 313.

ROBERT FOX: Right.

WILLIAM HINMAN: You know, because it's sort of an insider baseball kind of rule, and not everyone knows what you need to so, so we've been doing a few things, we've been turning the -- the turnaround time is a lot faster right now. We put out numbers for the staff pe -- person that you called depending on the area where you do need relief, so with phone numbers that will get directed more quickly into where you need it. And we are considering putting out more of what we've done in the past in this area. It's a little bit hard because they are always so fact specific.

ROBERT FOX: Uh-huh.

WILLIAM HINMAN: But we're trying to get people more guidance. My chief accountant is out there. Every time he speaks he talks about the 313 process and trying to make people more aware of it.

We're also suggesting that you don't need to do the 30-page treatise with your auditor to come in and see us. Give us a two-page outline of what you're thinking about, and we'll give you an idea of whether it makes sense to, you know, entertain that further, and we will act quickly. So trying to save people money and act more quickly, but I totally take your point --

ROBERT FOX: Yeah.

WILLIAM HINMAN: -- that we need to keep putting that out there and telling people that that's available.

ROBERT FOX: And I think, Bill, this was getting to your -- to your carve-out comments as well, correct?

BILL KORN: Right. Yeah. And I think, again, you know, our experience is that once we've actually convinced an auditor that it -- yes, it is permissible, they may never have seen it. You know, that was easier, but I'd love to figure out a way to carve out and just carve out what you bought. Sometimes you -- you know, what we've done is we've gotten it better because it was -- you know, it was part of a bigger business, but we've still spent a lot of time on -- on things that we didn't really buy that at the end of the day don't really have the relevance.

WILLIAM HINMAN: Yeah, really the proposal on carve outs and broadening the ability to use them is really generated by the work we've been doing on --

ROBERT FOX: On 313, yeah.

WILLIAM HINMAN: -- an ad hoc basis. We're trying to quantify a little bit of that in the rule, so that's where that all comes from.

JEFFREY SOLOMON: So the other rule changes I thought that you put in in terms of shortening the amount of time you get to go backwards in terms of doing quarterlies, that's -- that's actually super helpful just to give you some long feedback. I mean, when we did our -- we did fairly meaningful acquisition a year ago that we got at a bargain discount, so it was actually a discount purchase price and didn't meet a lot of the same tests, but from an asset standpoint we felt we had to do it. And it was a business that was owned by a private equity. Interestingly enough, private equity didn't do anything in that business to actually make it ready to be public.

WILLIAM HINMAN: Right.

JEFFREY SOLOMON: When we got into it, we -- we basically had a huge argument with them about having to go back and do three years of quarterly because it was seemed to be significant we had to show proformas of our own going back three years, and we had a huge argument with the seller about what they would have to do in order to make it compliant. And what it

ultimately came down to is we couldn't close on the transaction until they completed that work because we -- we didn't want to be in a position where we found ourselves "and by the way, three years ago this business didn't look anything like what it looks like or" --

WILLIAM HINMAN: Right.

JEFFREY SOLOMON: -- or the business that we ended up buying, so it was simply, you know, taking in time.

So I think shortening it up certainly is -- is -- is a very helpful thing. And I didn't even learn this exemption. I mean, maybe our team did, but I'll tell you where -- where we've even, we get advice that's, um, I've got to stop and think about it, so just to be candid.

You know, we're going -- we're taking that advice from our auditors all the time on what -- what they think the SEC will want to see. So in many instances the advice that we're getting is -- is -- is prophylactic advice. Like you don't want to get an SEC comment letter, so here's what you need to do. And that -- that -- of course when I hear that, and I was a CEO or CFO here is what they are like, Okay, well, we're going to jump through all those hoops because we

don't want to get an SEC comment letter.

And the amount of money that we spend to hopefully not get an SEC comment letter is significant. And so I just think anything that you can be doing around some of this you just mentioned is hugely helpful to us because then we can point to it in the public domain and say, See, here's an exemption or a place where we can go. It's not clear to me that our auditors, it's in their best interest to sort of give us that advice on how to streamline the likelihood of getting an SEC comment letter. They make a lot of money at it, you know, and -- and I am not -- I love my auditors, but I am -- they are in business too, right? And so I just think -- that will be really helpful.

CARLA GARRET: Brian?

BRIAN LEVEY: As part of the public company, smaller public company that's not yet GAP profitable, very much welcome that the revenue test, and certainly the market cap test is a step in the right direction. And to Matthew's point, I think it makes the smaller companies more competitive with the bigger companies. I did M&A and eBay for 13 years, and we never had to deal with these issues, and so there was a ton of deal certainty that we've had to look at a lot more lately to the extent we want to be inquisitive.

The one area that I thought didn't add to streamlining things was the synergies disclosure, especially for smaller companies, where it seems like it's very much up for judgment, we're going to be taking longer to work with the accountants and the auditors on the financials, there could be a release of sensitive disclosures. It just seems very open to discretion. And looking at some of the comment letters from folks that, you know, I have worked with before and trust that, you know, I would just -- I don't want to regurgitate them, but from a smaller business perspective, I think they could potentially add a ton of costs, make us more competition and add to that deal and certainty that other components of the release to try to improve.

CARLA GARRET: Thank you, Brian.

I would actually add on that. I was general counsel of a -- a smaller reporting company, and we did -- we acquired a lot of companies, and -- and that -- that last column would have scared me to death as a general counsel, and I probably would have -- not only from the sake of our perspective, which I appreciate you clarifying that that would be, you know, subject to safe harbors, but from a -- a really -- a morale of the business, the acquiring company, the

target company disclosing outright, you know, which facilities are going to close, how many employees are going to be laid off, some of that information you might think is going to happen at the beginning, but then when the acquisition actually takes place you close the deal and you realize actually that's not going to -- we don't need to do that, and so -- but you have disclosed that in a public document.

I'm just taking a step back and saying as a general counsel of a public company, I would highly recommend my client to be very, very conservative in terms of what I would have disclosed in that column, and especially -- you're not going to give us comfort on that, so --

ROBERT FOX: Nope, at least not unless the stand changed, yeah.

CARLA GARRET: Right. I mean, that would be a hard thing to get comfort on, so I was concerned about that too.

I -- I love the revenue test, I love, you know, the new denominator for the fair market value, I love the shorter periods of time. I -- I don't know how many other people want to talk about issues in particular or we now would like to -- to come up with some recommendations with respect to saying that we

support or we don't, you know, but voting on whether we support the -- the proposal to amend these requirements, we could make it where they were subject to, but we could say we do support the new revenue test, we do support having that fair market value as the denominator in the investment test.

Does anybody have anything else to say before I come up with a recommendation? Are we -- is there -- are there any subjects that you'd like to put in the recommendation?

SARA HANKS: May I?

CARLA GARRET: Yes, Sara.

SARA HANKS: Just subject to Reg A.

CARLA GARRET: Subject to Reg A.

SARA HANKS: Some kind of flexibility.

CARLA GARRET: And Greg?

GREG DEAN: And then some -- some potential tweaks or modifications on the -- the synergies of management adjustments piece just to -- to make it easier on small business, and so that I'm not frightened to enter into any M&A.

CARLA GARRET: Yeah.

JEFFREY SOLOMON: Yeah, can -- can we spend two seconds on that because I'd be curious to hear -- you know, I think Burt's right. I don't think Burt -- I

think you're right, but I don't think auditors will give you comfort on -- on all that management.

ROBERT FOX: Well, I mean -- well, two things. I mean, first of all living the current standards really wouldn't allow it, right?

JEFFREY SOLOMON: Uh-huh.

ROBERT FOX: You know, because I think you have to have fact-based certainty, right?

JEFFREY SOLOMON: Right.

ROBERT FOX: And you don't have it, right? And the points have already been made. But, yeah, I mean, I think -- you know, we raised it, my firm in our comment letter and all the other firms, right, that at least the way the current standards read and the way the liability structure is I just don't imagine -- you know, I mean, there's really two-fold, right? You'd have to have a change in the standards first, and then secondly even then we'd have to then get comfortable with having your factually adjustable, right? Because, I mean, every time we do a comfort letter we're taking on additional liability, right? And then you get into the whole issue of, you know, how judgmental is it, you know, how -- how supportable is it, so, yeah.

JEFFREY SOLOMON: Right. And so -- and I would say from -- from -- I'll speak from first the CEO's perspective, but then I'll speak from an investor's perspective because I spent a lot of time being an investor. So first I didn't care -- you know, as an investor -- I'll speak as an investor, I don't care if you got a comfort letter or not. I'm interested actually to know what management thinks because I am going to hold them accountable, right? So show me what you think the proforma is likely to look like. I mean, research analysts that actually -- right, will use that and then they'll make their own interpretations on whether or not they think you can achieve the synergies or whether or not the proformas will work. That's actually the job of a research analyst is to take what management says and say, I agree with it, or I don't agree with it, or here's where the risk is in this assessment. And so to me that's a very valuable communication tool post acquisition that the comfort letter is irrelevant for that. I'm not looking for comfort from an auditor on that, I just want to know what management thinks, and I want to hear what the research analysts and other people who cover the stock think, and that gives management a chance to say, This is what we think, and you can hold us accountable to this. I will say

whenever we do our proformas, that's where we spend most of our time with investors frankly.

Again, speaking now as a CEO, we spend a lot of time with investors on our proformas trying to -- it's a chance for us to say this is what we think will happen, and then if we don't deliver on that, obviously, you know, we have to be held accountable. But, again, all of that happens outside of the scope of -- of needing to get comfort because it's really just management's point of view. And so that would be very -- I think a very helpful tool to -- to get some guidance around not having to have comfort in those because it gives us a chance to present our case. And then when you think about all of the conference calls and everything we do afterwards, it's clearly highlighted as management's point of view, it's outside of the accounting scope, and then we can have a much more substantive conversation with our investors so they can, you know, choose to, you know, model it up or do whatever.

WILLIAM HINMAN: So --

JEFFREY SOLOMON: Does that make sense?

CARLA GARRET: Yes.

JEFFREY SOLOMON: But -- but is that kind of more of an argument, though, that it shouldn't be in the

registration statement itself, and should be allowed kind of what's going on now, which -- which I think is the issue you're trying to address, right, is that necessarily small businesses, but a lot of companies go out and they do a road show and they -- they talk about this stuff, right? It's in their analyst presentation and they talk about it, but it's not in the registration statement itself, but I think -- you know, don't you run a risk that if it's there, there may be a -- there may be an expectations gap of -- of what has been, you know, verified or not?

WILLIAM HINMAN: Sure I mean today as mentioned it's these numbers are often the nicer -- the better of synergies are discussed at length on the road show

JEFFREY SOLOMON: Uh-huh

WILLIAM HINMAN: The full picture may get some mention along the way, and it's not in the registration statement We certainly take the point that it's the kind of thing that auditors historically have not given comfort on or, you know, you wouldn't think it would be very hard to get comfort on Our rules don't require comfort per se, they require due diligence You want to have due diligence defense, one of the things you can do is to have a comfort letter There's other ways to diligence numbers where

you can do your own work and think about this if you're underwriting that deal or if you're involved in that transaction, and you would have wanted a comfort letter, but you don't get it, you do substitute diligence.

So the comfort letter point we'd certainly take, it's -- it's a good one. By requiring people to put those management adjustments in the book they are standing a little bit more firmly behind them. There's a different level of liability, and so the question is, is that useful?

We're asked -- you know, we've talked about this as something that would be required when either reasonably certain, some commenters have suggested that these should be optional. That might be another way to go, you would see people putting -- putting them in when they thought they were fair, a fair presentation and were comfortable with them.

JEFFREY SOLOMON: Uh-huh.

WILLIAM HINMAN: And everybody from a diligence point got comfortable with them, and you'd see that for that deal, and you'd see other deals that have been left out, and that may give you a better idea of what -- how firmly management believes in those synergies.

JEFFREY SOLOMON: That --

WILLIAM HINMAN: So that -- that's a comment, you know, we were receiving, that's another comment people could make. Right now it's proposed as a -- as a requirement, but that doesn't mean that you can't comment otherwise.

JASON SEATS: If -- if the requirement, though -- if the goal is to try to equal the playing field to a private equity buyer, private equity buyer is not required to make those filings, and so you get that it might be the same analysis they would be doing, but I don't -- it's -- it's a --

WILLIAM HINMAN: Well, in some ways we would be leveling the playing field because a private equity buyer certainly does take those synergies into account.

JASON SEATS: Of course.

WILLIAM HINMAN: And that's one of the things that --

JASON SEATS: And there's no reason that a public buyer would not also be doing that behind closed doors, right?

WILLIAM HINMAN: If they don't have --

JEFFREY SOLOMON: Except they can't get access to it.

WILLIAM HINMAN: Do they have the information, and is it as reliable as you'd want it to be?

JEFFREY SOLOMON: So a public investor can't get material non public information, right? That's the thing, is how does the information get into the public's hands, right? So if you think about it's really private equity versus public equity, right? And private equity has when it does its acquisitions it does the same due diligence, it just doesn't have a disclosure, it's consuming it for itself.

Public equity, there's no way for a public company to get that information into the public domain so you can actually have a conversation about it, and you then now you're -- you're on Reg FD and a bunch of other things where how do you talk about what your synergies are if you don't have a public document to actually talk about it. And if you have one-on-one conversations with public investors in about -- in something that's not disclosed in an 8-K or then all of a sudden you're -- there's an 8 -- you know, now you're running afoul some real serious problems.

WILLIAM HINMAN: Well, folks --

JEFFREY SOLOMON: So I think this is about how to get that.

WILLIAM HINMAN: Just to be clear, when folks do

this in an M&A context, they go on a road show, those road show materials are required to be furnished to the SEC, but there's a different standard of liability.

JEFFREY SOLOMON: Yeah.

WILLIAM HINMAN: It's not in a registration statement per se.

JEFFREY SOLOMON: Right, so we -- we've actually completed two things. I wasn't thinking about it from a registration standpoint. I mean, it would be if you're doing financing alongside of an acquisition.

WILLIAM HINMAN: Right.

JEFFREY SOLOMON: That's for sure. I just, you know, when --

WILLIAM HINMAN: Which is the only time you'd have a comfort.

JEFFREY SOLOMON: Right, you would be talking about an 8-K filing here where you're essentially doing proforma financials, which is essentially what -- it depends to your prior registration statement if you had any outstanding or your -- your public filings.

And I -- I agree with you by the way. So there's another thing to consider here --

CARLA GARRET: Question?

JEFFREY SOLOMON: Yeah, sorry.

ELAD L. ROISMAN: I'd rather hear from you, so --

JEFFREY SOLOMON: Oh, sorry. I -- I think it's actually -- from an investment banking standpoint, certainly fairness opinions can deal with a lot of the issues, you know, and -- and there when you're hiring a financial adviser like an investment bank, that investment bank can actually provide a fairness opinion. It's not the same things as a comfort letter, but it's an opinion that, you know, oftentimes goes along with a meaningful acquisition to the public. And there, I think that that -- you know, if there's some guidance around what -- what's allowed to be put into the management, what's -- what's allowed to be put into these proforma financials.

As an investment bank we -- we would take that under advisement and help to craft that and be able to say, you know, these are things -- well, based on our diligence as part of the fairness of being in process that we think are eminently achievable. It's a different level of --

WILLIAM HINMAN: Yeah, you'd have to do your own diligence.

JEFFREY SOLOMON: But -- but at least you have a financial intermediary in there who is, as part of the

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fairness opinion, deliverable and say, you know, this seems reasonable or fair.

Sorry.

ELAD L. ROISMAN: No, no, like this has been great. I like what I'm hearing, and I appreciate it. It's like, you know, you saw what we were trying to accomplish was make more proformas more useful and hold issuers accountable for the synergy disclosures. It just sounds like proformas is may be not the most perfect vehicle for communicating synergy, you know, predictions. So you understand what we're trying to achieve and also what you think is achievable. I would like to -- for you guys to think about whether it's there, or later, you know, what is the best way to kind of meet that burden, and to Brian's point, allow you guys to do what you're trying to so, so -- but this has been incredibly helpful.

BILL KORN: Yeah, I mean one thought maybe that proformas could go in the 8-K, but not necessarily transfer it to that registration statement so that you could do it there without the need for the -- for the comfort and -- you know, and then the -- then when you're doing proformas as part of an S1 or an S3 you include the transaction adjustments, but you don't include the management adjustment cup. So the 8-K

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could include it, you know, you could give it out to, what, the shareholders, you could actually talk about that on a road show and it would be in the public domain, but you weren't necessarily putting the same level of -- of heft behind it.

MATT SWARTZ: And just to add to that thought, Bill, to Brian and Carla's point, having serving and having served as general counsels of technology companies that are growing, but really any small business. I mean I think the cultural impact of having to publicly talk about what cost savings are going to result from the acquisition is -- is an enormous cultural and -- and real business issue for -- for -- certainly for sellers, but for buyers too. And it's a reality that all buyers are probably looking for synergies and cost savings, but the only ones that have to -- would have to make them public would be public companies. And I think the market in these things in M&As, more often than not I have experienced company owners telling buyers I want you to take care of our people for at least a year. I haven't seen a lot of agreements that go beyond a year, but often that point is specifically negotiated. What happens after a year, I think, you know, there's less control over, but it's -- proforma would be a

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very serious issue if you had to publicly announce your intentions to synergize employees away.

CARLA GARRET: I agree with that.

So at this time, let me see if I can summarize a little bit and tell me where I am right and tell me where I'm wrong, but a possible recommendation would be for us to say that the committee supports the commission's proposal to amend the financial reporting requirements for the acquisitions and dispositions of businesses including Rules 305, 314 and Article 11 of Regulation SX subject to the following recommendations, that the Commission continue to look at Reg A companies and them having different treatments under these rules, that the Commission further look at the disclosures of the management discussion, including whether synergies should -- and the proforma column should be mandatory or optional or not included at all.

Any object subject issues?

I think in addition to the revenue test we support the addition of the fair market value for the investment test as a denominator, to support the decrease in the number of years of financial statement from three to two?

SARA HANKS: Uh-huh. Yeah.

CARLA GARRET: Okay. On that what I'll do is

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I'll call for a vote on what I just stated unless somebody wants me to repeat it.

Is there a motion to approve?

HANK TORBERT: Motion to approve.

CARLA GARRET: Thank you. Is there a second?

WILLIAM HINMAN: Second.

CARLA GARRET: Okay. All in favor of that recommendation?

(Several ayes.)

CARLA GARRET: Okay. Anybody opposed?

(No response.)

CARLA GARRET: Great. We've just passed our first recommendation, and the recommendation has been approved by the committee. And I think we actually finished five minutes early before lunch. And so I want to thank you again to Matt and Bill for joining us here today. Your presentations were excellent, and I think gave the Committee a lot of insight to these matters, so thank you very much.

BILL KORN: Thanks for inviting us.

MATT SWARTZ: Thank you.

CARLA GARRET: You're welcome. And so what I'll do is I'll adjourn the meeting for lunch, and the meet -- the Committee will reconvene at 1:15. If you're joining via webcast, please note that the webcast will be stopped during this period, and that you can rejoin the meeting at 1:15 Central time.

Thank you.

(11:56 a.m. - 1:16 p.m. - Adjournment while the Committee broke for lunch.)

CARLA GARRET: Welcome back from lunch. I here -- hereby call the meeting back to order. I would like to thank Chairman Clayton and Commissioner Purse who have joined us. Welcome.

CHAIRMAN JAY CLAYTON: Thank you.

CARLA GARRET: And I understand that Chairman Clayton -- would you like to talk to the committee?

CHAIRMAN JAY CLAYTON: Oh, okay. Thank you, Carla. I -- I understand these mics are way hot.

Thank -- thank you members of the small business capital formation advisory committee, Martha Miller and the staff and Office of the Advocate for Small Business Capital Formation for holding this second meeting of the Committee outside of Washington, DC.

This demonstrates a clear commitment to capital formation across the country. I thankfully -- I thank you for your thoughtful and prag -- pragmatic exploration of how our rules, regulations and policies impact small businesses and their investors including

smaller public companies. In that vein, a very big thank you to Creighton University for the warm welcome to Omaha, Nebraska.

The agenda today is packed with substantive topics that I can -- that I believe can have a very positive impact on smaller companies and their investors. This morning you already heard from the staff and the Division of Corporation Finance about the SEC's concept release on harmonization of securities offerings exemptions.

The concept release is the first step in what we hope will be a much needed forum of our exemptive offering framework, which I have referred to before as an elaborate patchwork.

I understand that this morning was also the first step for the work of the committee in this area, and that you will continue to consider how we can harmonize and make more effective our exemptions from registration at a future meeting of the committee.

The opportunity for improvement in this area is stark. Private capital raising is now outpacing capital raising in our public markets, and our main street investors have no effective access to investments.

Further, the availability or private capital is

geographically skewed. And as we discussed at your first meeting, significantly favors companies with values and ex -- valuations in excess of $50 million. I look forward to your work in this area.

In the meantime, I encourage everyone, including small businesses and their investors to send us their comments and share their suggestions for how we can improve the exemptive offering framework.

This morning you also discussed our proposed amendments to the financial reporting requirements for acquisitions and dispositions of business. I am pleased you are tackling this topic, especially since I realize that it's not an easy one. So let me be clear about what I hope we can achieve with these amendments.

First and foremost, we need to ensure that investors receive the financial information they need to understand the potential effects of significant acquisitions or dispositions.

Second, I believe we can deliver for investors while eliminating all necessary -- all necessary costs and burdens imposed by the current rules, that in my experience can and do frustrate, and let me emphasize frustrate, attractive acquisitions and dispositions including those involving small businesses.

The proposed rules reflect the experience of the

staff and the Division of Corporation Finance gained through years of working with these rules. I commend them for their world.

The last topic on your agenda today is also a direct result of the efforts of the Karwin staff. Bill, you and your staff have been busy. In May the SEC proposed amendments to more appropriately tailor the accelerated and large accelerated filer definitions. Under the proposed amendments smaller reporting companies with less than 100 million in revenues would not be required to obtain an attestation of their internal control over financial reporting. They refer to it as ICFR, for an independent outside auditor.

Importantly, the proposed amendments would not change key investors protections from the Sarbanes Oxley Act of 2002, such as independent audit committees, CEO and CFO certifications of financial reports, or the requirement that companies continue to establish, maintain and assess the effectiveness of their ICFR. And, of course, the financial statements of those companies would continue to be audited by an independent outside auditor.

What the proposed rules would do is allow these lower revenue companies, many of which are biotech and healthcare companies and their investors to benefit for more tailored control requirements, so they will be able to redirect savings in growing their companies.

We are not proposing these changes in isolation. We are building from the experience we have gained since the Jobs Act of 2012 exempted companies with less than 1 billion in annual gross revenues from the ICFR attestation requirements during the first five years following their IPOs.

In many cases -- and this is important and has not been emphasized enough. The proposed rules would simply extend this widely lotted Jobs Act exemption beyond the five-year window for companies that have not achieved more than 100 million in revenues. I look forward to your discussion this afternoon. Thank you.

CARLA GARRET: Thank you, Chairman Clayton and Commissioner Purse.

COMMISSIONER PURSE: Thanks, Carla. And thanks to all of you for being here today, for making the trip out here to Omaha, and I am really delighted that we are meeting somewhere outside of Washington, DC. I always highlight the importance of thinking about capital formation from the perspective that's not just focused on the coast, but it's focused on the Heartland of the countries, where I am from as well.

I am not from Om -- from Omaha, but I am from Ohio, so there are a lot of similarities.

I want to thank Martha and her office for putting this together, and just sorry that I wasn't able to be here this morning for the discussion. It sounds like it was a very interesting and lively discussion this morning. I am very much looking forward to this afternoon's discussion. I think as the Chairman highlighted, we're really trying to get the balance right and making sure that investors get the information that they need, but not -- not imposing costs on capital formation that prevent transactions from occurring that -- that would happen in the absence of -- of those regulatory burdens. And so trying to get that balance right is very important to us, and I think you all are really key to helping us figure out how to get that balance right, so I look forward to hearing what you have to say this afternoon. Thank you.

CARLA GARRET: Thank you, Commissioner Purse. Commissioner Roisman?

ELAD L. ROISMAN: Yes. Well, thank you again everybody for coming here to Omaha and to Creighton University. Thank you, Creighton University, for allowing us your space and your time and all your

assistance. It's great to be here in Omaha. As much as I enjoy our meetings in the windowless basement of the SEC, the change of scenery is much appreciated.

So I -- as you can probably tell, I have been looking forward to this meeting since last May, since your inaugural one where I was -- I was president. I thoroughly enjoyed that first meeting. It's -- I remember being so impressed by your enthusiasm, your camaraderie and participation on a lot of really substantive matters, and I look forward to continuing that. It's already begun this morning, and into future meetings.

I'll say you guys have set a really high bar for yourselves, but I think you guys will -- will need it. I took a lot of notes during today's discussion, both on the harmonization concept release and the -- the proposal to amend the financial disclosures for acquisitions and dispositions. I think it has given us a lot to think about, which we'll take back to Washington, and I very much look forward to continuing that into the next topic, which is the proposal to amend the accelerated and large accelerated filer definition.

So when this was proposed, I gave remarks and I noted that it was -- the proposal we had was well

supported by the economic analysis provided. With that said, I think my question to you and to everyone else is is there different or more recent data that we did not take into account that would support explaining relief to appropriate issuers. And I think that's a question where your input would also be particularly helpful.

I would also be interested in hearing the proposed definitions will introduce complexity to small businesses trying to figure it out. We even kind of talked about that earlier today, but I think that's really helpful, and a lot of you noted that you'll go to sophisticated counsel or accountants or audits -- auditors to figure that out, is there a way for us to potentially simplify that.

So in closing I really thank you guys for your dedication and perspective that you provide the commission. Thank you to today's speakers, you know, your knowledge and insight on these particular issues is not only incredibly helpful to everyone here, but to everyone listening and watching and to the staff back in the home office who is working with us. You know, I realize you have day jobs and you're traveling here, which makes it a little harder, but we really do appreciate it.

And lastly, but definitely not least, thank you to Martha Legg Miller, Julie Davis, Jenny Riegel and the Office of Small Business Advocates. You guys have done a tremendous job, and I look forward to the continued work that you will do.

CARLA GARRET: Thank you. Thank you, Chairman. Thank you, Commissioners.

Our next agenda item is the SEC proposal to amend the accelerated and large accelerated filer definitions. And, Jeff, our vice chair, is going to introduce this topic.

JEFFREY SOLOMON: Thanks, Carla. And I hope I do as a masterful job as you did this morning, so -- probably won't, but it's -- it's a high bar.

Thanks to the Commissioners and to the staff for -- for making this easy for us. We actually do have day jobs, you're right about that. And -- and so any time you get called on to be able to participate in a public discourse around things that are really critical to the economic health of the country, it's an honor and a privilege, so thank you for giving us the opportunity and using your power to convene to do something I think we all think in this committee is extremely constructive.

I'll just say before we get started, one of the

things that in discussing all these topics, and in actually reaching out to a number of people to participate, it's given me a chance to articulate what the role of this committee is. And the feedback I've gotten almost uni -- unilaterally from companies and from investors has been, Wow, I had no idea that the SEC was actually so integrally involved in something so important. And it's really a great example of how -- I mean, how -- how government involvement can be extremely constructive around topics, and so I think, you know, you should just know that I think part of our responsibility in this committee is to communicate that more broadly. The fact that we're in Omaha today and tomorrow I think is indicative of really -- of the -- of the impact that we can potentially have beyond the coasts, and that's as you and I have discussed from being from the Midwest is pretty -- pretty critical, so --

Okay. So just some quick background, we'll get through the -- the detail of it and then we'll open it up for -- for discussion from our speakers.

In June of 2018, the Commission raised the threshold for qualifying as a smaller reporting company, or SRC, which means the company is eligible for scaled disclosures in their reporting obligations.

By increasing the public float threshold, more companies can become eligible, or have become eligible for less burdensome reporting requirements. The new definition raised the threshold from 75 million of public flow to 250 million to qualify. And the new definition also qualified companies as SRCs if they have less than 100 million in the annual revenues, and either no public float, or public float that is less than 700 million.

Here's the context, the commission's 2018 -- June 2018 release discussed, but did not change what companies fall into the categories of non accredited filers, accredited filers and large accredited filers through three terms that -- accelerated. I am sorry. Let me rephrase that. Thank you. Thank you.

The Commission discussed, but did not change what companies fall into the categories of non accelerated filers, accelerated filers and large accelerated filers.

Prior to the SRC amendments, non accelerated filers were those with the same qualification threshold of 75 million of public float as SRCs, and under Sarbanes Oxley, Section 404A, all companies must maintain internal controls over financial reporting or ICFR, which management must access in its periodic

reports.

Accelerated and large accelerated filers must also comply with 404B, which requires an additional independent auditor attestation of management's assessment.

Non accelerated filers are exempt from the additional 404B auditor attestation, as are emerging growth companies during their five year on ramp post IPO for the Jobs Act.

So the proposal in May of 2019, is that the Commission released a proposal to attend the accelerated filer and large accelerated filer definitions. The proposed amendments would result in smaller reporting companies with less than 100 million in revenues being non accelerated filers.

The proposal uses a different framework than the updated SRC definition, although both include a test based on company revenue. The proposal is intended to reduce the cost for lower revenue companies while also maintaining your effective investors protections.

So before we get started and I introduce the speakers, we're going to try on the committee to -- to follow the similar format that we did with the second section this morning, which is we're bring the conversation to a close, probably about 15 or 20 minutes before the end of our time, and then really try to get together and see if we can bring about some consensus on -- on making a formal recommendation. Obviously we will be having many conversations be -- before then, but the goal would be to be able to make a formal recommendation at the end of this session.

So our -- our speakers, I think you met Bill Hinman and Jennifer Zepralka this morning from the SEC, and then Charles Crain, who is the director of tax and domestic economic policy for the National Association of Manufacturers, which represents 14,000 manufacturing companies. Charles leads the organization's policy in advocacy work on corporate governance and financial services, and his prior experience includes work on the hill. He's a graduate of Mercer University in Macon, Georgia.

And David Maley is senior vice president and lead portfolio manager at Ariel Investments. He runs the funds micro cap and small cap deep value strategies, and manages the firm's domestic trading teams and chairs their trade oversight committee.

I joined the firm in 2009 bringing 25 years of investment experience as a graduate of the University of Notre Dame, where he has a BBA in finance, and the University of Chicago where he has an MBA.

Full disclosure, he is also a Cowan shareholder, so I just want everyone to know that, so I work for him. That's pretty much how I view that.

On the phone I think we have Mike Robb. Mike, are you there?

MIKE ROBB: I am.

JEFFREY SOLOMON: And Mike is the president and CEO of Ardelyx. Ardelyx is a biopharma company focused on developing treatments for cardio -- cardio renal diseases. Mike has experience -- significant experience as a CEO in the biotech space, and prior to that was spending 15 years as a venture partner at New Enterprise Associates, so we -- we really do appreciate you sharing your perspective, Mike, as well.

Okay. So let's -- I think I got it all. Did I get it all there? Great. So let's open up the conversation and we'll start -- I don't know, Bill and Jennifer, if you had anything that you wanted to start with, and then we'll -- we'll work down the line.

WILLIAM HINMAN: Sure. Thanks, Jeff. We'll get a little bit of more background on the proposed rule. I'll talk briefly, and then Jennifer will fill in some details, and then we'll hear from our analyst, whose perspective I am anxious to hear.

I think you did a really good job, Jeff, of summarizing what the rule is trying to do, you know, the perspective of a year ago we changed the universal companies that would qualify as small reporting companies to include companies with up to 250 million in market cap or 700 million in market cap if you had less than 100 million of revenue.

And it used to be if you were qualified as a small reporting company, you did not have to provide the outside auditor attestation over your internal controls. When we changed that rule a year ago, we did not sort of make that parallel change and say, So long as you're an SRC, you don't have to provide that attestation. Instead we decided to look at that a little harder. The chairman at the end of the rule making, and the rest of the commissioners directed our division to take a look at the qualifications where the exemption from the attestation requirements.

At that point, and right now if you're more than -- have more than 75 million in market cap, you have to provide that attestation. We were asking ourselves, is that the best place to draw the line, does that strike the right cost benefit analysis. Are all companies over 75 million getting the good -- the investor is getting a good return on the costs of that exercise, the outside auditor attestation, or is there another way to kind of describe that universe.

And so the proposed rule does try to have another test, which is basically a test that you could pass to be an SRC. You have under 700 million in market cap, and under 100 million in revenue.

If you do, perhaps your financials are less complex. With that little revenue, there is probably not complicated rec issues. You may still be in a very early development stage. You have a higher market cap, but you have very few revenues. And so you probably are early stage, and you're probably a kind of company that could really benefit from investing that money instead of with your auditors for the outside attestation, perhaps another clinician or more R&D, whatever it is that is causing that high-market cap, but low revenue profile. And so we took a real hard look at that as our colleagues in the division of economic and risk analysis to see what they thought.

And we think we have the right line there, that if you're under 100 million in revenue, and 100 -- under 700 million of market cap, perhaps the cost benefit is such that we don't -- do not require the outside auditor attestation.

We are -- also a question, though, is -- and to keep things simple, would it be better to say, If you're a small reporting company, you don't need to prove this attestation. And so that's a question in the proposal, it's something we're continuing to consider, people are commenting on that, we'll be interested in the Committee's views, but so far we have led with the 75 -- excuse me, 100 million of revenue and under -- and under 700 million in market cap.

A couple points that are probably worth emphasizing. Even if the companies that now would qualify for the exemption do not provide the attestation, their auditors when they do the audits still are required under the accounting literature to review the quality of the controls. So it's not like this is a free pass that the controls do not need to pass muster, the auditors will still look at them and take them into account as they structure the audit.

So if the controls are not up to snuff for an attestation, they may not be as systematized at that point. The auditors, we would presume, would be doing more manual checking and make sure that the audit still was done in a responsible way, so it's important. That's, I think, an important point to emphasize.

One of the things that we are interested in the Committee's views and others, is the cost of the attestation. There's been a lot of question around how do you measure these costs of going through the attestation requirement. And there's obviously the additional fees that the auditors may charge, there's additional management time

that folks will incur.

And the other thing that's -- I used to see in private practice that -- again, it would be interesting to hear the committee's views and the panelist's views, is that when companies got to that stage where they are thinking of providing the outside attestation, they typically had to go through some systems upgrades. If the auditor was going to attest, the auditor would say, It's time to do an upgrade if you want our attestation. It wasn't that the financials themselves had gotten to a point where they were so complicated that was required, it was because we needed to check the box and add the attestation. If left to their own, the committee -- the company may have decided to do that at a later stage, but not there's a systems upgrade that kind of follows along with this, and that's another cost that we're very cognizant of when we're thinking about requiring outside attestations.

So we are, you know, curious to hear from the committee on having the flexibility to decide when you do those upgrades and whether or not attestation is provided, you know, how useful is that for you, will the money saved by used in the business in other ways that could be productive, or because people have commented on attestations can be good for reducing our cost of capital. We voluntarily do it, but under this proposal what we're

suggesting is by lifting the thresholds more companies can make that decision for themselves as opposed to being required to do it through the regulations. That's what this is all about.

That's the broad overview, and those are some of the things that we're thinking about. I'll let Jennifer add a couple of details.

JENNIFER ZEPRALKA: Thank you. I -- you know, I think between Jeff and Bill you've heard now the contours of this -- this proposal that's in -- that's in the release about the -- the exception for small reporting companies that meet the revenue test.

I just wanted to mention before we get into the discussion, there's -- there's some other proposals in there. We are proposing to amend the transition provisions, so this is, you know, a little bit in the weeds, but when you are coming in and out of accelerated or large accelerated filer status there are -- there are tests that you have to look at.

Right now under the existing transition rules, an issuer that is accelerated or large accelerated doesn't fall out of that into non accelerated status until the public float falls below a lower threshold than the one that is required to come into the status. That's intended to keep companies from popping in and out of accelerated filer

status just based on minor fluctuations in their -- in their public float.

Under the proposed amendments we -- we're asking to increase the transition thresholds for those -- for accelerated and large accelerated filer for -- from 50 million, and to exit large accelerated filer status from 500 million to 560 million. This would align everything at 80 percent thresholds, which is consistent with the thresholds that are used for SRC, Small Reporting Company Status, and we would want to add the revenue test to transition thresholds for exiting both accelerated and large accelerated filer status, so that an issuer that is accelerated now would remain one unless -- unless either its public float falls below $60 million, or it becomes eligible to use the smaller reporting company accommodations under the revenue test, so it aligns coming out the way we're proposing to have it come in.

Again, it's a little hard to -- to wrap your head around that because it is pretty technical, but I just wanted to -- to mention that that's another part of the proposal.

And then briefly just before we start, the comment period ended on July 29th on this proposal, but you can, of course, still submit comments. We've gotten 62 letters as of yesterday. Many of the comments are supportive of the proposals, particularly from the biotech industry and some community banks have been very favorable Many commenters have noted the resource constraints for pre revenue and lower revenue companies that Bill was just talking about, and note that the resources that go to 404B attestation now could instead go to expanding their businesses and increased R&D

We've also heard support from issuers that are on the verge of aging out of emerging growth company status and concerned about the transition to needing to do the auditor attestation

A few other commenters are supportive of the proposals, but suggest we go farther and align the smaller reporting company and non accelerated filer status so that all small reporting companies would be non accelerated filers, and of course there are several commenters that I'm not saying last because we're not listening to them, but there are several who are not entirely supportive of this proposal and who are making sure that we hear their views about the benefits of the auditor attestation to investors in small, low revenue companies inciting a need for more analysis of the costs and benefits of our proposal

And with that, I think we can hear from our panelists

JEFFREY SOLOMON: Charles?

CHARLES CRAIN: Well, thank you so much, Carla and Jeff, for having me today, and -- and to Martha and Julie and -- and Jenny in the Small Business Office team.

I know Jeff already gave a brief introduction of me. I am Charles Crain again. I lead our corporate governance to finish services work at the National Association of Manufacturers. The NAMM has about 14,000 member companies, member manufacturers in all 50 states, every industrial sector you can think of underneath that large manufacturing umbrella. 90 percent of our members are small and medium sized companies. Looking at the manufacturing industry nationwide, there are about 250,000 manufacturers. 98 percent of them have fewer than 500 employees.

Do I need to do something?

CARLA GARRET: No.

CHARLES CRAIN: Okay. I have slides theoretically somewhere, but they are also in your -- I'm sure we'll send around the materials so I have notes without that.

Anyway, 98 percent of manufacturers have fewer than 500 employees, and three-quarters have fewer than 20, so these are -- these are largely small businesses, and there are -- these companies make up 64 percent of private

sector R&D spending in the United States, so that I think relevant to this conversation is a significant outlay, what do we talk about, what they might -- what else they might be spending capital on.

There are also 13 million men and women who make things in America, and we -- we sort of speak on their behalf as well.

Manufacturing is a capital-intensive industry, as I am sure all of you know. Manufacturers turn to the public markets for financing R&D, for significant equipment purchases, job creation, business growth, etcetera, and -- and those pro growth activities fuel economic expansion across the country, and certainly beyond just the coast. Just here in Nebraska, manufacturing makes up 11 percent of the state's domestic product, and it employs 100,000 people just here in the state.

And so when we talk about these issues, about access to capital, yes, it's obviously very important to manufacturers who are looking to expand their business, but it's also important to manufacturing workers. Our industry is above average in terms of providing retirement benefits to employees. About two-thirds of manufacturing workers have a retirement plan through their employer, and, of course, they are also individuals with their own, you know, mutual fund retirement account, what have you.

Those workers need companies to go public early in order to take advantage of the upswing as that company grows. The company needs to go public early obviously to fund its growth, to finance its growth on the public market, but from the workers' perspective, if companies aren't going public until they have revenues, have a higher public float, whatever it is, then -- then the workers -- the every day main stream investors miss out on that -- that growth opportunity. And unfortunately we can -- we can see that play out in the economy.

Over the last 20 years the number of public companies in the US has been cut in half, and they are much larger companies. In 1996, the average market cap of a public company was $1.8 million, today it's $7.3 million, so that's a more than three-fold increase in the size of company, and that issue starts at IPO. Over that same period IPOs sub 75 million have gone from 38 percent to all IPOs to just 6 percent.

So much larger companies are going public, which means that every-day investors can't get into those shares, and miss out on that growth opportunity. And so that's why the work that you all are doing I think is so important, and the work that the SEC is doing is so important in this space. You know, the SEC is in the middle of a year-long process looking at the proxy rules and the proxy process,

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and things like proxy-advisory firms act to the shareholders, proxy rating, stuff like that is providing a disincentive to IPO Not that those shouldn't exist, obviously they have a valuable role to play, but they take a lot of time and money to deal with as a small company even though they don't really have a stake in your business

Similarly, the SEC just had a roundtable on quarterly reporting, and how the short term look at meeting a Wall Street target may not align with what your long-term best interests are as a company

And then, of course, there's the cost of being a public company And I know that's what we're all kind of focused on today Time and again we have heard from member companies at NAMM that the cost of being public - going public and being public is a significant disincentive to IPO, and 404B is obviously a key piece of that

Yes

(Unidentified Speaker - I am not to that part yet)

CHARLES CRAIN: Thank you And so -- and so that's why, again, I think it's really exciting that you all are having this conversation

And so what I wanted to do is talk a little bit about how manufacturers experience 404B specifically And one thing that I think is important to point out, and

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Director Hinman did this as well is that this is not a conversation about 404A. No matter what happens with 404B under the proposed rule, whatever you all recommend, whatever the SEC finalizes, manufacturers value and rely on the 404A internal controls that they are required to do under Sarbanes Oxley, and -- and those aren't going anywhere. That's something that's very important for investors and it is a significant protection for them.

404B, on the other hand, is a different cost benefit analysis for manufacturers. In the proposal the SEC cites the direct cost savings, the floor of the direct cost savings at $110,000 per year, but they acknowledge that that's a conservative estimate, and that could easily be up to 200, $250,000 a year just in direct costs. That's the increased check that you write to the auditor for lack -- for lack of a more sophisticated description. And then they estimate non -- a non direct cost as well of about $100,000 a year. But I spoke to a company the other day where they were sort of in this SRC bucket, and they have an entire one person whose only job to do a 404B in house, and their combined salary benefits is $100,000, and that's just one person, so I am assuming the rest of their non direct cost would exceed $100,000, so, you know, when adding those together it's a quarter of a million dollars, 300, $400,000, which is significant for our growing manufacturers, and

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that's capital that is not going to job growth, economic expansion, etcetera

Excuse me

When we talk to our companies their main challenge actually is workforce, and so they might much rather be spending that capital on up skilling job training You know, with unemployment as low as it is they have a hard time finding workers, so if there was a way to save a little money on 404B compliance, and divert it to, say apprenticeships, that's something that would be incredibly impactful for our companies, and obviously for the broader economy as we continue to -- to bring folks into the skills that they need to succeed in the 21st Century economy

There are also significant opportunity costs, so it's not just the direct dollars and cents For a small company management, obviously is dealing with 404B, but, you know, they are also the senior salesperson, the senior relationship builder They are out doing on your road shows, and so there are only 24 hours in a day, and so if you are -- you know, every hour you're spending on 404B you're not out there finding a new client, finding a new investor And that's something that our company has raised with us as well in connection with the direct sort of dollars and cents cost

And -- and one other thing I want to point out is

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that any exemption from 404B, whether under the proposed rule, under the Jobs Act, under the existing standard at the $75 million in public float, that's an optional exemption. So if companies felt that they need to comply with 404B, they need to have that external attestation in order to give their investors the comfort they need, or, in fact, if their investors are saying to them, We're skittish about investing in you for this specific reason, they are always free to opt into compliance. The market is actually pretty good at this. We've seen this with the Jobs Act. Emerging growth companies are allowed to utilize private company GAP standards during a transition period rather than public company GAP standards, and no one is opting into that because the market has said, We don't -- we don't want you to do that, we'd rather you have on the public company standards so we can compare you with your peers.

As you all know, there's also a 404B exemption, the Jobs Act, and no one is opting out of that. Everyone is taking advantage of the exemption from the external audit.

So I think the market can dictate this, but unfortunately the threshold, as it currently stands is so low that the market is not given the opportunity to make that decision because these companies aren't qualifying.

So I want to talk about -- I'm going to press this button and see what happens.

Well -- there we go. Okay. So I want to talk about sort of how we got here, and I know this has been covered by the SEC staff and by Jeff earlier. The current standard, as we know, is at 75 million in public float, which as I've said, in our view and in manufacturer's views is -- is too low, and to the SEC's credit they've proposed to make changes in the space. I just wanted to - to give you all a friendly reminder that this committee or the previous iteration of this committee has recommended changes in this space before, and specifically has recommended taking that $75 million in public float and bumping it up to $250 million. So that's something that you all have done twice in 2013 and 2015.

The government business forum on small business capital formation, which is being held here in Omaha tomorrow has said the same thing every year for the past decade, so there's a pretty clear record that the business community and the investors who participate in these various four think that the 75 is too low, and it needs to be bumped up. And there's pretty clear consensus, in fact, on that $250 million level.

And so when we look at what the SEC has done with this information, there -- there are actually two definitions that play here as -- as Director Hinman laid out, the SRC definition, and non accelerated filer, which

has historically been identical And then you see here when they made the SRC change last year, they certainly took their recommendations from these -- these two forums, the Advisory Committee and the Government forum, and adopted them sort of as recommended with obviously their own robust analysis, but the result is that the -- what was recommended has now been finalized as the new SRC universe

On non accelerated filer, though, they only kept the revenue prong of the new SRC definition, and not the public foot prong So there's this universe of companies between 75 and 250 who are deemed sufficiently small to be an SRC, but not sufficiently small to be a non accelerated filer

And relevant to the conversation around 404B obviously they are not exempt from 404B if the proposal were to be adopted as proposed

And so what we did is we pulled some data on these companies in the manufacturing industry So we looked at companies above 75 million in public flow who are newly SRCs under the 2018 reforms So we didn't look at anybody below 75 and float because they've always been exempt, they're always going to be exempt, they are sort of not -- not relevant to this conversation Certainly small companies are glad they are exempt, not really up for debate here, but we looked at these companies that either meet the revenue

prong of the new SRC definition or the public float prong of the new SRC definition.

And so if you look at the left side of the slide here you see the low revenue manufacturing SRCs. Again, these are the ones that would be considered non accelerated filers under the proposed rules. You see they obviously have very low revenue, average market value. The -- the average market value for this whole sample is 180, so they are pretty similar to the universe, and you can't see my data labels on this presentation, but I will tell you what they are. That what we did is we broke out by sub industry, so this is all manufacturing, but the -- the darker orange, if you can -- if you're not colorblind, you can see the darker orange are bio pharmaceutical manufacturers, so they are a very important part of the manufacturing industry obviously. And as has been noted a couple of times, they very specifically benefit from the left side of this slide, which is the proposed change to the non accelerated filer definition that would allow them to newly qualify.

What you see on the right side of the slide, though, is that everybody else within the manufacturing industry is largely left out, so the right side -- those -- those percentages it's like 91 percent and 9 percent if I remember my numbers correctly. So of these companies who now on the right side would not qualify for the new 404B

exemption, 91 percent are everybody else, so the proposal very much works for bio pharma manufacturers. It very much doesn't work for every other sub industry within the manufacturing industry. But if you look at the sort of size metrics here on the slide, they obviously do have revenue because they failed the revenue test on the left side of the page, but it's not that high of revenue, the $100 million up to -- is the proposal. 228 is not that far, and in our view they are still substantially similar in terms of what they look like to an investor, and the market value is actually less, as you can see here than the market value from those who would be exempt.

So from a -- from a policy perspective as this committee considers what -- what to recommend, and as the SEC considers what -- how to finalize the proposal, you know, there's a specific policy choice to be made around who qualifies and who doesn't. And in our view you shouldn't leave out the rest of these manufacturers. They are creating jobs across the country, and they are still small businesses. I mean, that's the key here, that the goal is to identify who should be considered a sufficiently small business to qualify for this exemption.

And I -- and I would note that the charter of this advisory committee charges you with looking out for the needs of any company with a market capital of $250,000 million according to the statute, not just companies below 75 in public float, so there's a -- there's a clear nexus here of interest and expanding that public float test Obviously maintaining the revenue test is -- is a fantastic idea, and I think it's well justified in the rule -- rule proposal I should say, but there is definitely an opportunity here to go up to 250

And one last thing I'll say in my last 30 seconds is that there's a significant good governance concern here around consistency between these two definitions I have been working on this for a while, and I can't tell you how many conversations I have had where folks have said, Yeah, I am -- I am an SRC, I am exempt from 404B Not exactly Actually, if you look at this committee's recommendation from 2015, the recommendation says we should bump up the 75 to 250 in the SRC definition, and therefore more companies will be exempt from 404B, which we all know is not technically the case Appreciate the recommendation obviously, but given the confusion amongst the folks who do this every day, I think it's a significant barrier for small companies to overcome when they are trying to figure out who fits in which definition and I'm small and then I'm over 75, but I have this revenue, and it's -- it's complicated, and it's complicated for investors and it's complicated for issuers, and I think there's a real opportunity for

regulatory alignment here in addition to the fact that this is -- this is costly and -- and burdensome for small businesses.

JEFFREY SOLOMON: Thanks, Charles. App -- appreciate your perspective. David?

DAVID MALEY: Hello. Thank you, Committee, for asking me to speak on the proposed amendments to the accelerated markets, accelerated filer definitions. As Jeff said, it really is an honor and a privilege to participate in this process, so thank you again.

You're not going to hear me advocate strongly in either direction on these proposals. Rather what I am going to try to do is -- is share my insights as an investor who is focused on the small end of the US equity markets, and hopefully that will help shed some light on the practical implications of these definitions, and -- and obviously the proposed changes.

I have been in the investment business for 35 years now. I started out in a cell site at Goldman Sachs in Chicago. I spent eight years as an institutional salesperson, and there I discovered that I loved the markets, but I want to do what my clients did, I want to be a stock picker, I wanted to be an investor. So I am not being a portfolio manager for 27 years, and the last 20 I have been focused on long-term value investments in micro

cap and small cap companies. I managed my own firm for about ten years before I joined Ariel Investments in early 2009, and I brought my portfolio strategy to -- to the firm.

I am based in Chicago. Ariel manages about 13 billion along with the equities in three broad strategies. The firm was founded in 1983 by John Rogers as a small cap value manager, and John has always used a Warren Buffett-like approach, buying quality companies with solid growth prospects at prices below their long term intrinsic value. He's still our chief investment officer and our co-CEO, and he built the firm over the years from a small cap up into Smitt, and even some large cap investing.

And then when I joined in 2009, I brought a second strategy, and we called that deep value. We're foc -- I am focused on a micro cap in the very small end of small cap using more of a Graham and Dodd value approach. That is I am more of an asset-based investor looking for mispricings in a, we think, much less efficient part of the market.

And then our third leg of the stool was added in 2011 in the form of a global international team, which is based in New York.

Now, the one thing that we all have in common at Ariel is we're all long-term value investors. Our motto is slow and steady wins the race. Our logo is a turtle. Jeff has been in our office. He's seen there's probably

thousands of turtles in the office. We are really long term, patient investors, and we all run pretty concentrated high conviction portfolios, and all of us care deeply about the quality of the financial reporting of our companies. And our clients generally care as well. About a third of our assets are mutual funds, but the rest is in separately managed accounts for pretty sophisticated large institutional investors, private and public pension plans, endowments, foundations, large family offices. And our management agreements with those clients usually authorize us to manage their assets in accordance with one of our strategies, but they'll also from time to time impose restrictions, which are usually designed to control risk as they see it. And among those restrictions are restrictions on the type of securities including different classifications of equities that can be purchased and/or held in the portfolios.

Now, I manage the only portfolios at Ariel, as you can imagine, that are affected by the difference between non accelerated, accelerated, large accelerated filers, and therefore, which could be impacted by the proposed amendments.

To date, we've not made any formal distinctions in our process between non accelerated filers, accelerated filers, large accelerated filers, and nor ever done so with regard to smaller reporting companies. Where we have made a distinction is between listed and non listed securities. We don't buy pink sheet stocks, we don't buy OTC bulletin board stocks. And, in fact, some of our clients have imposed restrictions on those, but even absent a client restriction, since we believe financial reporting is so important and it's likely to be mediocre, even worse in those stocks, we have no interest in that part of the market.

And so as I said, we do care deeply about the quality of the company's financial statements, and there's this perception that micro cap means risky. And we want to take the risk of fraudulent reporting off the table right away. So, again, all of our companies, you know, file 10Ks, 10Qs, proxies, they are all listed, and I don't believe that the portfolios that I run at the very small end of the market have a materially or greater risk of fraudulent reporting than any other of the portfolios at Ariel, and so that's very important to me and to my clients.

And so as I looked at these specific amendments -- proposed amendments, I ask myself basically three questions, one, obvious simple question: Do we own any non accelerated filers? And the answer is, yes. I'll come back and give a little detail. Do we value the ICFR Auditor Attestation? Yes, and, again, I'll elaborate on that.

And finally, if a proposal is adopted and the

companies with revenue under 100 million no longer need the ICFR auditor attestation, what impact is that going to have on our process, and not by extension on my deep-valued portfolios, and that's an open question. I'll come back and touch on that.

So go back to our Question 1. I run two different deep-value strategies, as Jeff mentioned earlier, a micro cap portfolio, and what we call small cap deep value. And the only difference in how those are run is the upper limits of what we can buy in terms of market cap. So for micro cap we can go 500 million and under initial purchase, small cap we value 2 billion and under, but our averages are much smaller. The micro cap's dollar-weighted average is 140 million, and the small cap deep value is 240 million.

So, again, we really operate in a very small end of the market, really the -- the area that this committee is concerned with.

There are about 30 names that are in common to the two portfolios, and those generally have capitalizations I'd say in the range of 50 million to 500 million. And there's a handful of really small names in micro cap, and a handful of larger names in the small cap deep value. So there's 43 total companies that I own, and six of those are non accelerated filers.

Now, of those six, five I have owned for at least

six years, and there's even two that I owned before I came to Ariel more than ten years ago. So, again, you can see the long-term approach. And with such a long history with those companies, I'm very confident in the management teams, I am very confident in the quality of their financials.

So the one non accelerated filer that doesn't fit that description is my second smallest position, and it may or may not be coincident, but it's probably of all the names I own I have the least confidence in including the quality of its financials.

Now, Question 2, do we value the IS -- ICFR attestation, you probably can tell the answer is yes. Now, as a deep value investor, I am looking for mispricings of assets and/or ongoing businesses. So I like growth, but I don't want to pay for it. I view growth. It's very small companies, it's unpredictable, and therefore I'm really not willing to pay a lot for it.

So on Page 26 of the proposal there's a passage that refers to biotech and similar small, high growth low revenue companies. "We believe these and other low revenue issuers would potentially benefit from the cost savings associated with non accelerated filer status, and could redirect those savings into growing their businesses without significantly affecting the ability of investors to make informed decision based on the financial reporting of those

issuers "

I don't disagree with that at all when it comes to a newly public biotech, or one in its first couple years, but I don't buy that type of company That's not relevant, to at least what I do Instead, I tend to invest in more seasoned companies that have become orphaned by the market My bread and butter is under followed and overlooked in special situations And the passage on 25 from the proposals is more relevant, at least to me "We continually believe that ICFR auditing attestation requirement incrementally can contribute to the reliability of financial disclosures, particularly for issues that have more complex financial reporting requirement and processes "

So the idea of the market value of a company is more driven by its future prospects than by the current periods financial statements is only partly true in my world If I can buy a dollar's worth of assets for 50 cents, I am thrilled, but I need to be sure that those assets are truly worth a dollar

So on to Question 3, which is probably the most important As you can see, we don't typically invest in the companies that this proposal is designed to benefit, so how will it impact us if it's a doctor

Of the stocks that I own, which are now accelerated filers, an additional 15 have revenues under

100 million, and therefore could become non accelerated filers, so therefore roughly half of my current holdings would note -- would not need to obtain an ICFR attestation from an independent outside auditor.

Now, each of those companies would clearly obtain some cost savings, but there is not one company where I believe the investment thesis would materially improve by eliminating that cost, whether it's 110, whether it's even up to the 3 or 400,000. Charles said, Yes, those are meaningfully, but I don't think it changes the investment case. But there are quite a few where the attestation provides additional comfort to me in the quality of the financials. These are small public companies. They are often in industries that are out of favor. And therefore, they are probably on average more likely to have less depth in their management team, weaker boards, and therefore be more susceptible to -- I don't want to say fraud, but less -- you know, less robust financial reporting.

So absent this attestation requirement, we would actually, I am sure, take a formal re-examination of our process and determine the need, if there is any, for a formal delineation between non accelerated filers and accelerated filers. Again, we haven't done that in the past, but I think we would at least need to examine it.

The other potential reaction -- issue is the

reaction of institutional clients. Upon an announcement of this proposal being adopted, it's not out of the realm of possibility that some plans might restrict ownership to accelerated filers. But even absent formal restrictions there is some risk of the pool of non accelerated filers now being seen as a particularly risky subset of the micro cap world.

So in summary, I see clear -- clear pros and cons of the proposed amendments. There's a group of low revenue, high potential growth companies that would clearly benefit, and that might help invigorate the IPO market. In fact, it probably would. It would spur interest in micro caps as an asset class, that's all good, but there's no free lunch. Confidence financial reporting is crucial to properly functioning markets, and it might take more work to make sure that we keep that confidence. Thank you.

JEFFREY SOLOMON: Great. Thanks, David.

I think we're going to do this. Hopefully -- we haven't had a big talk, so hopefully everything works here.

TERRY McNEW: This is Terry McNew, can you hear?

JEFFREY SOLOMON: I think we can hear you. Go ahead.

TERRY McNEW: Okay. Great. Thanks. As you guys know, I -- I run a small cap public company. I have been working with the National Association of

Manufacturers --

JEFFREY SOLOMON: We can't --

TERRY McNEW: How about now, can you hear?

JEFFREY SOLOMON: We -- I think -- Mike I think is on mute, guys.

(The Committee waited for the audio visual technical issues to be resolved.)

JEFFREY SOLOMON: Oh, there you are.

TERRY McNEW: All right. So this is Terry McNew. I run a public company. Our market cap range is between 300 and 700 million currently. You know, we -- we produce a discretionary product in a very cyclical industry, so it's -- it's been out of favor for the last 11 months, however, due to several of the members' comments in the earlier session, it is expensive to be a public company.

Bill Hinman, you mentioned to us a little bit ago related to Sarbanes Oxley 404B --

JEFFREY SOLOMON: Mike, hang on just a second. We're still having a hard time hearing you.

DAVID MALEY: Sure.

(The Committee waited for the audio visual technical issues to be resolved.)

MIKE RAAB: Julie, if I could have the first slide, please. Julie, do you have them?

JULIE DAVIS: We're working on them. There they go.

CARLA GARRET: Mike, this is Carla Garret, the Chair. I think we might have missed your -- a little bit of your brief introduction of who you are representing. If you could just say that again, that would be great.

MIKE RAAB: Happy to. So you can go to the first slide, the intro. So thank you very much for the opportunity to present to the committee on clearly what's a very important topic for us in the biotechnology industry. And as other have said -- others have said, it truly is an honor to participate in this today.

So BIO represents -- and I am on the board of the emerging companies group that BIO represents 1,000 biotech companies across the United States. A vast majority of those companies are pre revenue companies. The average development timeline for drugs in our business is 10 to 15 years before ever thinking it, it will generate product revenue.

We also put more of all of our resources into research and development in the clinical work that we need to do in order to get our drugs approved. And the average cost of taking a drug from concept through approval is about

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$2.6 billion.

The next slide, please.

So bio techs must turn to the public markets for funding and to support this decade long billion dollar search for the next generation medical breakthroughs. So Ardelyz is a clinical state pre commericial company focused in the developing first in class medicines to improve choices for people with cardio renal diseases, specifically people who are on dialysis whose kidneys have failed.

Enapinor is a first in class inhibitor of what's called an HE3. An HE3 is a transporter that lines the epithelial of the gut and is responsible for the absorption of sodium, and also has an impact on the absorption of phosphorus, which is important for patients on dialysis.

What's interesting is that Tenapinor as a project was approved by the board of directors on December 23rd of 2008, and at that point it was a mere concept. Now almost exactly a decade later in November of 2018, we submitted a new drug application or NDA to the FDA for the treatment of IBSC, which is irritable bowel syndrome with constipation. This was accepted for a substantive review by the US FDA, and the PDUFA date, or theoretically when the drug could get approved, is September 12th of this year. And then we have a second indication in hyperphosphatemia, that if our clinical work is successful, would be approved on or around

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mid 2021

So our adult -- I took our audits public in 2014, initially invested in the company in 2007 on -- as an emerging growth company, which enabled us to access the kind of capital markets that we need to ensure our growth, and we're fortunate to have the Jobs Act that allowed us to do that

Next slide, please

The Jobs Act of 2012 has been a success for biotech The IPO on ramp, or the five-year exemption for emer -- emergies growth companies from auditor attestation, internal controls, has been important Jobs Act is almost 90 percent of -- all IPOs are emerging growth companies, and roughly 40 percent of those are biotech

We have 200,000 -- 200 percent growth and employment biotech since the Job Act was enacted

A couple of key numbers under the Jobs Act is we've had 332 IPOs, 91 preclinical Phase 1 IPOs, 29 newly approved novel drugs, and almost $30 billion raised at IPO for those companies And without the Jobs Act Ardelyx would not have been able to access the public markets to finance the work that we've been doing over these last five years

So the IPO -- the next slide, please

So most biotechs go public early in their 10 to 15-year development time lines because to access the kind of

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capital that we need for our clinical work is not really doable in the context or private financing And the five year 404 exemption typically comes well before any of us are generating revenue Ardelyx is a good example of this

Compliance with 404B means that biotechs must divert capital from research in the middle of the drug development process, and a growing number of companies will have to divert money to compliance after their status ends if the rule isn't finalized

So what is -- next slide, please

So what is 404 compliance costs biotech on an average of $800,000 per year? For Adelyx as we are aging out, our consultants, we spend $450,000 already Additional auditor fees from Ernst & Young is about $600,000, you have eight full-time employees working on the project What the consultants do is do 100 percent checks of the controls to make sure that we're following what we say we're doing Ernst & Young then checks 100% of those controls to make sure that we're following what we say we're doing as well And all this is happening in a span of the last couple of months to be ready

The value is we're really already doing most everything, and now the only thing that we need to do is further prove it with those costs is would it have been better to wor -- to direct that towards our clinical trials

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where you can imagine eight researchers could have been covered with that at roughly $100,000 a year, or an additional eight to sixteen patients could be enrolled in our clinical studies, which range from $50,000 to $100,000 per patient in most clinical trials. Most of our investors in biotech are focused on the science behind the company, and have never demanded, and can't imagine since we have 404A, would demand 404B.

Next slide, please.

So expansion of 404B, relief for companies until they exceed 700 million in public float, or at least what we responded to was or 100 million in revenue is a welcome step forward to making our public capital markets more accessible.

Bio and member companies, such as Ardelyx are pleased that the SEC recognized that 404B should be more appropriately tailored to the actual risks. While we fully support the proposed rule because of the expanded 404B relief, it will provide for many more small biotechs.

I also want you to know that there's still some biotechs that do not pose the risks for which 404B was designed, but may not be eligible for the proposed exemption because they not do -- do not meet both the public float test and the revenue test.

It's really not uncommon for biotech companies that are pre revenue and have simple financial structures with public float exceeding 700 million Similarly, there are examples of small biotech companies that exceed $100 million in revenue simply due to partnering revenue that isn't product revenue, and is not necessarily recurring revenue

So I applaud the SEC for its proposed rule At a minimum, I urge them to adopt it, or I suggest that you should consider expanding it further and changing the "or" to "and," as there are unintended consequences of using the word "or "

But I've been pleased to hear that Mr Hinman and Chairman Clayton did use "and" in the discussion, so I hope that that thought continues

I would like to thank the SEC for taking steps to expand the SOX exemption, and committed for its continued attention to issues that impact small public companies, such as companies like Ardelyx entering and staying in the public markets

Thank you

JEFFREY SOLOMON: Great Thanks, Mike, and thank you, all of our speakers Let's -- let's open it up for dialogue, or for questions I think -- you know, I think we've heard there's sort of the biotech/nonbiotech part of this discussion, which is

an important one. And also I think we've heard about some unintended consequences, so I would encourage everybody on the committee, or obviously any of the Commissioners, or anybody who wants to speak up and ask questions.

TERRY McNEW: Jeff, this is Terry McNew, can you hear me?

JEFFREY SOLOMON: Yes, we can.

TERRY McNEW: Okay. Sorry, committee members, I'm not able to be there today, but it's actually a bit ironic, I have an audit committee and an outside audit meeting this afternoon and tomorrow, so I was unable to be there.

Related to dis -- earlier discussions on 404B, I work closely, as you know, with the National Association of Manufacturers. I run a consolidation of companies with a 300 to 700 million market cap, and to Bill Hinman's comments about an hour ago, and to Mike's just a moment ago, I actually have a breakdown or our 404B costs. Now, we fall outside of the Jobs Act and emerging growth status in about a little less than 18 months, but our first four years plus of being a public company, annual estimated cost of Sarbanes Oxley is $700,000 a year. Bill was exactly right. There are software costs of just under 100,000. I have an internal Sarbanes Oxley manager. It's about 190,000 in

direct and indirect costs. I've got additional incremental outside audit costs of nearly 200,000.

After we lose our -- our emerging growth status, year six and thereafter, we estimate that our annual Sarbanes Oxley 404B costs would be just under $1 million, and so as a 00 we have just under a half a billion in sales we're able to -- to, you know compensate for that, but being a public company is expensive. It costs us probably around 4 million in total costs to be public, so I -- I applaud the comments earlier to balance both investor and company business needs. It -- it -- it's very much -- it's necessary, but I, like others, have never had an investor ask me about 404B. We're 404A, of course.

I have already conducted nine non deal road shows and investor conferences in the first six months of this year, and I generally do about 10 to 12 a year, and -- and not once have I had that, so the level today of revenue is 75 million. Assume your 5 percent net income at that level, which is -- is a bit of a stretch, but possible. Assume that's just under 4 million. That -- that equates to about 24 percent of your net income as being consumed just to be 404B compliant. So I would like to respectfully request keep the 700 million market cap requirement, and as -- As Chairman Clayton, Mike just mentioned, put the word "and" in there, but raise the revenue level from 100 to 250 million.

It sounds like a lot, but you're still a small company at that level

I could literally with 3 5 million, 4 million and additional net income, I could double product development, which would be, you know, wildly important of the company in tune to invest itself

I just wanted to provide a little bit of actual business perspective and -- and costs and recommend that the committee consider and that the chairman consider raising the revenue cap up to 250 million

Thank you

JEFFREY SOLOMON: Thank you Brian?

BRIAN LEVEY: We're going through 404B right now because we will no longer be an emerging growth company at the end of this year, and we're not going to fit within any of the exemptions being proposed, even at higher levels, but I can just walk folks through sort of our direct incremental costs related to 404B attestation It's about a million a year incremental It doesn't even include, you know, the SOX person who is likely to be, you know, 150, 200 at least It doesn't include others in finance in the non 404B costs, it doesn't include obviously our opportunity costs, but a lot of it is just the auditor incremental costs from the 404B We have to get another smaller audit firm to lead the project, and that's a good amount. The software upgrade for us is about $50,000, and then I think it was mentioned earlier -- I think Charles mentioned that we can no longer take advantage of the -- the private company GAP standards, so their cost to adjusting to the public company GAP standards in my finance team tells me that ASC 842 is just an example. And that's another $80,000 that the auditors will charge just for piece. So it is real. Certainly understand that, you know, there could be highest malfeasance as a result, but I will say that in the post Enron era it's awfully tough for companies like us, public companies to switch auditors. I find the auditors have become extremely thorough. The 404A certification certainly make our CFO and CEO very nervous. We conduct sub certifications across all our functions to make sure that they can sleep more easily at night. And then I think we can't forget just the whistleblower bounties that are out there now that can take care -- at least incentivize reporting of malfeasance too.

So to me I think, you know, very much welcome these proposals even though we can't directly avail ourself of them, but certainly see the advantages out there. And to the extent that, you know, this does become voluntary, it's

obviously something that makes sense for audit committees, for companies. And to the extent that a post mortem review is needed to review whether there's increased cash -- cost of capital, to the extent there is more malfeasance, that's probably a decent idea in several years just to see how the proposals are doing, so just some quick observation from my perspective.

JEFFREY SOLOMON: Other questions?

Burt?

ROBERT FOX: Well, I mean, I guess I am curious on some of these items. Like you talked about 800,000. And, Brian, I know you're general counsel and not the finance team, but, you know, it seems like some of that is probably things that would have, should have been done under 404A maybe. I don't know. I mean, I am trying to -- to understand what that difference really is, right?

I mean, Carrie, I think I heard you say that you're spending around 700 right now to comply with 404A, and you'll spend another 300,000 essentially getting it attested to. I think that's what I -- I heard.

And -- and so, I mean, I guess I am -- I am curious, and I like David's take of, you know, as an investor, does that give you pause that, you know, even the non accelerated filers may or may not be actually doing, you

know, what they should to even comply with 404A, and I'll also follow that up with a -- you know, in -- in the SEC's comment, or their proposal, I think they state a stat, but -- and Bill or Jennifer, correct me, but I think it's at 40 percent of non accelerated filers on a pad of material weakness, or some sort of control issue reported from 13 to 18, I think I am trying to remember that I don't have it in front of me, but it's something along those lines

UNIDENTIFIED SPEAKER: Those numbers are higher, but --

WILLIAM HINMAN: Yeah, one of the things to bear in mind is that is not the universe that gets relief here

UNIDENTIFIED SPEAKER: Right

WILLIAM HINMAN: It's a different group It's a bigger group

UNIDENTIFIED SPEAKER: Yeah

WILLIAM HINMAN: But, yeah, in terms of folks that weren't an attestation of the universe that we could look at that the econom -- the economists looked at were below 75 million I think you have the numbers probably in the ballpark

ROBERT FOX: Yeah

WILLIAM HINMAN: But that's not the group we're looking for

ROBERT FOX: So, I mean, David, I am curious from an investor standpoint, does -- I mean, what's your reaction to that?

DAVID MALEY: Yeah, I mean, there's -- there's a lot to unpack here. I -- you know, the -- the cost of just 404A are very high. And, in fact, in talking to a lot of the CEOs and CFOs, the cost of just being public at the smaller are very big, and that's no secret to anyone. And that extra cost to be -- you know, I am sure it's going to be different for different companies. What it does for us is it's just that extra level of knowing that there's another level.

Now, again, we own some stocks that don't have that right now, and we're very comfortable with them, and one of those is a case where the CEO is trying to figure out ways because he has different subsidiaries and he has to just to get the 404A is extremely costly for such a small company, and one of the answers may be no longer be public. And so, you know, we're sort of in that -- in that world where we want there to be a thriving public market for companies, obviously that's what I look for, but oftentimes the best realization of value for these companies is to no longer go public, and so have that turnover into a way that -- you know, that they be comfortable.

So it's -- again, it's an extra comfort level, and if you add this to the mix, I think -- I think we're going to at least have to have a formal review that says, How do we treat these because there's a big part of our world that no longer has this. I don't know that it -- that it means that there is anything that we own now that we wouldn't continue it on. I doubt if there is, but I think we'd have to do more diving, and I think others like us would, so it's not an easy answer, but there -- you know, there's like -- so there's a lot of cost there even without the B.

ROBERT FOX: I mean, because my perspective from what we see in practice, and, again, you know, from my firm we audit just under 300 or so issuers. The vast majority of them have a market cap under, you know, a billion dollars. We have some that are over two-thirds of those 300 or so are accelerated filers right now, but on that small end of that space, I mean, you definitely see that, you know, there's less sophisticated finance teams on average, there's less sophisticated systems. There are more errors in the financial statement that we find in that space, and -- and, you know, a lot of these $200 million revenue companies do have multiple entities, are operating internationally, they -- there's not necessarily -- I don't think you can say there's a direct correlation

between simply, say, $250 million of revenue and low complexity. There's a lot of companies in that space that have a lot of complexity to them, so --

JEFFREY SOLOMON: So just out of curiosity, I mean, one of the things that we've heard is that, you know, without auditor attestation, that's really what we're talking about here for the most part, because 404A is not really on the table.

ROBERT FOX: Yeah.

JEFFREY SOLOMON: So there will be a lot of work that has to get done anyway. How much of -- of those -- how much of those companies that you do the work for would fall into a control audit function as opposed to a sub -- or a substantive audit as opposed to a control audit? I think that's actually something that, you know, we might consider because if companies stopped doing, you know, auditor attestations, there is work that gets done by the auditors. Then all of a sudden, you know -- or if they do them every other year or every third year, how much of the -- of your population do you think falls then out of the control audit and into the substantive audit, which is expensive?

ROBERT FOX: Again, we have slightly under 300 or so issuer clients, about 2/3rds of them I think are

accelerated filers All of those we rely on controls during the audit process unless there is a material weakness, or some other issue actually with their controls You know, and so it is a true -- I mean, the days of -- you know, the first day of 404 when we literally had two different teams, one doing controls and one doing substantive audit have gone away I mean, we -- they are all integrated audits now So it's not a one for one There clearly is additional work of -- of us auditing and documenting the control work if that's your question

You have the non accelerated filers We -- to Bill's point, we still have a requirement to understand and evaluate controls, which is where a lot of these material weakness things are coming from But normally if an error is not found, there -- you know, that -- that's kind of more where the control weakness comes in through the substantive audit we actually find something, and in which case is it's kind of that early preventive wire of the control testing, you know, would have had -- you know, it -- ideally you would detect it early saying, Hey, they could have been in error because the controls aren't working It actually waits until the error is actually detected, and then that's kind of when it's being reported

CHAIRMAN JAY CLAYTON: Jeff, would it be okay if

I made observation then sought input?

JEFFREY SOLOMON: Absolutely

CHAIRMAN JAY CLAYTON: A couple things I want to say that high quality financial statements, including a high-quality audit is the bedrock of our capital market system, and I think the approach in the US has actually lifted the rest of the world The last things that I would want to do is do something to harm that, so that's sort of the baseline But the -- I think with -- you know well over a decade of experience with 404B and at least, you know, half a decade of experience with the Jobs Act relief from 404B for certain companies, the market is telling us something Now, you don't -- you don't listen to everything the market tells you, but it is telling us something I -- I -- I look at the private space Let's just look at the private space In the private space you have private equity firms, you generally have lenders, you also have bond holders These are people who care a lot about their money I'm clamoring for 404B attestation In fact, no one has ever come to me and said, Will you please add a 404B attestation to a company that uses the high-yield market for over, you know, a billion dollars That's not even -- I don't think it's ever crossed their mind

You know, and then you look at the US/non US market, and I don't know many portfolio managers David, I would be interested You know, it's a non US small caps, mid caps, no 404B attestation, you know, in some cases, you know, whatever

DAVID MALEY: We don't do small cap foreign because it's -- that is the Wild West, I think

CHAIRMAN JAY CLAYTON: Yeah

DAVID MALEY: There's probably opportunity, but --

CHAIRMAN JAY CLAYTON: So I think I'd like to know, you know, what -- are there people that make a difference, doesn't make a difference? It seems valuation aren't that much different It's converged Maybe there is a Wild West premium I don't know I am just asking

DAVID MALEY: Maybe Yeah, I mean, I don't know how those markets work

CHAIRMAN JAY CLAYTON: And then, you know, sort of -- we now have this experience with the Jobs Act companies rolling off I don't know of anybody that is, like, rubbing their hands saying, I can't wait until they get their 404B attestation so I can invest So those are the kinds of things that I am seeing that

-- that make me think, Hey, it's time to also recognize that Congress has told us that with Sarbanes Oxley 404B makes sense, that with the Jobs Act it doesn't make sense for everybody. You know, are we calibrating this correctly, so those -- those are sort of just my perspectives on this.

CHARLES CRAIN: And just from the -- from the company perspective, having talked to emerging growth companies, to your point, Chairman, if the investors aren't rubbing their hands waiting for your six to -- to get their 404B audit, the companies are very worried about rolling off, so it's sort of the -- the -- on the cost side we hear from companies all the time sort of it's a counting down time clock from, okay, this has been a really great cost saver, but I know in 18 months and 12 months and six months that I am going to be next up on the 404B cost trade, so --

JEFFREY SOLOMON: Other comments?

MIKE RAAB: Yeah, to follow up on what Charles just said is we're a perfect example of that at Ardelyx. We are aging out, and, you know, our cost of capital, we're a micro cap 145, $150 million market cap where that million dollars that I am spending, or just spent over the last six months is extraordinarily expensive capital.

So the cost of capital as you roll off in age, and you're no where near product revenue is something that needs to be factored into this as well.

CHAIRMAN JAY CLAYTON: I'll -- I'll just chime in there. That's the one that -- you know, that's the category that -- let me say this, it's the one that troubles me the least as we've gone through this process, which is the EGC company that's had five years of 404A, had five years of market exposure, rolling off EGC status, and now you're adding something new. I am -- no one seems to be asking for.

JEFFREY SOLOMON: Yeah, I mean, I think when we -- obviously we have a lot of experience in -- in -- in public biotech, and I -- I don't think I have ever heard a biotech investor ask about -- about that attestation. It's just the science is far more complex and far more determinative of those in terms of the outcome, right? So whether you're -- you know, and it's just -- the financial statements in many instances are just not -- they are not that complex.

And so I -- I'll go back to the framework that I think we laid out at the beginning, which is I think there's the biotech aspect of this, and there's the non biotech aspect of it, and frankly at Kalin that's actually how we look at a lot of things. There's what works for biotech and

what works for everybody else.

I would say it's a public company. Again, one of my largest shareholders is in the room, and, you know, I took a lot of comfort when we first -- we reversed merged into Kalin, my firm, and we did three years or four years of preparatory work to be public because we thought there was a point in time in which we might go public and never anticipated that we'd be reverse merging into an existing public company.

Had we not done that work ahead of time, we never would have been able to get it to the public. So I think there is sold value. But even with that, I think that the biggest stress we had was getting the attestation done on time, not our own work. Or own work and our own internal audit work and our own controls back in 2009, we had to do entry-level controls. I took a lot of comfort in going through that process to prepare to be public because I was going to have to sign, or as -- you know, my predecessors were actually going to have to sign those financial statements, which is a pretty dig deal. And I will just say, I've a lot of conver -- confidence in our team internally.

The question is really whether or not we needed to -- to actually have that third-party valuation and was it value added to us. And I think -- you know, I took comfort, at least at the outset, to be honest, that we had a third-party auditing firm. I was a little bit stressed that it took them so long to get it done. We were pushing them significantly against a deadline that was, you know, an SEC deadline frankly, so it was actually one of the more stressful things I remember about getting our deal done. And then I just questioned whether or not it was something that we needed to do every year. We're -- you know, and I think for us again, not similar to what you're talking about, Brian, it's cost us about $4 million a year to be a public company, not all that is the attestation, right? So being public is -- is -- is going to mean that you have more requirements. But I just ask the question, you know, do we need to have the attestation every year, or is it just -- is it -- it is too often. And I'll tell you my -- the response I got from our internal team is if we don't have the attestation, then we're probably going to end up paying for it in the form of a -- of an audit anyway because during the int -- because the teams are integrated, so much of the work that we're doing is -- what we would get we'd have to pay for in the audit function anyway, it wouldn't be so broken out.

So I -- I also will say we are not anywhere -- we're -- from a revenue standpoint we don't meet any of the tests, so none of this applies to Kalin. But when we were a

sub $250 million company, it was a much more meaningful number for us than it is now that we're north of the $900 billion a year revenue company. And so like a lot of other things, scale does matter, and -- and so as -- as, you know -- you know, as you think about -- as we think about the marginal costs, I think if you look at who we're trying to include in this group, it's a very significant cost for companies that are under $250 million. It's a very, very significant cost, and, again, as they grow, it's a lot less expensive, so I -- and I don't know that -- I can't draw any specific conclusions from our own experience other than to say, you know, at the outset I was very comfortable with it, but I'm not sure we had to do it all along the way, and I would certainly say for the companies that -- that fall under this accelerated filer, you know, status -- or non accelerated filer status, it's -- it's probably going to be a heck of a lot more meaningful, so --

DAVID MALEY: Jeff, maybe if I could add to that. If you think about, you know, the biotech companies, if that's what I invested in, I would be behind -- very much behind because it makes a lot of sense. You've got, as you said, simple financial statements, etcetera. If you go back to when we got invested -- involved in Kalin's stock two or three years after you've done a reverse merger, you're a pretty complex

business There's a lot of confidence that we have that, you know, this group of people who seem to have talent and an idea had merged into this shell that was kind of a mess, and that you had all of the auditing and attestation so everything was a benefit to know that now we could start looking at the nature of the business Again, if you go to biotech, it's all about the signs and symbols So I think that's the trade off you have here is how do you make it work for everyone, but make sure that you still have it

CHARLES CRAIN: It seems to me if -- if other investors have that experience where they are -- if -- if those controls -- or excuse me, if that attestation had been lacking, that either there would be a lower valuation or a willingness to invest generally, then companies will do the attestation, and so there -- there was a fair amount of, I think -- you know, let the market play it out here

UNIDENTIFIED SPEAKER: That's a really good point

ROBERT FOX: However, I think to Chairman Clayton's point earlier, if we look overseas, look at the UK right now, I mean, I'd argue that they are having quite a bit of issues, and I think it's unfortunate that a lot of the noise over 404B has potentially poisoned the well because I think we

actually have a very successful regulatory model that has proved itself that -- that I think they could adopt Now I think they are looking at other ways to go down the path, but, you know, we're not seeing the types of issues that we had here in the US I mean, I was an employee of Arthur Andersen and rode the ship down, and -- you know, and -- and I am seeing across the seas a lot of that history repeating itself right now, right, that doesn't have the same model And so I totally get the biotech thing, I totally get, you know, some of this stuff I am not trying to argue that 404B should apply to everyone, but it does seem to me that when I start looking at companies in the $250 million market cap space -- when you start going up to there and you start saying revenue should be 250 or more, you are starting to get a lot of companies that have complexity that it seems to that the -- the incremental benefit to investors -- I'm not sure we're capturing that just in the incremental piece here, so --

JEFFREY SOLOMON: Charles, you know, you showed us a median number in your -- in your slides I would be curious to know, you know, more -- when you crawl underneath that number and you actually look at the number of companies if you were to -- if we were to --

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you know, where does it start to cluster where you're capturing a certain percentage

CHARLES CRAIN: Yeah, so in the -- in the universe of -- of companies that would not qualify under the proposal, but did qualify as a new SRC under the 2018 change, they weree- it was like 65 or 70 companies, so it's not a humongous universe of issuers if you're just counting number of companies

(The Committee waited for audio visual technical issues to be resolved)

CHARLES CRAIN: They didn't want to hear what I had to say

UNIDENTIFIED SPEAKER: You're now off the record

(Laughter)

CHARLES CRAIN: I just bored them right to death there on that side of things

Yeah, so for that -- for that universal companies, as I said, it's 65 or 70 companies, their median revenue was 228, and their median market value was 167, so that's -- you know, they were covered by a public float test of $250 million, so we did not look at updating the revenue test, which I know has been mentioned as well That, as -- as you all know in the proposal is at $100 million, but we really were focused on the increased valuation test, which has been

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proposed by this committee in the past to bump up the valuation test from 75 to 250

JEFFREY SOLOMON: Brian?

BRIAN LEVEY: Okay And one of -- one of the thoughts on just the revenue test is I know this in the proposal for Reg SX this morning that was discussed, there's the notion for significance of a recurring annual revenue test, and I am wondering if it makes sense at all for that to be consistent here I could certainly see some in the biotech industry being subject to milestone payments from pharmaceutical companies that may be big ones in nature, and then they go away So it might be worth considering whether we want to incorporate or

UNIDENTIFIED SPEAKER: The commission wants to --

BRIAN LEVEY: -- or like a three-year rolling average or something like that?

CHARLES CRAIN: Yeah, so I know -- I know congress has looked at that for 404B specifically for companies that are rolling off of AGC status with biotechs specifically in mind, and and there's a bill that hasn't become law yet, it exists and it's exactly that, it's a three-year rolling average to -- to kind of call out some of those milestone payments When you're at 000, a hundred million 0000

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BRIAN LEVEY: Yeah, because it's my understanding the biggest costs for 404B compliance is in your one that once you get the SOX environment there, it's lower after that, so to have to comply in your one, and then not to have to comply with -- not to -- for perception purposes not need to comply, it just seems a little anomalous.

JEFFREY SOLOMON: All right. Other -- other questions? Because we want to make sure that we leave time to formulate our recommendations, to the extent that we have them.

(No response.)

JEFFREY SOLOMON: Okay. I'll turn it back over toeyou.

CARLA GARRET: So if I am hearing this correctly, it sounds to me, and tell me if I am wrong, that the committee does -- well, we've discussed a lot of it, so I don't know what your views are, but if the committee didn't support the proposal to amend accelerated filer and large accelerated filer definition such that smaller reporting companies with less than 100 million in revenue, would not be -- would be non accelerated filers. That -- that's almost been, it sounds like a baseline today that we've talked about that we might support as a

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committee. It sounds to me like some people were suggesting going farther, and whether that should be -- should all reporting companies, smaller reporting companies, be non accelerated filers, should we increase the amount of revenues? Instead of being 100 million, should it be something higher, 250 million? Should we look at three-year rolling average revenues?

So if I am correct in summarizing some of the committee members thoughts on that, can I get some feedback in terms of those three different suggestions that I just stated?

JEFFREY SOLOMON: So maybe obviously on one of these. So is there anybody on the committee who doesn't agree with the proposal as it's -- as it's written? And that just -- and then we've got to, I think, probably do some amendments to it. So if there's anybody that's not -- not in favor of the proposal, like we should hear that now, or otherwise I think you can say that at a minimum the proposal as written is something that we could recommend, but then I think we can go through some of the other things maybe along the way and see how the rest of the --

CARLA GARRET: I agree. Is there anybody that's not in favor of the proposal that the Commission has released?

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TERRY MCNEW: And that's the 100 million revenue hurdle?

JEFFREY SOLOMON: That's --

CARLA GARRET: Yes, so it would add to the definition of a -- well, a non accelerated filer would be somebody that has less than 100 -- 100 million in revenue.

TERRY MCNEW: I -- I would support it if that's the committee's decision. I still highly recommend 250, and I'll just make this closing comment, keep in mind the market is telling us something. The number of public companies has dropped by 50 percent in the last approximately 20 years. The -- the money that's out there in private equity is -- is huge and it is growing. If there was an overwhelming with infidelity in financials, the market would not be heading in that direction. I know there's risk, but it's expensive, and I get questioned often by investors, why don't you consider going private. That's not my call, but the math suggests that I could roll several million dollars to the bottom line, so I -- I understand there's -- there's complexity even up to 250 million in businesses, but let's try to understand, you know, and capture -- reduce the complexity if -- if 250 million doesn't statistically raise the risk to

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investors outside biotech and -- but for everyone, I would -- I would like to see an increase to 250. If the committee feels 100 is fine, you know, I'll certainly support that, but -- but I think $100 million revenue company it's eating up their bottom line, and -- and you can do it. Like Charles said, you can still volunteer to do it, your 404A. You know, if you get good business ethics, you're going to make sure your books are good. So I just don't want to make -- I just want to make sure that we're not trying to regulate this to the .05 offender; does that make sense?

CARLA GARRET: Yes.

TERRY MCNEW: Thank you.

CARLA GARRET: Yes, and I think supports what Jeff was saying that you're -- that you're in support of the rules as currently proposed, and so now you want to expand on that and if you would like to add to the Rule B suggestion.

JASON SEATS: One thing I wasn't sure if it was -- we kind of joked about, but is the new addition of 100 million?

WILLIAM HINMAN: Less than 100 million in revenue and less than --

JASON SEATS: And. Both. Both. Both factors.

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CHARLES CRAIN: But then there's also an "or" factor because you can also qualify, or you have less than 75 in public float.

So -- so there's an "or" and then within one half of the "or" there's an "and".

JASON SEATS: Got it. I couldn't tell if --

CHARLES CRAIN: It's confusing.

JASON SEATS: -- it was clear to everyone else, it wasn't clear to me.

CHAIRMAN JAY CLAYTON: I didn't do very well on the LSAT. This is why.

CARLA GARRET: It's confusing. I am a securities lawyer, and I have charts here, and --

JEFFREY SOLOMON: Well, see, yeah, we also -- we also put charts together.

CARLA GARRET: Right. And --

CHARLES CRAIN: And this goes to the complexity point, that if we all have charts and this is our job to do it, it's --

CARLA GARRET: Right.

CHARLES CRAIN: -- it's hard as a small company to figure it out.

CARLA GARRET: Well, and the other thing we might think about is, I mean, last year in 2018 you guys changed the definition of what a smaller reporting

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company was, and you decided that those companies were entitled to scaled disclosure, and -- but -- but not it does -- and scale -- smaller reporting companies used to be non accelerated filers, and - and now those two definitions are -- are no longer the same, and that's what is con -- I think creating a lot of confusion.

So one of the suggestions for this committee -- I am not -- is do we actually say that all smaller reporting companies who are -- benefit from the scaled disclosure requirements should be non accelerated filers, and therefore rid of a lot of this complexity.

WILLIAM HINMAN: Right. That is -- that is the second part of the proposal that we actually put forward, right?

CARLA GARRET: Yes.

WILLIAM HINMAN: We did the one we just discussed under 100 million of revenue and under 700 market cap. And then we asked the question, Should the two definitions be the same? You get the exemption if you're an SRC for any test. The second part of that would be any company with less than 250 million in market cap would also -- would be a smaller reporting company, and therefore also exempt, so that's the other piece, which if the committee wants to, they can say they would favor that or don't favor that second part of the proposal we put out.

CARLA GARRET: Right.

WILLIAM HINMAN: The question.

CARLA GARRET: Do members of the committee have thoughts on that?

SARA HANKS: The fewer chance the better.

CARLA GARRET: Excuse me?

SARA HANKS: The fewer chance the better. I mean, make it easy for companies to understand what they are supposed to be doing, so, yes.

Second part also approve.

CARLA GARRET: Okay. So if we have -- Jeff, what do you think?

JEFFREY SOLOMON: So I -- listen, I think scales disclosure is -- I mean, I have been a big proponent of scale disclosure for a long time, and I feel like -- you know, if -- if -- if we're having an honest conversation, companies of $250 million in market capital have a difficult time finding investors, and it's really expensive for them to be that. I am in favor of scale disclosure for public close of less than $250 million. I am -- I think the market will pretty quickly figure out who -- since they are all complying with 404A anyway, and they should have

internal controls, the -- if they can't convince shareholders like David, that they should be investors, then they need to do things to simplify their business models and they need to be able to engage with shareholders more directly.

I think where I end up coming out here is I am going to do the work anyhow, and I am going to engage with shareholders if I want to actually increase my -- my market capitalization. I don't know that we need to have an external third party accredit -- accreditation to basically give me that Good Housekeeping seal of approval. It's going to take time, it may take me longer, but over time it's going to save me money, and it's going to save me infrastructure costs probably along the way, and so I am -- I am more in favor of taking it -- making SRCs and non accredited the same definition. I just think it's an easier thing to do. That's where I am.

CARLA GARRET: And I would say I support that too. I -- I was actually general counsel of a public company when Sarbanes Oxley came into effect, and at that point in time there were not differences between large accelerated filers, accelerated filers, everybody was subject to emergent growth companies, everybody was subject to the same.

Over time obviously the SEC has decided that

there's a reason why smaller reporting companies or emerging growth companies should not necessarily, you know, have the 404B attestation. I didn't have that benefit when I was putting that together for the first time. As Brian said, it's a lot of work, so I would also be in -- in favor of -- of having all or -- all -- recommending that all smaller reporting companies be non accelerated filers, so --

WILLIAM HINMAN: Carla, if I could just add one thing just so the committee has the benefit of it.

CARLA GARRET: Uh-huh.

WILLIAM HINMAN: The -- the reason we led with the proposal that didn't make the definitions the same, but the fine tuning for just around revenue of 100 million was the DEER analysis was more supportive of that in terms of if you broaden the universe of folks who won't have to attest, the likelihood of finding problems in the financials down the road would be lower if we draw the line the way we did, that that complexity above 100 million actually had some impact on the -- the DEER analysis. So that -- that is why we led with that, but we also ask the -- the 250 general question, should these two things just be the same.

CARLA GARRET: Okay. Thank you very much.

WILLIAM HINMAN: Just so you have that.

ROBERT FOX: And, Carla, another thing, I have -- earlier I made my views clear, but I think to the point Bill just raised, I -- from -- from my experience in practicing and seeing companies like this and auditing them, I -- I don't think I would be supportive because I do think that there would be additional risk to the, you know, financial system of -- of not attesting to those above $100 million, so --

CARLA GARRET: Okay.

ROBERT FOX: -- again, it's not -- I can't quantify it, but I think that there is -- you know, it would -- it would change, and I think that -- you know, as long -- as long as we feel like 404B makes sense, then I think we ought to be applying it to companies that have levels of complexity of financial reporting risk. If we think 404B doesn't make sense, then I think that that's probably a broader discussion, and I am not sure why 100, 250 or whatever else should really make a difference there, so -- I mean, I -- I guess my point is is that, you know, it either should apply to complex financial reporting situations or not is -- is kind of what I am trying to articulate, so --

CARLA GARRET: Maybe I misunderstood you, but --

ROBERT FOX: Yeah.

CARLA GARRET: -- did -- did you say you would not be in favor?

ROBERT FOX: I would not be in favor of a vote.

CARLA GARRET: Of over 100 million?

ROBERT FOX: Over 100 million, yeah.

CARLA GARRET: Okay.

JASON SEATS: Do you have a candidate methodology for how you would measure the complexity?

ROBERT FOX: Um, I really don't. I mean, I think that the 100 million I could live with because, I mean, again, I totally get the biotech situation, and -- and some of the emerging IT. I mean, again, I think, you know, I could argue that in some of the situations some financial statements are almost irrelevant, right? I mean, what the investors are buying into is the technology and what's going on with the drug trials and everything else in the future, but I think at the $100 million mark I can -- I can live with it because, again, based on the analysis there's not enough companies that are outside of that space that are going to comply with this that it really lose the needle. I think if you take it up significantly past that, I think you are starting to get into, you know, companies that do have a lot -- a lot more complexity, so -- and I think, you know, it's --

it's -- you've got to keep it simple. I mean, you know, you could get into other factors, but then you get into lots more subjective and judgment and everything else, so --

JASON SEATS: So are you saying you would support it at 100?

ROBERT FOX: I -- I could support -- I mean, I don't love it, but I could support it at 100, yeah.

CARLA GARRET: Okay. So I -- I think I -- I have a recommendation here to see and for us to vote on, so let me know what you guys think about this.

The Committee (sic) supports the proposal to amend the accelerator filer and large accelerator filer definition such that smaller reporting companies with less than 100 million in revenue shall be non accelerated filers. That being said, we would welcome the Commission to possibly explore higher revenue numbers, and also explore whether all smaller reporting companies should be non accelerated filers, and also explore whether or not you should look at a three-year rolling average of revenue.

UNIDENTIFIED SPEAKER: Well said.

CARLA GARRET: Do -- is that something -- did anybody want to comment on that?

JEFFREY SOLOMON: So I -- I just want to -- I want to say one thing that -- so I think that probably

works, because I think there probably needs to be more work done between 100 and 250, and we should probably take a look at what that encompasses in terms of the total population of publicly-traded companies is that it's probably significant enough that we should consider that.

I think, you know, where -- where -- where David and I -- where I can agree with David is I think I spent most of my career prior to being in the seat that I am in investing in small cap companies, and what I would say is I don't think I ever thought twice about whether or not a statement was attested. That's not what we're really talking about here, we're not talking about whether or not they are going to be in compliance with 404A because that's -- that -- I wouldn't invest in a company unless I thought that they were doing the internal work and internal audit, and the boards were doing their job, so that's not really -- to me, if I -- if I sit back and think about it I don't think once I thought about, Hey, did they have their auditor attestation as a determinative factor in whether or not I was investing, and that's all we're really talking about here.

And so -- and I also want to say I think one of the -- and I go back to the original for Sarbanes Oxley, the big offenders that -- that got us to Sarbanes Oxley were not

small cap companies, they just weren't. They were big, complex companies like World Com and Adelphia and Enron.

And so I -- again, I was investing in small cap companies at that point in time, and the risks to the small cap companies were far more in the camp of they didn't execute on their business plan in whether or not they had their financial statements attested.

I didn't come across very many frauds at all. They just -- they promised a bunch of stuff, they didn't deliver, they ran out of money, I mean, and there was nothing fraudulent. I took their risk, and so I think the market will ultimately adjust to expecting a higher rate of return, which they are already doing for companies that are less than 250 million in free float, that's already happening. And I just -- I think if we're going to make a recommendation, we should strongly consider looking more aggressively at this because I -- I don't -- maybe pulling a bunch of investors -- I mean, David's point of view, but if -- we should be pulling other institutional investors and people who -- who focus on -- on small cap stocks to get a better sense for whether or not 404B is determinative in whether or not they get engaged with companies. If it is, then I think I feel a little bit different because I don't want to preclude these companies from getting investors, but if it turns out it's not that big of a deal, then, okay, then why are we getting hung up on whether or not there's an external attestation.

Again, 404A is not on the table here, so I -- I would suggest as a part of this actual that we actually encourage the commission to engage with a broad base of institution -- I would say institutional investors -- it's hard to get individual investors, but institutional investors in this space oftentimes represent pension years, and -- and individual shareholders as their ultimate investors. Let's go out to that community and find out whether or not 404B is really, really critical to them making an investment decision, and if it is, then I think we can -- we'll get our answer. That's what I would encourage the Commission to do.

CARLA GARRET: Okay.

CHARLES CRAIN: One other thing that I might add just for all of you to consider is that this committee has recommended in the past that $250 million public float threshold, and -- and that would now represent alignment with the SRC definition.

And to the extent that it didn't recommend it this time, I wonder if that would read as an affirmative dec -- decision that that was no longer a good idea. We used to think it was, and now we decided that it's not, so just something to sort of consider the objects of what the

recommendation looks like given that this committee is already on the record essentially at 250 and float, and -- and if -- if you are as definitive this time, sort of what does that read as?

CARLA GARRET: Well, thank you. We appreciate that, and we do note that this is a different committee, and --

CHARLES CRAIN: Right.

CARLA GARRET: But -- but thank you very much.

So can we have a vote on the proposal that Jeff and I have recommended? Does anybody need it to be restated?

ROBERT FOX: So is it the one you stated -- or Jeff kind of seemed like he had a different --

JEFFREY SOLOMON: Well, my -- my only -- and I guess what I add -- what I would add to it is I would encourage the Commission to actually go back -- go forth and -- and solicit input from institutional investors around the 250, and let's get some data around that. That would be helpful in terms of knowing whether or not we can extend to -- to 250.

CARLA GARRET: So I think that what Jeff is saying is he's adding an additional subject to. We support the amendment as you've proposed. There are a few things that we think that it would be useful for

the Commission to look into, and one of those is what Jeff has mentioned now is getting the input of investors of whether -- the importance of the 404B.

So may I have a motion to approve that recommendation? Anyone?

UNIDENTIFIED SPEAKER: So moved.

CARLA GARRET: So moved. A second?

HANK TORBERT: (Indicating.)

CARLA GARRET: Okay. All in favor of our recommendation --

(Several ayes.)

CARLA GARRET: All opposed?

(No response.)

CARLA GARRET: Okay. Based on that, then the recommendation by this Committee has been approved, and thank you very much. It was a quite interesting and spirited discussion on a lot of very interesting topics.

CHAIRMAN JAY CLAYTON: Carla, if I could just jump in, and just --

CARLA GARRET: Yes.

CHAIRMAN JAY CLAYTON: -- say thank you to everybody for sharing their views so candidly, it's -- it really helps us. It really does.

CARLA GARRET: Okay. We have about 25 more

minutes until 3:30. A couple things we would like to do between this period of time is, first of all, we would like to find out from members what other pertinent capital formation issues the members have that they would like to discuss at other committee meetings in the future, and also other issues that you would like to make members just aware of in general. So I'll open the floor right now to people that have other ideas to talk about.

Yes, Jason.

JASON SEATS: I have two.

CARLA GARRET: Okay.

JASON SEATS: And they are related, and they are -- they both relate to the -- the definition of qualifying investments under the venture capital exemption, and for -- just so you understand sort of my context that we operate funds, manage funds using that exemption, and the -- and the value that I perceive I am supposed to be bringing to this group is to help understand how -- you know, the things that we learned sort of boots on the ground, how it -- how it applies to -- to capital formation for -- for new and small business, and so the two specific items are the fund-to-funds restrictions and the secondary investing restriction, and the -- the commonality, and think the applicability to this -- this group is that expanding that definition for us from what we see would increase the flow of capital that makes its way into -- into investment and small companies in the middle -- middle America and places like -- like Omaha.

And so for -- and to give you a couple of anecdotes from our company, which is called Tech Stars, and so we -- we have offices in -- in two dozen cities in the US, and we have employees who are investors in those markets who -- who invest our capital from our funds into these companies, but we also encourage those individuals who raised outside capital themselves, and so it's a bit of a capital formation, and we're restricted in our ability to seed that fund formation because there's a limitation on how much money we can put into those funds, and we don't think that we are alone, and we see plenty of other coastal investors who view small funds in these cities as an important source of deal float for them, and what to see those funds and create those funds.

And from our perspective because the end benefit is the same, investing in a vent -- a venture-exempt entity, that that should flow through to a funds-to-funds level, and so that's the first item, and then the second is secondary investing. We invest very, very early, and -- and an angel investor or a -- a seed fund that invests before us. Even

after 7, 8, 10 years being invested in a private company will come to us and ask us for opportunities to get liquidity on their investment, we would love to buy those shares. We don't perceive a difference in buying those shares versus about buying primary issuance, and the benefit to the end market is that those investors who now have a track record of putting money to work in these companies will get profits and returns and -- and put them back to work in new investments, and so those two -- those two items are things that we like to get on the consideration set.

CARLA GARRET: Okay. Thank you. I appreciate that.

Yes.

SAPNA MEHTA: And those are, you know, some of -- a few of my items as well, and, you know, I work at Revolution, and we have a fund called Rise of the Red Seed Fund, and we like to deploy money throughout the country, outside of New York, Silicon Valley and Boston, and we have seen the impact we can have on -- in other cities and -- and in companies where we kind of provide catalytic capital once we invest. Oftentimes the companies are able to close out the round, and -- but the big hole is our inability to invest and regional funds, and we see that catalytic capital, like, really picking up speed and velocity in

deployment of the -- of capital to these companies, but because coastal investors that we -- we can't tap that expertise that a lot of these regional funds have given their geographic proximity to these com -- to these companies, and, you know, really knowing that network and industry, we just -- we perceive that as a gap, and we don't -- you know, as Jason was saying, as long as the underlying fund qualifies under the venture capital exemption, we don't see why we shouldn't be able to invest, and we, in fact, explore this option we wanted to create, have a fund of funds, but given the nature of so many of our investments and the fact that we would then have to aggregate all of our funds to become an RIA.

I mean, some of the funds -- I mean, we have $150 million seed fund, and we are invested in over 130 portfolio companies, and a lot of these companies have four to six employees. I mean, there's no way -- I mean our current standards are providing tax-based accounting because that's just what we have to do, but, you know, to be an RIA is just prohibitive for us, so we had to walk that back, and we decided we -- we could not deploy that strategy, and so -- you know, and again with the secondary, I -- I concur with Jason. I mean, that's also a pinpoint where we think being able to free up that capital from either early investors or,

you know, early founders, for them to go on and re-deploy that money elsewhere makes no difference whether we're buying it from the company.

A lot of times rounds are oversubscribed, and so secondary is the only way we can get into the round or maximize our stake in that company, so that is also something we would like to explore, and just, again, you know, venture companies are very different from private equity companies, and so I would like to hear more about, you know, what the risks are for venture in doing these things provided that you still have perimeters that we have to comply with to be able to take advantage of a venture capital exemption.

CARLA GARRET: Okay. Thank you. Catherine?

CATHERINE MOTT: Carla, I -- I would just like to, I guess, concur with my colleagues. We would be a region that would benefit from what you're discussing, and -- and the advantage is that -- you know, that successful companies -- what -- what makes them successful are the people you invest in, more so than the technology, and nobody knows the people better than the people on the ground. You know, you're coming in from out of town, you don't -- you don't know who you are investing in. We do, and so we benefit from that.

The other thing is liquidity is a big issue for us. If there was a secondary market, I mean, we would gladly take advantage of it, and we would deploy that capital back into the market, so just confirming. Thanks.

CARLA GARRET: Thank you very much.

Youngro?

YOUNGRO LEE: Yeah, this is -- I mean, this is really to the first session, but I want to -- when -- when Chairman Clayton spoke it he specifically mentioned two things as how do we get capital in geographies that don't have traditional capital, so that's -- that's the reason why we're in Omaha, and the second is how do we actually give the best boundaries to the national investors, and this is more of an expression, but all of the conversation we had today I feel like we barely touched on the second, if at all, right?

Besides saying we're going to change the definition of credit investors hopefully, but, again, that's focusing on the credit investors, and my sense is it's not going to go down, right? If anything, it's going to be additional, so kind of piecing these together, related to the harmonization, but maybe it's just the focus or principle that we should be thinking about is if we really want to

accomplish Chairmans Clayton's two goals of bring capital to where capital doesn't exist, No. 1, bring and allow the local basically non accredited investors to invest, what do you need to do? And to me that's really two things is incentives. Make incentives for capital to go into -- to physically go into those companies that are not in the outside -- you know, the coasts. And second is an incentive for intermediaries because that is -- I think Jeff expressed earlier, the traditional intermediaries of investing in banks and outside firms are just not going to deal with this space, so how do you incenticize them or the existing players or new players to service it, and that's kind of obviously what the investment industry and the Crowdfunding proffers are going, but one specific suggestion if a credit investor is the top of the agenda is so many non accredited investors would love to invest, I am sure, with Jason or something, like if these accredited investors are investing alongside Jason's company, he's at Tech Stars, right, why can't non accredited investors just invest alongside them on exactly the same terms, and the reason because of the way the laws are, legally Jason cannot accept that.

So even little things like that in terms of how do you change the definition of credit investors, for example,

if somebody just trusts their money with Jason, can they invest? Adding those things would be really helpful in a very specific way to address the concern as well as the allowing more people to invest in these opportunities.

JEFFREY SOLOMON: We face this in our own system highlighted, but we -- we arguably have a lot of sophisticated investors in our company. I mean, we have 1400 people globally, and we work in the business.

And we have co-investment opportunities all the time that come through is -- you know, even if we don't take on an assignment to advise the company on how to raise capital, oftentimes, you know, we may be just casually introducing them to people that we think would be -- would have interest. And then they come back to us and they are like, okay, well, you know, maybe we leave a couple of million dollars for you and your partners or your employees to invest in.

And I think one of the challenges we have is we actually have to go through a roster and put out a questionnaire internally to try and determine in a very benign way who is accredited, who is super accredited, who works in the business, close enough with the business to try to figure out whether or not we can get them in under an exemption, and then we have to try to

convince the company that they are not taking any risk in that

And so I would just say even with a business that I think is arguably filled with sophisticated people who might otherwise qualify, I can't sit here and tell you that we're -- we have a clear path, we're doing the best we can to try and get capital overflow from -- from those folks That would be really helpful

CHAIRMAN JAY CLAYTON: Can I -- can I -- can I jump in on this?

JEFFREY SOLOMON: Sure

CHAIRMAN JAY CLAYTON: And, again, I am going to throw this out as sort of my thinking in this area as we sit here today, and I would love for, you know, others from the SEC to chime in as well But the accredited investor structure is designed for a distribution model It's designed to protect people in the case of distributing investment opportunities And -- and that's what, you know the person is sourcing the opportunity and the person investing are different The source gets paid for that transaction, and they are gone

What you just, Jeff, and I think it was co-investment opportunity, and, you know, where I can get more comfortable -- or not more comfortable -- where I think we should be looking is where those incentives need for the long term.

Now, there the -- that's called the lower income, lower net worth accredited investor, or somebody who is a non accredited investor by today's definition gets a great deal of comfort that they are actually investing pari passu alongside long sophisticated money.

JEFFREY SOLOMON: Uh-huh.

CHAIRMAN JAY CLAYTON: For me, just speaking personally, I take much more comfort that I am investing alongside somebody who is putting their money pari passu with mine, than -- that I have enough money to lose. And it's -- I think we need to change the paradigm a little bit from one that's dealing with a distribution model to one that's dealing with a co-investment model.

WILLIAM HINMAN: And not surprisingly, you know, we ask that specific question in the -- in the harmonization release. I wonder where it came from, but, you know, that approach as well as thinking about vehicles through which non accredited investors could invest, where there's a sophisticated intermediary, where there's someone who either has co-invested or has, you know, fiduciary obligations to the investor

or ways to pool some of the smaller investors together so the issuers that you all are looking out for are not overly burdened by having high numbers of retail investors, and those are all things we're looking at in that harmonization release. And, you know, Jay's last point is a good one. You know, if you have someone there alongside you who is very sophisticated investor and you're 15 percent of the deal, you're probably pretty well protected, so we want to look at those things.

YOUNGRO LEE: Yeah, I mean, the main point from the committee perspective, we want to add value to that conversation, and -- and to address the -- the goal is, again, I am just going to focus on bringing capital to non traditional markets and allowing it to everyone. What I am saying is it's not just -- it can't possibly be change -- just change the definition of credit investors. It has to be holistic in how we think about the entire investment infrastructure and systems, and I think that's where really the sophisticated investors, whether it's an investment bank or -- or recognized brand name, CV firms, a product firm taking a lead, but you have to create incentives for them to want to do it. Because right now if you ask every single legitimate investment

firm, nobody literally -- and maybe I am exaggerating, but I feel like 99 percent will say no way in hell am I accepting a non accredited investor because there's no incentive.

So that's kind of where --

JEFFREY SOLOMON: Or worse yet, if you do it and there's a problem.

YOUNGRO LEE: Right.

JEFFREY SOLOMON: So that -- and that's -- this goes to something I think -- I am largely in agreement with what you said. Here's the challenge. Every time somebody loses money, it's -- it's not in their own mind because they made a risky investment, it's because somebody did something to me, and -- and that's the knee-jerk reaction. And I'll say even in the public markets, you know, when we have all these protections and we're underwriter and we have all these responsibilities, as soon as something goes a little bit -- you know, as soon as anybody loses a little bit of money, everybody is just -- you know, everybody is getting sued.

CHAIRMAN JAY CLAYTON: Well, and the public market are, and will remain a distribution model, right?

WILLIAM HINMAN: Uh-huh.

CHAIRMAN JAY CLAYTON: We -- we put tremendous liability on the issuer and the underwriter at the time of an IPO because the underwriter is out, the issuer is dis -- and it -- and the people they are distributing it to by and large do not have the ability to kick the tires

I -- I do think that the private markets, which, you know, weren't around in any way, shape or form like they are today when we develop the accredited investor model, and they weren't around really when we developed the -- the private markets have developed to not be as much of a distribution model, and our distinction between how main street investors invest in the public and private markets hasn't really evolved with that change And I think what you're saying is let's recognize that there's probably some holistic development that need -- you know, changing the -- changing the level from $300,000 to 500 or 100, or changing the net worth from 1 million to 500 or excluding That's not really going to solve the problem

MARTHA LEGG MILLER: I'll -- I'll jump in here for the first time today It's been really fun, this meeting, to let Carl and Jeff do all of the leg work of leading the meeting, unlike last time, so --

JEFFREY SOLOMON: You mean Carla just to be clear

MARTHA LEGG MILLER: You've done a wonderful job, and I am very grateful for your leadership I think that this is really probing the session that we started the day with

I think it's nice that it's almost bookends, that we started out talking about thinking big thoughts about how the market could and should work, and the context of questions that are teed up in the harmonization release, and I think what we're discussing really goes to the heart of how does this committee think that the rules could and should be changed to work better Looking at the way that the market has evolved, those are big questions, and that's a big topic

That's a lot to tackle, but I feel confident that we're in good hands given the wealth of experience that each of you brings from very different areas, and so I just -- I am excited to see the ways that we take the different experiences You know, Youngro, you're talking about one set of experience, but you have the -- you know, you have seen lots of different areas that are focused and Crowdfunding

You've got Jeff in another area looking at a totally different segment, but I think it is the confluence of these perspectives that's going to really provide for an enriched discussion particularly when we meet next and we start really delving into the harmonization release, but I just -- I want to encourage all of the Committee members to -- at the same time that you think on very micro levels of does the acc -- you know, does the accredited investor definition technically work the way that we think it should thinking more broadly about the entire construct that we are dealing with, the pooled investment vehicles with individual investors who back them, and with the companies that we are interested in supporting as they grow in scale. So I just want to encourage the breadth of thinking on this because it's -- it's the type of thing that it gets me excited, it's the reason that I love what I have the opportunity to do at the SEC, and I think it's the reason why each of you were interested in serving on the committee, it's to get the think big thoughts, and to shape how the rules work.

CARLA GARRET: And I'll say just to follow up on what we talked about earlier about framework for the November meeting and the harmonization rules. There

-- there's, you know, been the suggestion that it might be useful to have a group of people, maybe a subcommittee look into the -- the rules that do, you know, facilitate, um, the main street investors, access to the markets, looking at the Crowdfunding 506(c), Reg A, possibly pooled investments. I think Youngro is interested in that topic, and it could be something that a subcommittee looks into more, and comes back to the full committee with recommendations on.

YOUNGRO LEE: I would love to do that along with anybody else who is interested in the topic.

SARA HANKS: I would love to help.

CARLA GARRET: Thank you, Sara.

Is anybody else interested in that?

UNDETERMINED SPEAKER: I'll join the team.

JASON SEATS: I am interested. Two things that pop out to me that I think, Martha, you hit on a little bit that I think about with what you -- the points you have brought up, Chairman Clayton, the -- I wonder if something from a framework standpoint if we should think about different rules as they apply to investing in individual issuers versus as they apply to investing in pooled capital because they have a very different risk profile at this end of the market.

And then the second is should there be different designations?

And I don't know how you measure this, but based on either capital at risk that's -- that's put in place by the fund managers, and would that create a distinction. And so those are two levers that I don't really see. They -- they don't exist in terms of regulation, but in terms of the way that the private market operates they do exist because a large LP when they are evaluating a fund, they want to know how much the GP is putting in the fund, it matters to them, and it matters so they are not just how -- what the size of the check is, but what the size of the check is relative to the net worth that they think that person has because it says a lot about the competence they have in the product, and I think that there's some element of that that could float through from a regulatory side too, but I don't know how you think about encoding that, but I am just trying to think big picture, like, what are some of the levers that haven't been used.

WILLIAM HINMAN: That's where -- you know, that -- that was the point of the co-investment point.

JASON SEATS: Right.

WILLIAM HINMAN: And we're going to be looking at it, and give -- we'll look forward to the committee side of that.

Actually, tomorrow is a panel on the harmonization release, has some folks that have been thinking about some of those issues. I think they will be pretty informative, whoever is participating in the subcommittee here may want to listen to that panel tomorrow because I think they have some ideas along those lines.

JASON SEATS: Uh-huh.

CARLA GARRET: Does anybody else have other items that they'd like to discuss?

Okay.

JEFFREY SOLOMON: So on the subcommittees for the harmonization from the first discussion we had, are we going to have a separate sort of -- I mean, this is a good subcommittee that's going to deal largely with investments and private companies and maybe venture -- more venture oriented. We had talked a little bit about maybe sort of trying to take on some of the pooled investment vehicles that were outside of that.

I just want to make sure, are we having two subcommittees or one?

CARLA GARRET: I think right now we're starting

with one, and then we'll also talk about -- we can talk about speakers and people that we could have address the full committee. That might be a good person to have a speak talk about the difference for the full committee.

JEFFREY SOLOMON: Great.

CARLA GARRET: Okay. Thank you to everybody. I think this has been a great meeting, and thank you so much for coming to Omaha. Our next meeting is November 12th, it's in Washington, DC. As you know, we'll be focusing on the harmonization release, as we have been talking about. Thank you to the SEC staff, thank you to the chairman and the commissioners for being here, and with that I adjourn the meeting.

(Whereupon, at 3:27 p m., the meeting was adjourned.)

* * * * *

PROOFREADER'S CERTIFICATE

In the Matter of: SMALL BUSINESS CAPITAL FORMATION ADVISORY COMMITTEE

File Number: OS-0813

Date: Tuesday, August 13, 2019

Location: Omaha, NE

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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