

U.S. SECURITIES AND EXCHANGE COMMISSION

MEETING OF THE SEC SMALL BUSINESS
CAPITAL FORMATION ADVISORY COMMITTEE

Tuesday, November 12, 2019

9:37 a.m.

U.S. Securities and Exchange Commission

100 F Street, N.E.

Washington, D.C.

1 PARTICIPANTS:
 2 Jay Clayton, Chairman
 3 Hester Peirce, Commissioner
 4 Carla Garret
 5 Jeffrey Solomon, via phone
 6 Sara Hanks
 7 Youngro Lee
 8 Brian Levey
 9 Sapna Mehta
 10 Karen Mills
 11 Catherine Mott
 12 Poorvi Patodia, via phone
 13 Jason Seats
 14 Hank Torbert
 15 Gary Yadley
 16 Martha Legg Miller
 17 Greg Dean
 18 Mike Pieciak
 19 Mark Sharma
 20 Collin Caleb
 21 Jenny Riegel
 22 Jessica McKinney
 23 Rick Fleming
 24
 25

1 SPEAKERS:
 2 Ross Baird
 3 Richard Horowitz
 4 John Finley
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1 PROCEEDINGS
 2 MS. GARRETT: Good morning. I hereby call the
 3 meeting of the Small Business Capital Formation Advisory
 4 Committee Meeting to order. I am Carla Garrett, the
 5 Chair of the Committee. And via webcast, I believe we
 6 have Jeff Solomon, the Vice Chair of the Committee. I
 7 believe we also have the following committee members who
 8 are participating via phone or webcast. As I said,
 9 Jeff, Steve Graham, and Poorvi Patodia, excuse me,
 10 sorry.
 11 MS. PATODIA: Hey, there. This is Poorvi
 12 Patodia. I'm here.
 13 MS. GARRETT: Is Karen Mills on? Okay.
 14 Julie, is there a quorum for the meeting?
 15 MS. DAVIS: Yes, there is.
 16 MS. GARRETT: We would like to thank also
 17 Terry McNew for his service on the committee. Terry is
 18 no longer on the committee because he has left
 19 MasterCraft Boats and he has joined Klaussner Furniture
 20 as their new president and CEO, but we would like to
 21 thank Terry for all of his time on the committee.
 22 Thank you to the members of the committee and
 23 the SEC staff in attendance. I welcome the people
 24 attending the meeting in person and the viewers via
 25 webcast.

1 Today we will be discussing and possibly
 2 making recommendations on the SEC's Harmonization
 3 Release. The goal for the meeting today is for the
 4 committee to be a source of original thought from the
 5 perspective of how to facilitate capital formation for
 6 small businesses. As director Hinman stated in our
 7 August meeting, the SEC would like this committee's
 8 input both at the high level of addressing the exempt
 9 offering framework as a whole, and at the detailed level
 10 by making recommendations on discreet areas of the
 11 release.

12 Today's agenda will be as follows: First we
 13 will have a guest speaker that will talk about how small
 14 companies are assessing capital at a company's early
 15 stage. Next, the committee will discuss the
 16 Harmonization Release and will work to develop possible
 17 recommendations. After lunch the SEC Investor Advocate
 18 will provide an introduction to the Office of the
 19 Investor Advocate. We will then have two guest speakers
 20 that will provide background on ways to facilitate
 21 capital formation and exempt offerings through pooled
 22 investment funds, which could provide retail investors
 23 with greater access to private growth stage companies.
 24 And following these speakers, the committee will
 25 continue its discussion on the Harmonization Release and

1 deliberate on potential recommendations.

2 I'd like to turn the meeting over to Martha
 3 Legg Miller, the SEC's advocate for Small Business
 4 Capital Formation, for more introductions.

5 MS. MILLER: Thank you everyone and I
 6 appreciate everyone being here today with what sounds
 7 like lovely weather and some metro delays, so I know
 8 that we have one, our speaker Ross Baird, who will be
 9 joining us as soon as he can.

10 I did want to start with something that I've
 11 really appreciated, the number of our advisory committee
 12 members who have reached out after the meetings and
 13 touched based to share thoughts and ways that we can be
 14 an even stronger group.

15 One of the things that was raised by one of
 16 our committee members was a discussion of first
 17 principles to ground us, and the discussion of how we
 18 approach and think about the issues. And so I just
 19 thought I would take two minutes to briefly kind of take
 20 a step back and remind everyone of kind of the enabling
 21 legislation and what the thought process was behind the
 22 creation of this committee is just something to ground
 23 us as we look at topics today that can go down many
 24 different rabbit holes and take on a lot of different
 25 perspectives, and that was that Congress wanted to

1 create an advisory group that could think strategically
 2 about the encompassing issues of the marketplace from
 3 small companies that are start-ups and very early stage
 4 in emerging, and across their life trajectory all the
 5 way up into small cap public companies, and thinking
 6 about how we can approach that from a perspective that
 7 balances the needs of companies and investors, but that
 8 is looking holistically and prioritizing that entire
 9 pipeline and trajectory for growth.

10 And so with that, I think it's a helpful
 11 framework for thinking about the issues, thinking about
 12 holistically what enables the emergence of new
 13 marketplace entrants to grow and thrive and scale as
 14 meets their needs. And if anybody has any additional
 15 further thoughts they wanted to add in about legislative
 16 history, there is a good bit that is out there, but
 17 hopefully that's helpful as just a grounding first
 18 notion, and I appreciate the recommendation to start
 19 with that.

20 MS. GARRETT: And Martha, did you want to
 21 introduce Chairman Clayton?

22 MS. MILLER: Yes, I am happy to introduce
 23 Chairman Clayton. And before I do it, I will also give
 24 the lovely disclaimer that we give at everything you
 25 come to with the SEC, which is when any of us are

1 speaking, we are representing our own perspectives, not
 2 necessarily the views of the organizations we represent,
 3 whether that is the Commission or your respective
 4 companies, which is a good omnibus disclaimer that can
 5 get us scot-free out of having to do that for the rest
 6 of the day.

7 And with that, Chairman Clayton, we appreciate
 8 you being here today to kick things off.

9 CHAIRMAN CLAYTON: Thanks, Martha, and thank
 10 you, Carla. It's nice to join all of you today, and I
 11 want to recognize that you all have day jobs, busy day
 12 jobs, hard day jobs, and we greatly appreciate that you
 13 are lending your time, your limited time to help us with
 14 these issues. And it's very important because you are
 15 the boots on the ground. You are the people who
 16 actually have to navigate our markets and our laws to
 17 try and get things done. It's fairly easy to sit up
 18 here and talk about how great things can be and whatnot,
 19 but when you're doing it every day, it gives you a
 20 tangible insight, and I can tell you that that tangible
 21 insight is very important to us. So I'm pleased that
 22 you will devote today's meeting to a discussion of our
 23 concept release on Harmonization of Securities Offering
 24 Exemptions.

25 Taking a critical look at our offering

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1 exemptions is important for investors and issuers alike.
 2 Are they working? I believe that our private markets
 3 are not providing opportunities to our Main Street
 4 investors to the same extent, including quality, they
 5 provide to our institutional investors. Our markets are
 6 far different today than they were 35 or more years ago.
 7 Then, our private capital markets were a minor component
 8 of our economy for both companies and investors. Today,
 9 in terms of the amount of capital raised, investment
 10 opportunities, returns, and other key metrics, our
 11 private capital markets often are seen as more
 12 attractive for companies and professional investors than
 13 our public markets.

14 However, our overly complex and rigid approach
 15 to private offering regulation was built on a patchwork
 16 basis for the markets of 35 years ago. This approach
 17 focuses on direct access and it is rooted in investor
 18 protection concerns that, to be sure, let's repeat this,
 19 to be sure must be respected and furthered. However, I
 20 believe it is an overly reliant system on the wealth-
 21 based definition of accredited investor and it
 22 effectively prohibits or significantly restricts all but
 23 our wealthiest Main Street investors from investing
 24 directly or indirectly in our private markets. Worse,
 25 because the costs of providing access to Main Street

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1 investors on an individual by individual basis,
 2 including those who are very wealthy and qualify as
 3 accredited investors are high, those seeking to raise
 4 capital in the private markets generally may turn to our
 5 Main Street investors only if institutional investors
 6 are not sufficiently interested. Said another way, the
 7 way economists would talk about it, there may be
 8 significant selection bias that adversely affects Main
 9 Street investors.

10 For these and other reasons, I believe it is
 11 our obligation to explore whether we can reduce costs
 12 and complexity and increase opportunity for our Main
 13 Street investors in this important market, including
 14 through professionally managed funds. To be more
 15 specific, I'm thinking about funds where Main Street
 16 investors are able to invest in the private markets on
 17 terms similar to those available to institutional
 18 investors and on a diversified basis.

19 Importantly, and contrary to what some have
 20 suggested about our efforts, we must ensure appropriate
 21 investor protections for our long-term Main Street
 22 investors in any action we take. Here I note that our
 23 public capital markets protect our Main Street investors
 24 in many ways including that our long-term Main Street
 25 investors get essentially the same terms, they get the

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1 same deal as our long-term institutional investors. We
 2 should think about replicating that in the private
 3 capital markets.

4 Let me pause and deviate a second from my
 5 prepared remarks. If you look at well-managed pension
 6 funds across the spectrum, some have no private equity,
 7 some have a lot, but on average they have a fair amount
 8 of private equity exposure for their long-term
 9 constituents. It seems odd that when you're investing
 10 for the long term as an individual in your retirement
 11 account that you would have no such exposure when the
 12 professionals all think that kind of exposure in today's
 13 marketplace makes sense. That asymmetry, dichotomy, is
 14 something that we should at least look at and recognize.

15 Okay, next. Second, as you well know, small
 16 and medium-sized companies are increasingly relying on
 17 our private capital markets to raise capital. We have
 18 found that these markets are all too often not
 19 functioning so well between the very early stage and, I
 20 would say, almost medium-sized stage. You guys have
 21 identified this well, from two, three million dollar
 22 valuation to a fifty million dollar valuation, the road,
 23 particularly the capital raising road, is very bumpy,
 24 very cumbersome, and takes a long time. For innovative
 25 companies, that time means the market can change and

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1 their opportunities can fade, or competition from
 2 others, maybe larger companies, 00:10:24) anyway, limit
 3 their opportunity set. I really want to hear from you
 4 on how we can bridge this gap, make it easier for those
 5 companies to access capital while maintaining investor
 6 protection.

7 Again, I'm going to deviate from my prepared
 8 remarks and say that for the past two weeks I've been
 9 traveling, meeting with central bankers and regulators
 10 around the world, the nimble nature of our small- and
 11 medium-sized businesses, our capital and labor markets,
 12 remains the envy of the world; it enables us to adjust
 13 to changes in the economy, changes in technology. We
 14 need to do whatever we can to continue to facilitate
 15 that. It is a comparative advantage for our country and
 16 it's one that we should continue to recognize. So your
 17 work is very important to us.

18 And I think our speaker is not yet here. Or
 19 is here? Okay, I was going to fill the time and say ask
 20 me any questions you want until -- but you have spared
 21 me from the press conference-like grilling, so there you
 22 go. I'll come back and answer any questions you want
 23 sometime in the future. Thank you.

24 MS. GARRETT: Thank you, Chairman Clayton.
 25 Before diving into specific areas of the Harmonization

1 Release, we thought it made sense to step back to look
 2 at the bigger picture of how small companies obtain
 3 capital, which is much broader than just through the
 4 securities laws. To help give context to the various
 5 situations in which securities laws may come into play,
 6 it seems relevant to have the fundamental data on how
 7 entrepreneurs finance new businesses, whether it be
 8 bootstrapping, credit cards, family or personal savings,
 9 bank loans, friends and family, or venture capital.

10 Our first guest speaker is Ross Baird. Ross
 11 has an interesting biography. He founded Village
 12 Capital, an active venture capital firm that invests in
 13 so-called overlooked entrepreneurs. Ross is also the
 14 CEO of Blueprint Local, a platform to help people across
 15 the country to invest in their own communities. And the
 16 committee has extended an invitation to Ross for this
 17 meeting because he also wears the hat of innovator and
 18 residence at the Kauffman Foundation. Ross has authored
 19 multiple reports for the Ewing Marion Kauffman
 20 Foundation on the state of access to capital for
 21 entrepreneurs. The Kauffman Foundation supports a
 22 number of programs including many that offer guidance,
 23 resources, education, and events for aspiring and
 24 existing entrepreneurs. They have published multiple
 25 reports with fascinating data, and we look forward to

1 hearing about those findings from Ross.
 2 Welcome.

3 MR. BAIRD: Great. Thanks for the invitation,
 4 and Chairman Clayton, thanks for inviting me. Sorry to
 5 not give you open mic time, but hopefully we make this
 6 worth everyone's while. It's good to see a lot of
 7 familiar faces, good to see a lot of new faces. I
 8 really, really appreciate the introduction. I'm hopeful
 9 to give you a couple of insights that will lead your
 10 discussion.

11 I come at this from two levels. At the one-
 12 foot level as a founder of a series of different funds
 13 over the last 10 years investing in entrepreneurs and
 14 small businesses in the distressed parts of the country.
 15 I've had the privilege of coming across a lot of you in
 16 that work. And second, from a 100,000 foot level with
 17 the Kauffman Foundation, which has been the leading
 18 backer of entrepreneurs and entrepreneurial initiatives
 19 in the country. And I want to talk about some of the
 20 research we've done on the latter of what is happening
 21 in the country as entrepreneurs try to access capital,
 22 and just a few observations that may be helpful for this
 23 committee to consider as you do really important work.

24 So I, about two years ago, worked with
 25 Kauffman Foundation to do a study of -- there's a lot of

1 conversations whether it's venture capital or lending,
 2 it's very obvious that for a lot of businesses and a lot
 3 of investors, the market is not working particularly
 4 well. We looked at the data and it turns out there's a
 5 lot of focus on getting venture capital to more places,
 6 a lot of focus on getting small business loans to more
 7 places, and it turns out 83 percent of businesses that
 8 start don't access formal forms of capital. Fewer than
 9 1 percent of businesses access venture capital; about 18
 10 percent of businesses will get a loan. But 4 out of 5
 11 businesses don't access any form of capital. For many
 12 of them it's they don't want it or they're not
 13 investable, but many more face structural barriers that
 14 this committee's looking at.

15 As we look a bit deeper, this is from census
 16 data, here is how entrepreneurs and small businesses
 17 finance their start-up or their growth, the other 83
 18 percent, so to speak. Here's a breakdown. You see
 19 businesses starting with personal savings, personal
 20 credit cards, bootstrapping, no outside capital, home
 21 equity loans.

22 One of the things that the data shows us is
 23 despite a boom in the media on entrepreneur activity,
 24 entrepreneur activity in the U.S. is hovering at near a
 25 40-year low. And one of the things that we saw in 2008

1 was the great recession for the bottom two-thirds of
 2 families wiped out savings, home equity, a lot of the
 3 sources of capital for small businesses. So without
 4 rethinking how capital flows to businesses, it used to
 5 be a lot of businesses would bootstrap their start-up.
 6 You know, 2 out of 3 families don't have boots, so to
 7 speak, post-recession and it creates real geographic,
 8 real demographic, real gender barriers, real race
 9 barriers that are really important to dig deeper into.

10 Just to tell a story of a business that is a
 11 meaningful business, creating meaningful jobs in the
 12 country that doesn't fit the venture capital profile,
 13 doesn't fit the small business lending profile, a firm I
 14 founded, Village Capital, in 2012, one of our first
 15 investments was this company called Fin Gourmet.
 16 They're in Paducah, Kentucky, southwest Kentucky.
 17 Unemployment in the county was about upwards of 20
 18 percent in 2012.

19 And this woman, Lula Luu, she's an immigrant
 20 from Vietnam who settled in the Mississippi Delta and
 21 realized two things: one, Asian carp is a huge
 22 environmental threat; and two, people love to go
 23 fishing. And so she developed a brand around Asian
 24 carp, which was not selling well in the mainstream
 25 market. She rebranded Asian carp "Kentucky Blue

1 Snapper." It's like how Chilean Sea Bass is actually a
2 muckraking bottom-feeder.

3 And she would literally give unemployed people
4 in Kentucky fishing rods and go out and they'd catch the
5 fish, rebrand it Kentucky Blue Snapper and sell it.
6 Now, you can buy Kentucky Blue Snapper in high-end
7 restaurants in New York and San Francisco.

8 And so we met her. She was doing about
9 \$250,000 a year in revenue. She was about two years
10 old. She was employing 12 people. She needed \$250,000
11 in growth investment. No bank would touch her because
12 she was two years old and venture capital said, well,
13 that's not really what we do.

14 So we did a kind of alternative investment
15 structure where we did -- we (18:22) a group of
16 investors; we put in \$250,000; about half the money was
17 local, half the money was national from funds like ours;
18 and we did a revenue royalty share where we said we'll
19 get 5 percent of your topline revenue until we get a
20 three times repayment, you know, or 10 years passes,
21 whichever comes first.

22 So with that \$250,000 she built a processing
23 facility. Today she's doing about three million in
24 revenue. She's employing 50 people. She's in a county
25 where she's one of their largest most meaningful

1 are a fast-growing tech company in San Francisco, the
2 institutional framework kind of pulls capital towards
3 you. If you're a business that needs \$250,000 of growth
4 capital in southwest Kentucky, there's just not plumbing
5 to get capital to what you're doing.

6 I think the second issue -- so that's kind of
7 a demand side issue. Businesses are not big enough to
8 access institutional capital. And then there's a supply
9 issue which I know, for example, Youngro and NextSeed in
10 Houston has been extremely focused on. The average
11 person -- you know, our pension might be invested in a
12 venture capital fund that's invested in growing
13 companies, but you can't invest in it. And this is
14 exactly what you were saying to kick off the day.

15 So if you look at, for example, I was in
16 Baltimore yesterday and there's a group of young
17 professionals, young African-American professionals, you
18 know, these are doctors and lawyers, people making, you
19 know, six figures, like reasonably great salaries for
20 Baltimore, and they want to invest in growing businesses
21 in Baltimore, but even making, you know, \$100,000 a year
22 as a lawyer in Baltimore you don't clear the accredited
23 investor bar, let alone the qualified purchaser bar. So
24 you have young, black professionals in Baltimore wanting
25 to invest in black businesses in Baltimore and there's

1 employers.

2 I bring this story up because it's very easy
3 to get in the policy weeds, but this is what the 83
4 percent look like. And it was just a couple of people
5 at an individual level in one town in Kentucky that made
6 this investment happen. But what the Chairman is
7 talking about, institutionalizing this kind of long-term
8 equity investment in companies like Fin Gourmet, will
9 make a massive difference in our business environment.

10 So why aren't more businesses like Lula's
11 getting financing? We looked at a few barriers in the
12 Kauffman Research. Number one, and the Chairman talked
13 about this a bit, there's a real gap between
14 institutional asset management and the needs of everyday
15 businesses in America. So we interviewed over 300
16 institutional investors, pension funds, endowments, et
17 cetera, who manage more than 1 billion. Fewer than 5
18 percent said they would even consider an investment fund
19 of less than 100,000 million just because of sizing and
20 time, and it takes a lot of time to do diligence on a
21 fund manager.

22 So the way the regulatory framework should
23 look at this is the way the market sits today. It is
24 massively privileging large funds that are doing billion
25 dollar funding rounds in large cities. And so if you

1 just no institutional way to do it.

2 So, you know, and if a very wealthy person,
3 you know, if you make over \$100,000 you're one of the
4 wealthiest people in America. If that person can't
5 invest, what happens with the vast majority of the
6 country? So there's a lot more we can go into, but
7 there's a barrier on companies not being large enough to
8 receive capital, and there's a barrier of investors not
9 being wealthy enough to invest capital.

10 And then I think the third barrier is
11 structural. I tell the story of Fin Gourmet, and this
12 is where Kauffman's work has really focused over the
13 last year. So venture capital is incredibly important
14 and fewer than 1 percent of businesses raise it. Small
15 business lending is incredibly important, only about 1
16 in 5 businesses get a small business loan. The average
17 business is like Fin Gourmet in that they would be seen
18 to be too risky for debt and not unicorn-y enough for
19 venture capital. It's very unlikely that Fin Gourmet
20 will be a billion-dollar business but that doesn't mean
21 they're not an important part of the country's economic
22 fabric.

23 And so there are a number of different models
24 that we've looked at that are more similar than
25 different. The revenue share model that I talked about

1 with Fin Gourmet; there are profit sharing models;
 2 employee ownership models; pay for success. There's a
 3 model called performance-based equity where I invest
 4 equity in your company and when you hit certain revenue
 5 triggers you pay investors a dividend. They're all
 6 somewhere on the spectrum in between equity and debt,
 7 and our hypothesis is these models fit a certain type of
 8 company. I don't think it's the whole 83 percent, but
 9 it's probably 15 or 20 percent of businesses that are
 10 investable, would provide a good return on investment to
 11 investors, create meaningful jobs, but for whatever
 12 reason don't fit the current regulatory framework which
 13 is highly focused on what a (00:22:57) bank should be
 14 regulated, how a venture capital fund should be
 15 regulated. So that's just an area for discussion and
 16 exploration.

17 Kauffman actually launched a pilot called the
 18 Capital Access Lab where Kauffman as a foundation would
 19 take LP positions in funds that have some of this
 20 profile between equity and debt. There were over a
 21 hundred funds that applied from 32 states. 55 percent
 22 of these funds are women-run; 42 percent are led by
 23 people of color. As we look at alternative models that
 24 are a bit more grassroots, we see very different
 25 managers, very different entrepreneurs than the stats

1 you see on venture capital. So that is hopefully what
 2 you guys were looking for. That's an overview of what
 3 we're seeing.

4 I'm happy to go deeper, I just hit a bunch of
 5 bullets and I'm -- I don't know how much time we have
 6 but I'm happy to go deeper if you'd like on any of those
 7 topics or whatever is of interest.

8 Yes.

9 MS. MOTT: Ross, thank you so much for this
 10 presentation, and this data supports what a lot of what
 11 I see. So one of the things I do run into in the region
 12 I'm in, which is mid-America, is that there are revenue
 13 share funds which they are starting to, you know,
 14 they're starting to grow. The bar seems to be a million
 15 in revenue before they'll get a revenue share
 16 investment, which sometimes by then you're bankable, you
 17 know what I mean?

18 MR. BAIRD: Right, right.

19 MS. MOTT: So they're still in my, you know,
 20 just my thoughts about what I'm seeing, not that I have
 21 any data points, but what I'm seeing in the marketplace
 22 is that there are revenue -- there's that gap between
 23 what the Fin company in Kentucky, so probably they would
 24 fall into that gap because they're not making that
 25 million dollars. So just something to say what I'm

1 seeing in the marketplace.

2 MR. BAIRD: Yes, so I would say it's easy to
 3 say this is, you know, this is the landscape; what's the
 4 answer. And if you jump to, for example, a revenue
 5 share fund, there are, for example, there's a company
 6 called Lighter Capital that has a hundred million under
 7 management. They're more -- their risk profile is much
 8 more kind of mezzanine debt than early stage equity. It
 9 would be extremely unlikely that Fin Gourmet could get
 10 an investment from Lighter Capital, and that's fine. I
 11 mean there are other models that are looking at
 12 financing of earlier stage businesses that look more off
 13 of dividends based off of free cash flow or look at
 14 profit sharing versus revenue sharing when companies
 15 reach profitability.

16 One of the things that we looked at in this
 17 study is we looked at a lot of the early private equity
 18 funds and we talked to people that were early on at
 19 funds like KKR and Bain Capital and Wesray out of New
 20 York. And they said, you know, we were all doing very
 21 different things; it was just kind of people trying to
 22 figure out how to finance private companies, but we
 23 spent a lot of time in working together around concepts
 24 and categories and the creation of an asset class,
 25 because of even though, you know, Wesray and Bain

1 Capital in 1981 were competitors for limited partners,
 2 if investors make an allocation to private equity as a
 3 category, it's actually better for both funds.

4 And so one of the things that I am seeing is
 5 these funds that are trying to solve for in between
 6 venture capital and debt, some of them don't solve
 7 Lula's problem; others do. We are seeing these funds
 8 viewing themselves as more similar than different,
 9 saying here's the category that we're going to.

10 So I would say what you're seeing in the
 11 market is right and true, and then there are other funds
 12 that are probably more solving the gap that you care
 13 about. And we should, as we look at it from 100,000
 14 foot level, is you think about the work you're doing
 15 (00:26:54) think of, you know, what Youngro is trying to
 16 do in Houston which is get people in Houston to finance
 17 Main Street businesses in Houston, as a category is
 18 probably more similar than different than how a business
 19 in Paducah that can't access venture capital gets
 20 financed. And if you think about it as a category in a
 21 regulatory framework, I think it would be really useful.

22 MS. GARRETT: I have a question. What stage
 23 do you believe a company needs to be at in order to get
 24 the institutional investments and so therefore, you
 25 know, just thinking about how many companies are not at

1 that stage yet and so the population of companies.
 2 MR. BAIRD: Yes, I think there are two things
 3 to unpack in that question. I think, I mean the biggest
 4 risk of just anybody can invest in any company is it
 5 opens things up to massive fraud risk, and that's what a
 6 regulator should be very worried about. I would say
 7 that there is a -- I mean I would say there's a certain
 8 stage of maturity where companies have had for a year,
 9 two years, I'd say there -- I'd say the earliest
 10 solvable gap is where companies have two or three years
 11 year-on-year revenue growth, fulltime employees, they
 12 are going concerns. That is one category that I would
 13 say is incredibly difficult to finance if the company
 14 doesn't have or invent a hockey stick growth trajectory
 15 that gets venture capitalists theoretically interested.
 16 But so I'd say the easiest place to start,
 17 knowing that there are tens of thousands of business
 18 that should get capital and don't, is businesses that
 19 are profitable or close to it and reliably growing and
 20 do not fit banks' current underwriting algorithms and do
 21 not fit venture capitals growth trajectory. And I would
 22 say we try to figure out of the 83 percent, what
 23 percent. It's probably 8 to 10 percent of businesses
 24 that are reliably profitable and growing and haven't --
 25 just don't fit into institutional categories.

1 The second thing is if I own three restaurants
 2 in Houston and I want to open a fourth, a generation ago
 3 a community bank would have looked at my reputation and
 4 extended a loan saying these three restaurants are doing
 5 -- today, banks would say, well, it's a start-up
 6 restaurant, those are incredibly risky, why would we do
 7 this. So I think, you know, proven independent
 8 businesses that are trying to grow or move into new
 9 categories where, in an age of much more diversified
 10 banking reputation and track record, would have mattered
 11 more, but -- and I think this is the world that you're
 12 very much in with NextSeed.
 13 So I'd say that's a second category of kind of
 14 small businesses that want to grow but don't fit. I'd
 15 say that's probably another 5 to 10 percent. Those are
 16 the two places I would start to look at what could be
 17 better addressed.
 18 MR. LEVEY: Hey Ross?
 19 MR. BAIRD: Yes.
 20 MR. LEVEY: Thanks for coming in again. Do
 21 you get a sense that sort of the trends are getting
 22 worse here --
 23 MR. BAIRD: I do.
 24 MR. LEVEY: -- that, you know, as opposed to
 25 stabilizing or even improving a little from sort of when

1 you did your study?
 2 MR. BAIRD: I think the trends are getting
 3 worse for two reasons. I think, one, on the capital
 4 side, and I think both of them are concentration issues.
 5 So on the capital side, funds have every incentive to be
 6 as large as possible. Why would you raise a two-
 7 billion-dollar fund if you can raise four-billion-dollar
 8 fund. And so one of the issues is you have fewer and
 9 fewer managers out there who are taking -- like if I'm a
 10 first-time manager, I will take some risk to invest in a
 11 business that no one else is investing in because I want
 12 to prove my track record, I want to make my career.
 13 Larger and more consolidated funds mean fewer and fewer
 14 decisionmakers. I mean 2 percent of venture capital
 15 goes to women; less than 1 percent goes to African-
 16 Americans and Latinos. 2 percent of decision-making
 17 partners at venture capital and private equity firms are
 18 also women; same stats with African-Americans and
 19 Latinos.
 20 So I think we have a concentration of
 21 decision-making power over capital on the supply side
 22 that is hugely problematic. And it just means more and
 23 more things like the SoftBank vision fund and fewer 50-
 24 to 100-million dollar regional funds that take local
 25 risks.

1 And then I think on the demand side, you have
 2 -- you know, when I started Village Capital in 2009,
 3 Facebook had just gone IPO, and a question gets asked
 4 all the time today which wasn't even asked 10 years ago,
 5 which is oh, you're doing something online journalism or
 6 whatever. Facebook owns that category, you can't
 7 possibly compete, dot, dot, dot, therefore you're not
 8 investable. It's seen, I think today, much more
 9 difficult for businesses to compete with Facebook,
 10 Google, et cetera than it was 10 years ago. So they're
 11 huge competition issues on the small business and start-
 12 up side. So I do think it's getting worse,
 13 unfortunately, because just because of bigness.
 14 MR. LEE: Ross, thank you for all the work you
 15 do. I know, I mean you're one of the, literally,
 16 experts on this through Village Capital and BluePrint
 17 that you're really focused on small businesses.
 18 So one of the questions that we go through,
 19 and I'm sure you do as well, is when you're now
 20 presenting these opportunities in these local businesses
 21 as you're being very clear, right? These are not
 22 unicorns, but they're solid businesses and there's
 23 potential.
 24 One of the common feedback from investor
 25 advocacy groups and interest, sort of interested

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1 personnel rather, they're well-meaning, right, but
 2 they're very conservative investors and they're
 3 basically saying that's high risk, right? Restaurants
 4 go out of business all the time; retail investors should
 5 not invest in such businesses as a blanket category.
 6 How do you address those points and how do you
 7 respond to that? Because I think that's the biggest
 8 barrier to, at least in my personal opinion, these
 9 issues that we have today because you've basically
 10 established institutional capital as a systematic matter
 11 is just not going to invest in these businesses, right?
 12 So we're now thinking about, okay, so who is
 13 the category people who are willing to invest, and the
 14 natural answer is basically retail investors. So how do
 15 you adjust that dynamics in a professional way for the
 16 investor protection kind of considerations?
 17 MR. BAIRD: I think this goes back to my
 18 earlier comment of how important it is to create
 19 categories or asset classes. So, for example, the
 20 Kauffman Foundation, 20 years I think how Kauffman --
 21 what Kauffman views success in this exploration, and
 22 this goes back to Carla's question as well, is 20 years
 23 ago angel investing was not a term. There were a bunch
 24 of rich people around the country who did individual
 25 checks into individual deals, and Kauffman Foundation

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1 said there's a lot of stuff going on around the country
 2 that's more similar than different, and actually it
 3 could be really good for entrepreneurs if this becomes
 4 much more common. So Kauffman founded and funded the
 5 Angel Capital Association; they gave grant funding to a
 6 lot of early angel groups.
 7 Today if I say I am an angel investor, and
 8 you're in the entrepreneur world, you generally know
 9 what that means. But the intentional creation of a
 10 category really, really accelerated that. So I think
 11 there is a type of Main Street business, for instance,
 12 that is riskier but higher return than debt, lower
 13 return but more liquid than equity; it's probably more
 14 similar than different. And if you said this is the
 15 category or asset class that we are investing in, you
 16 know, revenue-based businesses or whatever, I'm not a
 17 branding whiz, but people are, how do we invest in that
 18 category.
 19 So if you said today -- and real estate has
 20 done this incredibly well -- if you said, I like
 21 investing in multifamily housing, people know what that
 22 is versus commercial real estate versus single-family
 23 housing. They all have different risk and return
 24 profiles. I don't think we have that level of
 25 granularity around different types of business investing

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1 and so, you know, one thing in your committee, like, how
 2 do we create and think about and regulate and model
 3 different categories because if there were an
 4 equivalent, you know, if restaurants and, you know,
 5 growing retail and all that are a category 10 years from
 6 now, and say I'd like for you to make an investment in
 7 these type, this category in Houston, people would
 8 understand kind of what that mean. That may not be the
 9 right answer but that's how I've been thinking about it.
 10 MS. HANKS: Thanks, Ross. I think (00:35:51)
 11 is being too modest and he doesn't want to raise this,
 12 but so many of those 83-plus percent companies would be
 13 ideal for crowdfunding and (00:35:59) for a platform
 14 like Youngro's. Do they know that this is a thing? And
 15 is there any way we can reach out so that they know
 16 that's a resource for financing?
 17 MR. BAIRD: I would say the vast majority of
 18 businesses when I've talked to about crowdfunding say
 19 it's just too complicated, why bother. It seems great
 20 but it seems like it's incredibly complicated. I mean
 21 intermediaries like NextSeed that make crowdfunding
 22 incredibly easy for small businesses are very important.
 23 So that's kind of one. I think the intermediary
 24 framework of crowdfunding is not -- I mean I think it is
 25 in the top half of the first inning of what it could be,

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1 and that's really important.
 2 I think the second piece is investor
 3 education. I think that the average -- I mean one thing
 4 that kind of annoys me is there's a huge paternalism
 5 sometimes talking towards investors saying, oh, the
 6 average person doesn't understand how they can make
 7 money off of an equity investment in a company, dot,
 8 dot, dot, therefore they shouldn't. The average person
 9 who has a mortgage, even if they don't have a college
 10 degree, knows that owning a home can build wealth. Like
 11 people understand ownership but I think there has been a
 12 tremendous amount of focus in our economy and as
 13 homeownership is a way you build wealth, business
 14 ownership is not -- there's not the same level of
 15 fluency.
 16 So think just basic, like, here is how you
 17 make money owning your business: either if you work for
 18 a business the employee ownership -- I mean people even
 19 in companies that we have invested in that have goals of
 20 their eventual exit being an ESOP or -- they have a very
 21 difficult time explaining to their employees, here is
 22 why you should take a lower salary in exchange for
 23 equity, in a lot of cases. And so I think there is a --
 24 if we're going to create community wealth, I think
 25 ownership creates wealth a lot faster than income does.

1 And there was a lot of studies around this.
 2 And so ownership as north star is just a really
 3 important concept that is very poorly socialized,
 4 outside of home ownership.
 5 MR. TORBERT: Ross, good to see you again.
 6 MR. BAIRD: Yeah, great to see you again.
 7 MR. TORBERT: I want to ask you a quick
 8 question about the sector buys that occurs because many
 9 instances some of the (00:38:33) focused on tech and so
 10 on. Can you speak to some of the other sectors that you
 11 can find in other areas like the Midwest or the Gulf
 12 where I'm based that are actually -- that do offer high
 13 returns and potential for investment. Manufacturing.
 14 There's a high density of other strong sectors that
 15 exist that are investable but no one seems to focus on
 16 them, and why should they.
 17 MR. BAIRD: Yeah, I mean I do think that there
 18 is a geographic bias of understanding -- investing in
 19 what you know and understand. If you look at what
 20 SoftNet or (00:39:05) has done investing 150 million in
 21 the middle of the country, the investments in the
 22 Mississippi Delta region, you know, from St. Louis up to
 23 Chicago down to Louisiana are much more ag tech,
 24 manufacturing, logistics, and they should be; those are
 25 strengths of the heartland, they tend to be much more

1 consumer-focused in L.A. or, you know, and gov tech in
 2 D.C. And I do think that there is a somewhat
 3 institutional bias that VC investments should be high-
 4 growth consumer tech investments.
 5 But when you have funds that have different
 6 regional winzes, they tend to have very different
 7 portfolios, and I mean one of the things that Kauffman
 8 research shows is smaller funds actually outperform
 9 larger funds. And I think this goes back to the point
 10 that we were talking about, smaller managers are more
 11 motivated to invest in different businesses which tend
 12 to be outliers. But smaller funds also have, I've
 13 found, much more sector diversity than larger funds.
 14 MR. TORBERT: Could you speak to the time
 15 period that you used for that, whether it's 10-year, 20-
 16 year, et cetera?
 17 MR. BAIRD: Ten year.
 18 MR. TORBERT: Yes.
 19 MR. BAIRD: Some of the most interesting funds
 20 I see in the country tend to smaller, tend to be hyper
 21 sector -- I mean there's a fund here in D.C. called Anzu
 22 Partners that basically goes to labs, university towns,
 23 like third and fourth -- I mean cities that are like
 24 18,000. They find the one inventor with the one
 25 technology that it's never come across even with capital

1 and they invest in it and license it, and they've done
 2 remarkable well with, you know, lasers coming out of
 3 national labs that VC wasn't looking at. I mean Rise of
 4 the Rest Fund, this is your exact thesis. So I do think
 5 this kind of answers your question. There's a kind of
 6 homogeneity of large venture funds where competing over
 7 getting in the same four or five deals is just -- it's
 8 not really a free market versus finding the
 9 opportunities that other people aren't.
 10 MR. TORBERT: Would you argue that that
 11 distorts the market --
 12 MR. BAIRD: I think completely.
 13 MR. TORBERT: -- valuation --
 14 MR. BAIRD: Completely, completely. I would
 15 say businesses that are consumer tech on the coast as a
 16 category are overvalued, and if the SEC is listening
 17 this is not investment advice or anything -- you guys
 18 are lawyers, whatever disclaimer --
 19 MS. MILLER: You missed the earlier
 20 disclaimer, on behalf of everyone you're covered.
 21 MR. BAIRD: Okay, great, all right. So all
 22 disclaimers aside, I'd say they're overvalued because,
 23 and if you follow the money because institution LPs are
 24 incentivized to invest in large coastal funds for
 25 various structural reasons we went into, which have a

1 very specific profile so these, you know, these funds
 2 compete over a relatively small number of businesses.
 3 If I've got a very compelling, I don't know,
 4 in San Antonio if I have a very compelling drone
 5 technology in San Antonio, there aren't a lot of funds
 6 that are looking in San Antonio. There aren't a lot of
 7 funds that understand drone technology. It's
 8 systematically undervalued I would say. And I think
 9 that's systemic risk.
 10 I mean if I were a regulator this is how I'd
 11 be thinking about it. And, you know, SoftBank is doing
 12 a great job proving this point. VC funds say we are
 13 diversified and that mitigates risk for institutional
 14 investors. But if you're diversified in a monocrop
 15 culture of companies that are all following the same
 16 playbook and you realize that all of these companies are
 17 heavily incentivized, for example, to bias growth over
 18 profitability, if you hold a diversified portfolio of
 19 extremely risky assets, diversification doesn't matter.
 20 So I actually do think we have systemic risk
 21 in the VC world among mainstream funds because of these
 22 various structural issues that we talked about.
 23 MR. SEATS: And also one interesting side
 24 effect, you get large enough and the largest asset
 25 managers have more lawyers than the SEC and so try to

1 think about an arms race of regulation to change the
 2 dynamic is challenged from the start.
 3 So Ross, I totally agree with your world view,
 4 I think it's a super logical framing. And also you
 5 dropped in a little bit of a history lesson on origins
 6 of private equity and origins of, sort of, angel
 7 investing as a category.
 8 So one question I have, both of those stories
 9 have a similar thread in that the construction of the
 10 new category, the new asset class, happened in the
 11 private market. It didn't start from a regulatory
 12 framework and get pushed down. So think if we could all
 13 agree that, you mapped out hey there's a big opportunity
 14 here and maybe there's something in between debt and
 15 equity, this is different, and we're missing a
 16 nomenclature in a way that sort of categorizes this, I
 17 guess the question I'd have for you is how do you think
 18 about the work of this group and the Commission in terms
 19 of being able to influence how the private market
 20 creates those categories with the way that they invest
 21 and the way that they think about approaching fund
 22 construction and whatever else.
 23 MR. BAIRD: Yeah, I mean I would say something
 24 around, you know, what can you, the SEC as a regulator
 25 do is a very powerful and limited toolkit. So things

1 like the venture capital exemption. The cap of the -- I
 2 believe it's a hundred million, is that right? I'm
 3 turning to my lawyer friend, (00:44:30). So the venture
 4 capital exemption is capped at a hundred million. If
 5 you were to say -- so running the numbers, let's say you
 6 and I are, you know, well-educated white guys and we're
 7 partners at wherever, Mackenzie, and we have some idea,
 8 we go and raise \$100 million, we get 2 percent, you
 9 know, that's 2 million. We're making a million at
 10 Mackenzie. We see this all the time, say, well, we
 11 should pay ourselves what we were making at Mackenzie,
 12 we make a million dollars each, that means we have, you
 13 know, maybe a little bit of money for analysts or
 14 whatever, but there's very little -- there's very little
 15 opportunity for growth in regional or demographic
 16 diversity because venture capital funds are small and
 17 pretty top-heavy.
 18 And if you were to say if you are a fund that,
 19 I don't know -- I mean and there are other regulatory
 20 frameworks from SBA or the Office of the Comptroller of
 21 Currency (00:45:24) Reinvestment Act and qualified small
 22 business credit. If you said, you are a venture capital
 23 fund that invests more than 50 percent in low and
 24 moderate income (00:45:33) tracks or in X, Y, Z excluded
 25 populations, you know, women, people of color, et

1 cetera, your venture capital exemption is now 400
 2 million. I'm just making this up. Something to
 3 encourage the stimulation of smaller funds using SEC
 4 exemption rules or more regional funds or more
 5 economically distressed areas, it's just -- that would
 6 be a line of -- I'm already out planning my coverage, I
 7 don't know any more than I've just said, but something
 8 to encourage smaller funds that go to undercapitalized
 9 places is something to think about.
 10 I think the second thing I would think about
 11 is probably part within the SEC's purview and part
 12 outside, and it's how these funds are regulated and
 13 taxed. So for instance, one of the issues with revenue-
 14 based investing is it's if you structure it like equity,
 15 you make it as capital gains, but it's incredibly
 16 complicated from a regulatory side if you structure it
 17 like debt, it's simple from a regulatory side but it's
 18 taxed like ordinary income.
 19 So people want to go with the incredibly -- so
 20 if you say something around employee ownership or
 21 alternative investment structures have a much simpler
 22 regulatory framework so that people pursue it in a tax-
 23 advantaged way, that would be another thing I would look
 24 at. So just general regulations around fund
 25 construction I would say.

1 And then the third that is who's an accredited
 2 investor, who's a qualified purchaser, are there ways --
 3 because a lot of these things, I mean the venture
 4 capital exemption I don't believe has changed since the
 5 '40s. It was set at a hundred million in the '40s. I
 6 might be -- it was certainly -- it has not kept up with
 7 inflation. So these are -- I know I'm just throwing out
 8 a bunch of bullets for you guys to chase down and it's
 9 easy for me to opine and you to do the work, but these
 10 are systematic things we've observed that you could
 11 actually work on.
 12 MS. MOTT: So Ross, I'm sitting here thinking,
 13 as former chairman of the board of the Angel Capital
 14 Association, I'm thinking about investor behavior so
 15 people feel comfortable investing in what they know and
 16 understand. Then I'm tying that into I went back to my
 17 hometown that I grew up in, it's in northwestern
 18 Pennsylvania, small town of about 11,000. Now at 5,000
 19 because of the decline of manufacturing. And one of the
 20 major companies in that town was Werner Ladder company.
 21 It moved to Mexico and all the jobs went there as well.
 22 And what was interesting to me was tied to
 23 what you were talking about in sectors and people invest
 24 in what they know, a group of people got together,
 25 accredited investors of course, that know manufacturing,

1 got together and put together a framework for a small,
2 that can use that Werner Ladder facility and make it
3 into specialty aluminum extrusion company, maybe saved
4 50 jobs or something like that.

5 So around that thought, if you think about
6 people investing in what they know, would pulled
7 investments with people with expertise in those areas,
8 like you were talking about with real estate, would it
9 make sense to have them, because they know
10 manufacturing, right, be managers. And what we see is
11 those who get involved with companies because they know
12 that industry, help that company, mentor them, make
13 introductions, they tend to be more successful. So
14 along that line, you know, getting professional managers
15 maybe manage that know those industries, right, would
16 probably serve that best.

17 MR. BAIRD: I think this goes to the question
18 of small -- making it possible for smaller investors and
19 smaller funds. It's just that a very large thing for
20 all of you to work. So I completely agree with you. We
21 were working in Austin, Texas earlier this year on a --
22 there are two census tracts in Austin that were
23 historically labeled by the city "The Negro District".
24 That's literally what it was called, on signs and
25 things, in 1928. A hundred years later, there are no

1 health clinics, there are no grocery stores. So there
2 was this -- and there are these retired doctors in
3 Austin who are very familiar with public health
4 challenges. And there was this project where they were
5 trying to get people interested in how to get invested
6 in this community health and wellness effort, and have a
7 health clinic, grocery stores. Very -- very Next Seed-
8 y. It's a cool idea.

9 So there is one guy, a very wealthy guy, a
10 qualified purchaser, very. And he was a retired
11 doctor. He wanted to lead the investment. And we
12 talked to him and he said well, you know, go talk to my
13 wealth advisor in New York City. And I happened to be in
14 New York the next week. And it's like, the guy lives
15 five minutes from the -- and it's like, you have to fly
16 to New York to ask permission to send \$500,000 five
17 minutes east. And the guy said, that's idiotic, that's
18 too risky. Why would he ever do that? Even though it's
19 something that he knew and understood. And so the
20 layers of kind of -- I mean, this guy is worth enough to
21 where losing \$500,000 would not impact his lifestyle and
22 he wanted to do it.

23 And I don't -- I don't -- just the layers of
24 complexity and how money flows in the economy prevents a
25 lot of things like that from happening. And whether or

1 not -- I mean, the Austin thing ended up happening, but
2 there's a -- there's systematic thing. So I think what
3 you're saying is exactly right, and there are layers of
4 regulatory complexity that prevent that story from
5 happening more often.

6 A PARTICIPANT: -- purchasers, there's been
7 sort of a mix. And maybe you sort that money a little
8 to see where you're investing it. Is that something that
9 you would consider?

10 MR. BAIRD: I will tell you a problem that I
11 would love for you to think through solving. Because
12 right now, I don't have a great answer. And it's the
13 story I told earlier about the, you know, young African
14 American professionals in Baltimore who on average have
15 a net worth of about \$250,000, who want to invest in
16 real estate and growing businesses in very poor parts of
17 Baltimore. So you know, we at Village Capital and with
18 partners like Rise of the Rest have invested all across
19 the country. We've gone deeper into a few ecosystems
20 where we've been particularly active. Baltimore is one
21 of them.

22 MR. FOX: Ross, I'm sitting here thinking
23 about this, and I guess I have a couple different
24 thoughts. One, I keep hearing about this, approaching
25 it from hey, we need more individual investors in the

1 marketplace. And I kind of wondered about that because
2 I'm kind of thinking well, gee, if we get more
3 individual investors in the marketplace, well, isn't
4 that just going to -- isn't BlackRock or one of these
5 other big -- you know, how are we going to end up having
6 more individual investors invest in these big uber
7 funds, right?

8 MR. BAIRD: Mm-hmm.

9 MR. FOX: I'm not sure that that's going to
10 ultimately translate into individual investors in FIN,
11 you know, in Kentucky, you know --

12 MR. BAIRD: So, if Andreesen Horowitz and
13 BlackRock form a partnership to say --

14 MR. FOX: Right. Yeah, yeah.

15 MR. BAIRD: -- you, schoolteacher in Joplin,
16 Missouri, can --

17 MR. FOX: Right.

18 MR. BAIRD: -- now invest in Andreesen --

19 MR. FOX: Yeah.

20 MR. BAIRD: -- I don't think that solves the
21 problem --

22 MR. FOX: Right, exactly.

23 MR. BAIRD: -- that we care about solving for
24 policy.

25 MR. FOX: But it goes back to -- I'm trying to

1 think through, okay, how do we get to solving maybe the
 2 question you very articulately posed? How does the
 3 Vietnamese, you know, lady in Paducah, Kentucky, get
 4 funding? And you know, okay, she needed a \$250,000
 5 investment. And you said, you know, very articulately,
 6 the way it is right now is it's easier to do a four
 7 billion dollar fund than a two billion dollar fund.
 8 Well, frankly, even a two billion dollar fund isn't
 9 going to be interested in making a \$250 million (sic)
 10 investment.

11 MR. BAIRD: Never, yeah.

12 MR. FOX: It's too big -- I mean, too small.

13 MR. BAIRD: Mm-hmm.

14 MR. FOX: You know, even on a \$250 million
 15 (sic) investment in Paducah, Kentucky, what I'm thinking
 16 is gee, the deal cost alone had to eat up a lot of your
 17 investment cost, right?

18 MR. BAIRD: Mm-hmm.

19 MR. FOX: And I'm just wondering, as I'm
 20 thinking it through the role of this committee and the
 21 role of this SEC, are there some things around the role
 22 of technology and regulation that could be reducing the
 23 role of deal costs?

24 MR. BAIRD: Completely.

25 MR. FOX: Right? If I think through, are

1 there ways that technology and other things could be
 2 going on? Could there be kind of standard agreements?
 3 Could there be standard ways of introducing investors
 4 through technology and other things, right? We're
 5 getting -- I don't want to -- I know there's a lot of
 6 attorneys at the table. But getting some of the
 7 attorneys out of the process. Getting things like that
 8 to where you could do a \$250,000 investment with little
 9 cost, or you know, reduce costs to where you're not
 10 having to spend \$50,000 or more to do a \$250,000
 11 investment to where the hurdles, the investment hurdles
 12 just aren't so high to overcome.

13 MR. BAIRD: Mm-hmm. Mm-hmm.

14 MR. FOX: Because it seems to me that that
 15 might be one of the biggest barriers, right, to prevent
 16 a lot of that. And I'm wondering if what isn't maybe a
 17 lot of the barrier to a lot of these things -- and maybe
 18 I'm completely wrong -- isn't just that gee, it's just
 19 so hard to overcome the transactional costs to do a
 20 \$500,000 investment even though it's a decent deal in a
 21 non-traditional bankable you know, deal for a \$500,000,
 22 \$750,000 investment, it's just not worth it.

23 MR. BAIRD: Mm-hmm.

24 MR. FOX: And I'm wondering if there's some
 25 things to be thinking about, using you know,

1 modernization technology and other forms of regulation
 2 to reduce that. To reduce those barriers. And advancing
 3 that so we can actually then bring more capital to those
 4 transactions.

5 MR. BAIRD: Yeah. I mean, one thing that
 6 Kauffman thinks a lot about is some -- did I ever --
 7 something like a FICO score for small businesses. So
 8 this is something that has happened -- if you look at
 9 how the FICO score evolved historically. A lot of banks
 10 have their own propriety algorithm and you know, in the
 11 '50s and '60s, and there was clear regulatory guidance
 12 and there was some kind of public engagement. But it was
 13 generally seen to be a good thing if there were a way to
 14 compare credit. And there are all kinds of FINTEC
 15 companies out that say the FICO score is problematic and
 16 we have ways to improve on it, and that's all justified.
 17 But getting, having a FICO score that was generally
 18 agreed upon by lenders played a major role in expanding
 19 home ownership in the U.S. as a positive outcome that
 20 seems like the kind of thing this committee would want
 21 to talk about.

22 So if we were to say something like here is
 23 Fin Gourmet in Paducah, and their business FICO score
 24 equivalent is 760 out of 800 and these are the five ways
 25 that everyone looks at it, that would cut some element

1 of the transaction costs quite a bit.

2 MR. FOX: Well, but also there's a standard
 3 mortgage contract and you know, typical closing attorney
 4 costs are a couple hundred bucks now --

5 MR. BAIRD: Right.

6 MR. FOX: -- or a thousand dollars, right, and
 7 it's not a customized contract anymore, and that sort of
 8 thing too. Right? I think there's a number of
 9 different things that go along with home ownership in
 10 addition to the FICO score as well, right? And I'm just
 11 trying to think through, I think there's a lot of
 12 different things, right? If I think through all of the
 13 probably things you did as you made your investment,
 14 right?

15 MR. BAIRD: Yeah. I mean, it was, it was
 16 insane.

17 MR. FOX: Yeah. It was insanely complicated,
 18 right? And I'm just not sure -- I mean, my guess is if
 19 you had the passion for making that investment, it's
 20 probably not replicable.

21 MR. BAIRD: Right. And we had a -- you know,
 22 we had an attorney who happened to have grown up in
 23 Paducah, and he did an insane amount of pro bono work
 24 just because he personally loved this story, and that's
 25 not a replicable story. But I think that what you're

1 saying about standard mortgage contracts -- I mean, in
2 the '60s the U.S. -- I mean, the policy -- this is more
3 of a values question than a technocratic question, but
4 in the '60s the U.S. said home ownership is a national
5 goal. We are going to do a number of things at the SEC
6 and at HUD to make home ownership easier. And whether or
7 not that is a valid policy goal is a policy question.

8 MR. FOX: Right.

9 MR. BAIRD: But if you say our goal is to
10 remove barriers in access to capital for small
11 businesses across the government, that is a policy goal.
12 And if you do that, you're right, there are 20 different
13 things that could reduce the transaction costs from five
14 figures to hopefully three that are steps I think this
15 committee would, I think, be well-served to spend some
16 time talking about.

17 MR. FOX: Okay. Because again, I just think
18 that if we're thinking through this, I just don't know.
19 If we don't contemplate that as well -- I think we can
20 talk about all these other issues, but if we're talking
21 about hey, how do we get these small businesses -- you
22 know, we're never going to address how do you really,
23 realistically get to -- and maybe it's crowdfunding and
24 how do we get to make that easier and other things. But
25 yeah, that's a technology play that maybe again, reduces

1 If you -- if the money -- if you -- if there were, if we
2 were to create a regulatory regime or recommend a
3 regulatory regime that would enable you to access
4 capital from non-accredited investors with the safe
5 harbor or maybe in conjunction with a certain amount of
6 qualified purchasers, in sort of a mix -- and maybe you
7 sort of set money a little to see where you're investing
8 it. Is that something you would consider?

9 MR. BAIRD: I will tell you a problem that I
10 would love for you to think through solving, because
11 right now I don't have a great answer. And it's the
12 story I told earlier about the, you know, young African
13 American professionals in Baltimore who, on average,
14 have a net worth of about \$250,000, who want to invest
15 in real estate and growing businesses in very poor parts
16 of Baltimore. So you know, we at Village Capital and
17 with partners like Rise of the Rest have invested all
18 across the country. We've gone deeper into a few
19 ecosystems where we've been particularly active.
20 Baltimore is one of them.

21 Baltimore's racial history, history of
22 institutional racism, redlining, et cetera, has left a
23 very unequal city. And it is right now kind of a
24 noblesse oblige, almost a philanthropic mindset where
25 wealthy white people in Baltimore will from time to time

1 the cost of capital again. But it just seems to me that
2 if we don't address some of these other things, we're
3 never, these smaller deals are never going to happen
4 because they're just going to be too expensive because
5 of the transactional costs in them, so.

6 MS. GARRETT: I also wanted to ask or think
7 about --

8 MS. PATODIA: Hey, guys, this is --

9 MS. GARRETT: Go ahead, on the phone?

10 MS. PATODIA: Hey, guys, this is Poorvi.

11 MR. SEATS: I had a quick question. Sorry.

12 MS. GARRETT: Go ahead.

13 MR. SEATS: All right. Real quick. Can you
14 just tell me where your capital comes from?

15 MR. BAIRD: In the funds that I've started,
16 it's primarily qualified purchasers so, and
17 institutions, so the aims of what I've done in my career
18 are democratic. The sources of capital are not. So I am
19 I think living the exact issue for a lot of things that
20 we're talking about, that we're talking about here. So
21 a lot of, a lot of my observations are definitely borne
22 from experience of what we're trying to do with money
23 we've raised and the restrictions around the type of
24 money we can raise.

25 MR. SEATS: Well, let me ask you a question.

1 give a little bit of grant funding to entrepreneur
2 incubator programs. But not put real money in. But if
3 you talk to young African American professionals in
4 Baltimore, they would like to invest real money in,
5 like, their actual nest egg into the black neighborhoods
6 of their city, A, because they think as a financial
7 decision they're very undervalued. B, they're very kind
8 of personally motivated. So I talked with a group of
9 them yesterday. They're neither credited investors nor
10 qualified purchasers. But I mean, they're securities
11 lawyers. They're highly sophisticated investors. And
12 currently there is no way to make money flow.

13 So I use that as kind of a focusing anecdote.

14 You know, getting the shopkeeper in Baltimore to invest
15 \$25 into a \$20 million Baltimore fund is probably the
16 next step. And that's actually you know, the current
17 step for NextSeed and others. But I think for me, like,
18 getting, you know, upper middle class, you know, whether
19 it's -- whether its Baltimore or Kansas, getting upper
20 class people from places that are not well-capitalized,
21 that are not accredited investors or qualified
22 purchasers to invest in the business growth of their own
23 city or community is -- I think there is appetite for
24 that today all across the country, and the regulatory
25 framework makes it extremely difficult today.

1 A PARTICIPANT: And let me -- let me ask this
2 question. Not to throw more regulation on you, or any
3 regulation on you for that matter. But if you -- if you
4 had to -- sort of maintain certain licensure that
5 qualifies you to take money from non-accredited
6 investors, would you do it?

7 MR. BAIRD: I mean, I would say -- this is
8 just one opinion. I'd say, frankly, there's a reason
9 why we've chosen, out of the funds that I've started, to
10 go the qualified purchaser route. I think the licensure
11 standards are cost-prohibitive for what we're trying to
12 do.

13 MS. GARRETT: Poorvi, did you have a question?

14 MR. BAIRD: Go ahead.

15 MS. GARRETT: Poorvi, did you have a question?

16 MS. PATODIA: Yeah, this is Poorvi. Yes. I
17 just wanted to go back to a comment that was made
18 earlier, and to make sure that I'm understanding what
19 you're saying, but also to talk about it, whether I'm --
20 someone made the comment earlier that having more
21 individual investors in the market would not help. And
22 I'm curious about that comment and what you meant by
23 that.

24 MR. BAIRD: Robert, I think -- I think --

25 MR. FOX: Well, I mean, I guess I made the

1 comment. I guess I'm just saying that -- well, my
2 concern is, is that with some of the lobbyists and other
3 parties in play that you know, if I think about the big
4 players in the marketplace, if we allow just more
5 individual investment into quote, "private equity" and
6 venture capital and things like that, then some of the
7 large institutional money management firms may just --
8 you know, we may just get more individual ownership into
9 the larger private equity -- you know. I mean, KKR and
10 some of the other larger private equity firms already
11 allow individual ownership and we may just get more, you
12 know, individual ownership into Andreessen Horowitz and
13 you know, some of the others. Carlyle and some of the
14 other earlier stage funds, right? And so I guess my
15 point is, is that I'm not sure that to quote Chairman
16 Clayton's point earlier, that you know, quoted my 401(k)
17 if I have a private equity option, that that's
18 necessarily going to always be invested into the you
19 know, you know, Kentucky Blue Fin Company, right? It
20 may be invested into more institutional private equity
21 type options, right? That was the point I was trying to
22 make.

23 MR. BAIRD: Well, when you're looking on the
24 menu, it's Kentucky Blue Snapper.

25 MR. FOX: Oh, sorry.

1 MR. BAIRD: And please order it if you see it.
2 It's really delicious. But no, I think your point is
3 well-taken. I think this is the policy question. The
4 goal -- you know, I view crowdfunding and expansion of
5 the accredited investor definition is really a means to
6 an end. And if you guys do a tremendous amount of work
7 and make a big policy change and the outcome is, you
8 know, BlackRock and Carlyle partner to get you know,
9 Maria from Joplin, Missouri to invest in Carlyle, I
10 think that that's not the policy goal. The policy goal,
11 the North Star, should be how do you get more
12 investments in Lula from Paducah, Kentucky. And so I
13 think your point's well-taken that you know, expanding
14 investor base is a tool but not a goal. And policy is
15 about accomplishing goals and figuring out the tools you
16 push and pull to get there.

17 MR. YADLEY: Ross, do you think it's -- it is
18 a requirement that --

19 MS. PATODIA: Yeah, I mean, I just --

20 MR. YADLEY: Go ahead, Poorvi.

21 MS. PATODIA: Yeah, I was just going to say,
22 you know, speaking as an entrepreneur and a woman who's
23 founded a business and done multiple rounds of financing
24 starting with a seed round and later a Series A round
25 and then two years later a Series B round which I just

1 closed, and having worked with different types of
2 investors, both friends and family as well as angels and
3 as well as VCs, I mean, I just -- I don't know that -- I
4 don't think that we're -- when we -- at least in my
5 head, when I think about expanding the base of the
6 number of investors that are available, I don't think
7 that it's automatic that the people that we're talking
8 about here, that if they suddenly have the ability to
9 make an investment that they're going to go to these
10 large PE firms and track. Many of those don't even know
11 about those large PE firms, right? So, I guess I'm just
12 saying that that assumption in itself I don't know if
13 that's literally correct. Because I think, when I think
14 about my challenges as an entrepreneur raising money,
15 especially before we were large enough or could
16 demonstrate the types of growth that is required for VC
17 investment, you know, the biggest problem is -- the two
18 biggest challenges are that you don't know where to
19 start. You don't. As a first time CEO, you don't know.
20 You haven't done this before.

21 And then the two -- the second part is, you
22 don't know who to go to. You don't know who to raise
23 money from.

24 MR. YADLEY: Mm-hmm.

25 MS. PATODIA: And the people around you are

1 not -- cannot or do not meet the definition to become an
2 investor. All the stuff about deal costs, all the stuff
3 about, you know, some of the other things that we're
4 talking about, I think they do meaningfully impact the
5 end result, but I don't know if those things are the
6 things that are preventing someone from raising money.
7 Ultimately it is about access to capital, who you can
8 raise the money from and how to do it.

9 MR. YADLEY: Ross, thank you for being here.
10 I'm on the advisory board of the entrepreneurship
11 council of the University of South Florida which you all
12 support.

13 MR. BAIRD: Excellent. That's good.

14 MR. YADLEY: And it's great, and it's been
15 very helpful. I think we have to separate out two very
16 different things that we're talking about. One is the
17 Chairman's desire to allow Main Street investors to have
18 opportunities for investments. So to that extent,
19 getting individual investors into KKR and Carlyle is a
20 worthy goal, and there's no reason that we shouldn't
21 support that and make that easier. The harder one is
22 the access to capital. And one of the hurdles, frankly,
23 is paternalism. And that is a very understandable
24 attribute for a regulator to have to worry about. And
25 you can see in the comment letters that are less

1 supportive of the concept release than others that
2 people are going to get ripped off by fraud.

3 MR. BAIRD: Mm-hmm.

4 MR. YADLEY: And that's absolutely true. It
5 will happen. It happens to accredited investors and
6 qualified purchasers every day and it will happen to
7 middle America investors too. So the way that works
8 best in the marketplace is the Paducah, Kentucky story
9 and a million other stories of local investment.

10 MR. BAIRD: Mm-hmm.

11 MR. YADLEY: Because one of the things that
12 the crowdfunding, the way it came down from Capital
13 Hill, didn't really address the local pizza shop that
14 was on the border between Kentucky and Ohio, so the
15 intrastate exemption didn't apply and things like that.

16 There's no way that we can -- and therefore we really
17 shouldn't -- prevent people losing their money. We
18 don't do that in the public markets. We address it by
19 disclosure and independent boards and things like that.

20 And I think that same framework can work. I'm not sure
21 that we can, without a policy initiative, get to the
22 home ownership analogue for businesses where you could
23 cut out the costs and just give people alternatives
24 within that large asset class.

25 So some of the things we've talked about,

1 including lead investors and pool investments and things
2 where the lawyer that knew Paducah and really cared, or
3 the entrepreneurs, the professionals in Baltimore that
4 they live there, and yeah, they could lose their money
5 but they're investing in a neighborhood they can see,
6 and they can look people in the eye. And it's the old
7 why general solicitation wasn't -- wasn't available is
8 that people had the opportunity to get the information.
9 So I think the things that we're discussing that will
10 allow people that don't have the time or the expertise -
11 - and it's in -- whatever we do to the accredited
12 investor definition, and I hope we do a lot to enhance
13 it -- it still won't allow everyone to have the
14 individual ability to completely understand what it is
15 they're investing in. So therefore a focus on who
16 invests at the purchase stage, a lead investor or some
17 other mechanism that allows diligence and full
18 disclosure will be a real pathway I think to helping the
19 system.

20 MR. BAIRD: You know, one -- you brought up a
21 lot of great points. One point that I think about a lot
22 is the risk of fraud does significantly decline when it
23 is local. When there are reputational risks and personal
24 fallouts. You're ripping off a bunch of people that you
25 know and you're going to have to continue to deal with.

1 And as I think about -- you know, there are a lot of
2 conversations around regulatory sandboxes and pilots.
3 And I do think there might be -- and I think -- and
4 Youngro has been right in this -- Texas and Georgia are
5 two states that have done a lot of experimenting with
6 intrastate crowdfunding with, I would argue, much more
7 success than not, but the local nature has really driven
8 that. I would say if you figure out things like
9 regulatory sandboxes or pilots that are distinctly
10 local, that would be a good thread to pull on. One
11 thing, if you look at the history of, I mean, why the
12 SEC was created was a bunch of people in Kansas City got
13 ripped off by people in New York leading up to the stock
14 market crash. I cited how entrepreneurial activity is
15 at a 100 year low. Entrepreneurial activity in the 40s
16 and 50s is the highest we've seen, and in part because -
17 - and I'm not advocating for a return to this but I
18 think there's an illustrative lesson. Banks in New
19 York, old school folks call them money center banks. And
20 it's because you literally sent your money from Kansas
21 City to Chicago to New York to buy stock. It would pool
22 there. And there was as part of the New Deal a
23 prohibition on sending money from one bank to another.
24 So Commerce Bank in Kansas City, in order to make money,
25 had to find businesses in Kansas City to lend to in

1 order to make money. And so there was a real
2 localization of capital coming out of the New Deal, from
3 a regulatory standpoint.

4 And you saw immense increases in
5 entrepreneurial activity. And not all of that is
6 attributable to that, but you know, it was post war and
7 boom and all of that. But there is, A, there's a real
8 thread of the things that a regulator might be worried
9 about are mitigated locally. And most money in -- if
10 you -- most money coming from these invested areas is
11 not invested there, and something around that thread
12 would be worth -- worth pursuing.

13 MS. GARRETT: Thank you, Ross. We appreciate
14 all of your thoughts and comments. And I think that
15 today we're going to follow up on a lot of the different
16 points that you've raised and a lot of the different
17 points that the people on the committee have raised, and
18 it's going to provide a great discussion for our session
19 today. So thank you very much for joining us.

20 MR. BAIRD: I appreciate it. Thanks for
21 inviting me. And sorry to deprive you of open mic with
22 the Chairman. That's --

23 MS. GARRETT: I'd also like to welcome
24 Commissioner Peirce, who has joined us.

25 COMMISSIONER PEIRCE: Thank you. It's a

1 internet. And we focused on that, and not these other
2 buzzwords, because as a practical matter, the issues
3 that we're talking about is in fact able to be addressed
4 we think more effectively in the context of online
5 sales. Because if you sell securities online, you are
6 number one, increasing transparency by definition,
7 right? It is much harder to commit fraud, for example,
8 when everything is online for people to check, versus
9 one on one meetings. And that was obviously the
10 definition and the intent for the Jobs Act. The other
11 part was because it enables technology. And when you
12 use technology -- I think some other folks have made
13 this point -- you're reducing the actual transaction
14 costs of doing the deal, whether its in the form of
15 investment agreements or diligence or what have you.
16 And the point of this enterprise -- or let's just say
17 this industry of online securities sales, as guided by
18 the SEC and the Jobs Act, was in fact the system that
19 Congress and the SEC tried to institute to help address
20 some of these issues that we are talking about today.

21 So the subcommittee members, I really want to
22 thank Sara Hanks, Catherine Mott, Jason Seats, Hank
23 Tobert and Greg and Mark from the agencies, as well as
24 Carla and Jeff, who participated. We met several times
25 or virtually met and talked over it several times since

1 delight to be here. I spent part of the weekend
2 watching the part of the last meeting that I had missed.

3 And I was just really impressed at the quality of
4 discussion and the efficiency with which you operate.
5 So I'm looking forward to more of that today.

6 MS. GARRETT: Thank you. The next item I'd
7 like to turn it over to is to Yougro Lee. During our
8 August committee meeting, we created a subcommittee to
9 explore segments of the harmonization release. And
10 Youngro graciously offered to chair the subcommittee.
11 He's going to give us a brief overview of some of the
12 ideas that were discussed by the subcommittee that
13 should form a foundation for our discussion of
14 harmonization and following up on what Ross had to say
15 earlier. Thank you.

16 MR. LEE: Thank you so much, and thank you
17 guys for really paying attention to this idea. I think
18 it's a really important one that I've personally been
19 involved with as well as several other folks on this
20 committee. I think it gets less attention because we
21 get kind of bombarded by the headlines of the big
22 companies and so on. And we really missed the point
23 which Ross was really great at explaining.

24 So the subcommittee that we formed, we called
25 it the subcommittee on selling securities over the

1 the last meeting, including just really critically
2 thinking about these issues. So I'm just going to
3 highlight a few of the items that we agreed. Actually
4 it's on this list right now, so I'll try to summarize
5 into these five points. And I think throughout today
6 we'll be discussing each of these topics a little, a
7 little further.

8 So the first was -- and we summarized in words
9 here, but I will just give you the full phrase. SEC
10 should cease regulation of offers and focus only on the
11 actual sales of securities, since there is no practical
12 harm caused by mere offer of investment opportunities.

13 Well, the first thing is harmonization. I
14 mean, that is the catch all for everything. So
15 harmonization will be basically going off, going off
16 based on the SEC harmonization rules and then kind of
17 summarizing all these things we talked about. The
18 second point was the regulation of offers and sales that
19 I talked about.

20 The third point was the definition of
21 accredited investors. And essentially, to encourage
22 participation of more investors into the startups and
23 small businesses that we're focused on, by changing the
24 definition of accredited investors.

25 The fourth point was really the other side of

1 it, which is the non-accredited investors. Regardless
2 of how you define accredited investors, there's always
3 going to be a group of people that are not that. So how
4 do we help these investors access? And that is in the
5 construct of Regulation crowdfunding and Regulation A,
6 which literally is the mechanism that is in place. So
7 we don't need to invent new things. It's been in place.
8 And the issue, the more practical solution that we're
9 trying to come up, how do we modify at least some parts
10 of it, so it's not something starting from zero.

11 And the final point really is about the pooled
12 investment. And the issue of gatekeeper obviously
13 overlays everything we just talked about. But how do
14 those particular concepts interlay? How does, for
15 example, pooled investment funds -- could that be -- I
16 don't want to use the word "compromise" but could that
17 be at least one solution that addresses both the
18 business focus on trying to bring access to the capital,
19 as well as investor protection concerns?

20 So, that's a summary of the major points that
21 we discussed on the subcommittee. And again, I'm really
22 grateful for Carla and the committee for giving us the
23 opportunity to discuss these in detail.

24 MS. GARRETT: Thank you. And I will say that
25 the subcommittee kind of evolved, not only talking about

1 investors can invest. And some exemptions limit the
2 amount certain investors can invest, and some exemptions
3 don't.

4 And the commission has asked us as a committee
5 to provide input on this exempt offering framework as a
6 whole, and whether or not we believe it could be more
7 concise and less complex. And they've also asked for our
8 input on specific conditions that -- to each of the
9 current capital raising exemptions, and whether those
10 exemptions are appropriate to helping small businesses
11 raise capital.

12 I'm also just going to provide a really brief
13 introduction to 506, because 506, as everyone knows,
14 under Regulation D, is the most commonly used private
15 placement exemption. And I would say in my experience,
16 it's used not only by companies seeking large amounts of
17 money, but it's also used by small, small companies
18 obtaining smaller amounts of money. And if you sell to
19 only accredited investors in 506(b) then you can have an
20 unlimited number of accredited investors. There's no
21 limit on the amount of money that can be raised,
22 provided that there's no general solicitation or
23 advertising, and they're not subject to specific
24 disclosure requirements. If you include one non-
25 accredited investor in a 506(b) offering, then you now

1 selling securities over the internet, but then we became
2 just talking about the harmonization release in general.

3 And so, a lot of the points we'll be talking about
4 today don't necessarily fall into just selling
5 securities over the internet, but they do fall into just
6 the harmonization release. I'm just going to kick it
7 off. What we're hoping to have between now and
8 lunch, which will be in a little bit over an hour, is a
9 pretty broad discussion on different aspects of the
10 harmonization release. We will also have time this
11 afternoon to continue our discussion. I'm going to kick
12 it off on the very high level of just what the
13 harmonization release is conceptually.

14 You know, the SEC took a broad review of the
15 available exemptions and they seek from us our input, in
16 order to assess whether the current exempt offering
17 exemptions are consistent, successful and effective for
18 small businesses wishing to raise capital.

19 A couple points to note is that the current
20 exemptions have a variety of very diverse requirements.

21 Some limit the amount of securities that may be sold.
22 Some limit the manner in which they can be sold, so that
23 there's no general solicitation. Some exemptions have
24 information disclosure requirements. Some don't. Some
25 exemptions limit who can invest, so that only accredited

1 have information disclosure requirements. And the rule
2 under 506(b) states that you can have not more than 35
3 non-accredited investors.

4 I think that a lot of comment letters have
5 discussed how it is costly to bring a non-accredited
6 investor into a 506(b) offering. And so I think that
7 that would be a good thing for us to discuss today.
8 Also a lot of the comment letters talked about how
9 506(b) is working for accredited investors in its
10 current state. And so, if we look at 506(b) we might
11 want to think about maybe whether we change it or
12 whether we keep it as is and we broaden it in different
13 aspects.

14 I just want to also note 506(c) which is where
15 an unlimited number of accredited investors can also
16 invest, but there can be broad general solicitation in a
17 506(c) offering as long as all of the purchasers are
18 accredited investors. The one issue with the 506(c) that
19 has come up is that an issue owner has to take
20 reasonable steps to verify a purchaser's accredited
21 investment status. And if you read the comment letters,
22 it becomes clear that issuers also often don't want to
23 take these steps or find it burdensome to take these
24 steps. So 506(c) is not being used as much as 506(b).

25 With that brief introduction, I wanted to open

1 it up to the Committee. I want to also point out that
 2 we're going to -- we could simultaneously have -- I
 3 think Catherine was willing to talk a little bit about
 4 the accredited investor definition. All of these items
 5 go together. Because if you -- if you tweak the
 6 investor, accredited investor definition, then that
 7 means that more people could fall into the 506(b)
 8 category. Sarah is going to talk about whether the
 9 offer should be exempt, and that definitely can impact
 10 whether or not general solicitation comes into play.
 11 And when we get, later on this afternoon, into the
 12 pooled investments, that can be a great way to get non-
 13 accredited investors possibly into the market. And
 14 Youngro is also going to be discussing Reg A, Reg CF and
 15 other ways to get non-accredited investors into the
 16 market. So with that, I'll open it up to the committee.
 17 COMMISSIONER PEIRCE: I'll just start just
 18 with one observation, just to reflect what you were
 19 mentioning about the comment letters. In our office,
 20 many of whom are seated right here today, when we have
 21 been out and about and leaving D.C. and talking to
 22 businesses and investors, one of the things that we
 23 consistently hear is one, a reflection of the local
 24 nature of investing and how most capital starts out
 25 local. You may move into raising capital from those who

1 are further away that don't know you. They don't know
 2 the business. But it tends to start more locally, which
 3 our speaker just conveyed. But one thing I'll just say
 4 as a starting point as we talk about the framework, kind
 5 of terrible analogy, but I love terrible analogies.
 6 They've kind of become one of my favorite things. Is if
 7 you think about, we have a garage full of different
 8 types of vehicles. You have everything from bicycles to
 9 motorcycles to maybe a golf cart and then a car, and
 10 each of them can take you to different destinations at
 11 different speeds with different capacity load. I think
 12 that there's a lot of people who, as they look at it,
 13 they see problems with each of them. They see that the,
 14 you know, the speed regulator on the motorcycle, they
 15 wish you could take that off. They might wish that you
 16 could put, you know, a carrier seat on the back of the
 17 bike to bring an extra passenger along. But they're
 18 very worried that you're going to mess with the family
 19 vehicle that they use day in, day out, and the one that
 20 is consistent and that has been a reliable resource.
 21 And that's something that we have heard reflected.
 22 So as we think about the tools that are
 23 available, I think it is important to think about, not
 24 only as we were talking earlier about kind of the top
 25 down size of the funnel and the capital that goes in but

1 also the bottom of the funnel and where the money is
 2 going out. And how companies start out raising capital
 3 and then how they scale in to other sources of capital,
 4 and making sure that we don't have kind of a singular
 5 angle view, nor are we looking at only one of the
 6 vehicles that is in the garage, and instead thinking
 7 about all of the different tools that are available,
 8 because they do have different utilities, and making
 9 sure that they're all optimized, so that different
 10 companies and investors can get to their destination
 11 efficiently and effectively. So that's just a
 12 reflection of what we've been hearing. I thought it
 13 would be important to share it. It backs up a lot of
 14 what we've seen in the comment letters.
 15 MS. GARRETT: Very well said. Thank you,
 16 Martha. Catherine, would you like to talk about the
 17 accredited investor definition?
 18 MS. MOTT: Sure, I'd be happy to. I was
 19 planning to sort of introduce this as the accredited
 20 investor definition, which is a central component of
 21 several registration exemptions. It serves as a proxy
 22 for an investor's financial sophistication and ability
 23 to fend for itself. Accredited investors have
 24 significantly more access to the ability -- or more
 25 access to a wider range of investment opportunities,

1 compared to non-accredited investors. Therefore, the
 2 release -- the harmonization release solicited input,
 3 among other things, whether additional categories should
 4 be included as accredited investors, whether existing
 5 financial threshold requirements should be adjusted and
 6 whether alternative sophistication measures should be
 7 used to qualify investors as accredited. And whether a
 8 broader range of investment opportunities should be made
 9 available to non-accredited investors. So I'm going to
 10 give you some thoughts that might even -- not might but
 11 will reinforce what Ross has mentioned already.
 12 It's well-known by economic development
 13 professionals and economists that all net new jobs in
 14 the United States are created by companies five years
 15 old or less. And accredited investors play a key role
 16 in this. And I think Martha was just mentioning this
 17 about talking to the local people and how much more they
 18 are involved in the early side. So accredited investors,
 19 now known as angels, provide 90 percent of outside
 20 equity for the early stages of company development. On
 21 average, annually, they invest in 70,000 new companies,
 22 somewhere around an annual average of \$25 billion a
 23 year. Now, just for perspective, venture capital
 24 provides most of the later stage capital. That
 25 assistance scaling the company, around 7,000 to 8,000

1 companies annually, but around \$70 to \$80 billion
2 annually.

3 But unlike venture capital, where 80 percent
4 is deployed in California, Boston and New York City,
5 only 45 percent angel capital is concentrated in those
6 three locations. The remaining 55 percent is invested
7 in flyover regions. And as you heard today, angels
8 invest in their own backyard and are very active in
9 regions hurt most by structural changes, like the demise
10 of manufacturing, loss of jobs due to automation and in
11 regions recovering from the great recession.

12 These angels are not investing in Uber or
13 WeWork or other such unicorns, but are investing in
14 companies like Wombat, Inc., which was a cyber security
15 -- which is a cyber security solution which started with
16 five employees and can now account for over 300 plus
17 employees. The Angel Capital Association supports
18 expanding the pool of angel investors to include those
19 with professional experience and professional
20 certifications like CFA, CPA, MBA, JD, Series 7
21 securities. They're just a few examples to consider.
22 The education and experience of such individuals can
23 easily assimilate the information required for sound
24 investment decisions.

25 Also, the ACA recommends a "do no harm" by

1 writing the checks. One of the things we think -- we
2 don't know for sure but we think -- is that the reason
3 that these -- that individuals are willing to risk their
4 capital on the lower wealth spectrum is that they're
5 interested in gaining more wealth. They're willing to
6 risk some to gain more wealth. Whereas those who are at
7 the upper end or in the -- they're in family offices.
8 People are managing their money. They're all about
9 thinking about how do I retain this wealth, versus how
10 do I create more wealth. So that behavior of active
11 accredited investors tend to be on the lower end
12 spectrum.

13 A 2017 McKenzie study on the future of work
14 suggests the following: sustaining robust aggregate
15 demand growth is critical to support new job creation,
16 as is support for new business formation and innovation.
17 Fiscal and monetary policies that ensure sufficient
18 aggregate demand as well as support for business
19 innovation and business investment will be essential. It
20 behooves us to expand the definition and considering
21 that a one size fits all is impractical for regional
22 economic dichotomies. Furthermore, China has gained
23 significant ground at a remarkable rate in advancing
24 innovation and encouraging capital investment in
25 multiple sectors, and the United States is falling

1 retaining the financial criteria for an accredited
2 investor and leaving the thresholds unaltered. If the
3 income and net worth criteria are increased, the flyover
4 regions of our country will be hurt the most. Cost of
5 living in Saint Louis, Missouri cannot be equated to the
6 cost of living in New York or San Francisco. A \$200,000
7 annual income in Saint Louis likely equates to \$450,000
8 in New York City, and a net worth of a million in middle
9 America is likely to be equivalent to about a \$2.5
10 million net worth in New York City and San Francisco.

11 And most importantly, nowhere in our country is
12 investment more needed than in middle America. It is
13 imperative that we don't damage the ecosystem that is
14 helping distressed regions slowly recovered. An example
15 of such stories are prevalent in Greenville, South
16 Carolina, Detroit, Michigan, and Saint Louis, Missouri.

17 These regions have active angel groups investing in
18 startup and consequently are even attracting VCs looking
19 for opportunities in underserved cities, like Rise of
20 the Rest.

21 If the thresholds are raised to the Dodd Frank
22 recommendations, the Angel Capital Association as well
23 as the OCC have previously estimated a reduction of
24 about 60 percent active accredited investors. I say
25 active, not qualified, active. The ones that are

1 behind. So I hope today we can deliberate on meaningful
2 changes to mobilize more investors and accelerate the
3 economy of the United States. But I do -- and I do see
4 the 35 unaccredited investor definition, the additional
5 disclosures is, I think, a problematic issue for
6 advancing this.

7 MS. GARRETT: Thank you, Catherine.

8 MR. SEATS: In terms of trying to make
9 progress and structure that conversation, just something
10 that's occurred to me just sort of reading through notes
11 on the comment letters is there's really a couple
12 different baskets of change that are being proposed.
13 And so I'll throw out how I think about it, and it may
14 help, it may not. One are what I'd think about as maybe
15 incremental changes to the existing definition.
16 Examples are things like, including you know, primary
17 residence towards the net worth calculation, or moving
18 towards percent of net income for you know, versus,
19 versus a wealth or a dollar, right? So the -- so, like,
20 those are sort of minor changes. Then there's a whole
21 set of the recommendations that fall into the category
22 of testing for sophistication in a different way, either
23 because it's a knowledgeable employee or some sort of
24 testing or some other framework. And then there's a
25 whole other category which is assuming accreditation

1 under, because of the circumstances of how you're
2 investing. So either because the vehicles that you're
3 being pooled into have either direct or indirect
4 regulatory regimes that provide investor protections, or
5 there are co-investors who are investing on same terms
6 alignment who are sophisticated. I think of those as
7 sort of three different paths. I mean, I don't know if,
8 where the viewpoint is in the room on which ones feel
9 like no brainers, which ones there's a lot of work to do
10 or if there are other categories besides those broad
11 three.

12 MS. MOTT: So one of the things, Jason, had I
13 not lived through the Great Recession here '08, '09, and
14 I was actively involved in a business and saw what
15 happened -- when they did add the -- you know, or
16 eliminate the value of your home as net worth, I would
17 not add that back in. I would not. I would say a
18 residence should stay excluded. And even before that was
19 excluded, when people would join our group I would tell
20 them hey, your financial advisor recommends that this
21 asset class should be no more than 10 percent of your --

22 MR. SEATS: Right.

23 MS. MOTT: -- investable assets. And I say,
24 your investable assets. Your home is not an investable
25 asset. So I'm reluctant to, you know, to say oh, yeah,

1 let's put that back. And that's just because I -- you
2 know, I saw what happened with the Great Recession. I
3 will tell you this. The more resistance there is to -- I
4 guess to validate your sophistication, I think the less
5 people you'll get involved. I mean, a good example of
6 that is 506(c). Because there's so much that you have
7 to go through to verify, and like every quarter. And
8 you're trying to build a portfolio of 35 companies every
9 quarter, and the companies are back raising another
10 round. And I mean, that's why people don't do it. The
11 more resistance there is -- I mean, that's human
12 behavior -- the less likely they'll participate. So if
13 we have a -- you know, right now you self-certify. And
14 if you include in there, you're not an accredited
15 investor but you have a check mark that says, I have one
16 of these certifications, I'm a JD, I have a Series 7,
17 whatever, I think you'd be inclined to get more people
18 involved. A sophistication test, maybe.

19 You know, I think about the example Ross was
20 talking about, an individual who is an attorney making
21 \$100,000 a year. Would that person bother with you
22 know, with a sophistication test? I don't know. Would
23 we get a greater number of people to participate if we
24 didn't? So that's one of the things I would encourage
25 us to think about it, is the more barriers we create

1 because we're trying to protect people -- and I get it,
2 protection is important -- is that the less people will
3 participate. So how do we find a balance there that
4 allows us to say yeah, this person has reasonable
5 expertise without having to go through, you know, jump
6 through several hoops. Because that is -- in my opinion,
7 that's what's prevented 506(c) from being more
8 successful.

9 MS. HANKS: Could I just weigh in on this
10 whole 506(c) and 506(b)? Some of the barriers that
11 Catherine is talking about are not actually barriers
12 that the regulations or the staff put into place. A lot
13 of it is interpretations -- and sorry about this -- by
14 the lawyers. And I think one thing that the staff could
15 usefully do is revisit the whole self certification is
16 okay for 506(b) trope, because it doesn't actually --
17 when you talk to the staff, the staff will say we never
18 actually blessed that. And we do see in this whole
19 market this whole check the box mentality where everyone
20 is like 506(b) all I have to do is check the box. I
21 don't even have to spell my name right. And 506(c)
22 you've got jumping through all of these hoops and you've
23 got the safe harbor and the lawyers are pushing the safe
24 harbor you've got to get recertified every quarter. The
25 law doesn't actually say that. And so some kind of

1 pronouncement from the staff on the -- we never said
2 that with respect to (b) and we never insisted that with
3 respect to 506(c) would in fact be very useful. And
4 sorry to throw it back on the staff.

5 MR. LEE: Can I just -- just one on the topic,
6 because it's really two points. We are a platform that
7 in fact do 506(c) offerings, and exactly the point -- I
8 agree with Sara. But because of the way the world
9 works, we literally require people to submit their tax
10 forms, get a certified letter from their accountants,
11 and we have to check it every six months or three months
12 or whatever that test is. And we literally have
13 investors that I know personally is an accredited
14 investor because they're a member of the angel network.
15 They have literally invested in some other things that
16 you know -- you so, so forth. And they frankly don't
17 want to give us their tax forms and their income
18 statements and so on, so forth.

19 So I think this is a very critical point to
20 make clear. Because right now every single 506(c)
21 offering, at least the platforms that are doing it right
22 -- that's an issue with gatekeepers that I'll reserve
23 for a later discussion -- the platforms that are doing
24 it right are penalized by trying to be more compliant,
25 better for regulators and investors, so that's a very

1 critical issue. But the other main point that I want to
2 just emphasize is the issue of risk. Like there's a --
3 I don't know what's driving it, necessarily. It may
4 political. I'm not sure. But there is -- there seems
5 to be this bias that risk is not good, right, for an
6 investors, frankly. But the entire purpose of the
7 securities laws, especially private placement, is that
8 no, we want -- we are willing as a system to provide the
9 investment risk to individuals who are understandably
10 willing to take that risk.

11 So like when we -- this is an earlier point
12 that I said earlier, when I talk about small businesses
13 which is often food and beverage or more retail, they
14 just say that's just risky. I'm like what does that
15 mean? Because risky is if you're getting nothing for a
16 very risky investment. If you're getting, you know,
17 just making this number of, 15 percent returns, or 25
18 percent returns or even -- at least you're targeting for
19 that risk, I'm sorry, that return. There is a
20 commensurate amount of risk that is being provided where
21 people are trying to -- individuals are wanting that
22 risk.

23 So I think if you keep that principal in mind
24 is, risk is not an inherently bad thing. The bad thing
25 is if you're not pricing that risk well. I think that's

1 an important point, because when I come back to, and how
2 it relates to this question that Jason asked, is, is
3 through the sophistication and certification, however
4 you define it -- because there are so many individuals
5 that are generally younger. The example that Ross said
6 was the young lawyers in Baltimore who presumably know
7 what they're doing, especially in their back yard. But
8 even in these professional private equity firms that we
9 think are -- every single of their analysts and
10 associates and VPs that are doing the actual work, I
11 guarantee you, 90 percent is not -- is not accredited
12 investors, but they are the ones that are actually
13 analyzing investments to decide whether this product --
14 we manage to make the investment or not.

15 So it's just so -- to me there's a big gap in
16 what we consider risk and what we consider the
17 qualifications to assess that risk. And clearly it's not
18 how much money you have; it's what you know. And so my,
19 I guess, if I can make a suggestion, would be to
20 definitely include some sort of whether it's a
21 sophistication or certification test, based on whether
22 your prior performance or education necessarily,
23 whatever it is -- because right now the accreditation on
24 income or net worth just doesn't reflect the ability to
25 assess that risk.

1 MR. SEATS: Just one minor clarification.

2 MR. YADLEY: And --

3 MR. SEATS: When I said this sophistication
4 test, I meant that broadly, not specifically here's the
5 test to take. But I think it's a spectrum of what is the
6 criterion by which you measure sophistication. The most
7 lax version that was in a comment letter was just
8 requiring the non-accredited investor to opt in and
9 claim that they have sophistication, which is in many
10 cases what's happening on the public market side for
11 retail investors. And so I think it's a spectrum, from
12 take an actual test, get a you know, certification, to
13 I'm acknowledging that I can lose all of my capital and
14 this is a self-certification test, right?

15 MR. YADLEY: I think this is a public policy -
16 - isn't there really a public policy matter there that's
17 more like, you can't absolve people -- you can't just
18 wave a magic wand and have people absolve their right to
19 pursue remedies if they feel like they've been, you
20 know, misled. I mean, the issue -- and just going back
21 to something that Catherine said, I think one of the
22 issues around interpretation from lawyers are all about
23 you know, protecting yourself from the plaintiff's part,
24 frankly. It would be helpful if the SEC gave guidance.
25 But most lawyers I know ask us to do things to

1 basically put rails around ourselves to be protected in
2 some way, shape or form from lawsuits that will
3 ultimately be arbitrated on, you know. And so that's,
4 that's sort of where I think that comes from. Let me
5 ask it a little bit differently. Is there a general way
6 to go at this and maybe think about, again, looking for
7 regional investments? So is there a way to think about
8 creating exemptions to the existing rule based on
9 geographical participation? I'm going down the thread
10 of, people are less likely to -- the strong desire seen
11 from our speaking this morning, and from what I've heard
12 from a number of people is that there are a number of
13 individual investors who want to be able to invest in
14 their own communities and businesses they think they
15 know well.

16 And so I'm wondering if we -- if we thought
17 creatively about it, say creating a 20 mile radius or a
18 25 mile radius or something in and around the investable
19 area, is there a way to carve people out of the
20 accredited investor based -- if they have a geographical
21 test there is a presumption if you are investing -- if
22 you live in an area and you are investing in a business
23 in that area, that there is a presumed level of
24 sophistication that essentially allows you to invest,
25 without you know, pursuant to an example from 506(b) or

1 (c) or whatever those are. Is that something that
2 anybody else has thought about?

3 MS. HANKS: I think -- this is Sara. I think
4 that the more you do that kind of thing, the more you
5 make it complicated and the more you create incentives
6 for people to just check a box and lie. Yeah, I lived
7 there. Or why are you not including me, because my
8 grandfather lives there and I go there every weekend.
9 So I know that place. I mean, the more different
10 categories we create, the more incentive we create for
11 somebody to go around it.

12 MR. YADLEY: The sophistication knowledge
13 point, I think the best way to start addressing that
14 would be to be very clear about what it is that we're
15 quote, "testing" for, or whether there's an actual test
16 for all these other things. So for example, since I
17 have a JD, I'd be happy to become an accredited investor
18 on that account, because I don't have an MBA. But on the
19 other hand, law school doesn't teach you anything about
20 management and reading financial statements. So I think
21 the knowledge, sophistication really ought to be on
22 those things that are common to all businesses, and then
23 leave it to risk factors and disclosure to talk about
24 the specific business. You could then get more specific
25 and say for banking and financial and FINTEC investments

1 then maybe there'd be other categories. Again there's
2 the worthwhile goal of including more people with
3 corresponding complexity that Sara just mentioned, that
4 you could become crazy figuring out, now which of the
5 categories of sophistication am I going to fall into.

6 MS. MILLER: I was just going to add one note
7 to Jeff, to your question about the regional investing
8 exemption. We do have the intra-state exemptions, and
9 states have been left to craft some of their own rules
10 and frameworks, many of which allow participation by
11 non-accredited investors. I think Mike could speak for
12 hours about the different tools and ways that states
13 have done it and companies that have famously -- like
14 Ben & Jerry's raised capital in his own state. But that
15 is a framework that exists. It's not based on a mileage
16 radius, but it is looking more at activities which
17 happen within the framework of a state. So that does
18 exist as one option.

19 MR. PIECIAK: Martha, maybe I could just use
20 this opportunity just to say one point I wanted to make
21 about this discussion generally and talk about something
22 that we did specifically in Vermont with our intra-state
23 exemption. So we do allow for something that we dubbed
24 a certified Vermont investor, which is basically half of
25 the accredited investor financial requirements, and we

1 allow people to invest more than the cap for a normal
2 retail investor. But we do put a cap on it of I think
3 it's \$25,000 that they can invest. So I just mentioned
4 that concept that we put into place in Vermont as part
5 of this larger discussion about the accredited investor
6 test is there to show sophistication or a proxy for
7 sophistication and also the ability to withstand the
8 loss as well. So I think that ability to withstand the
9 loss is equally important for, if we're talking about
10 opening up the definition to allow individuals in that
11 maybe don't have that same ability to withstand the
12 loss, then think about other protections that can be put
13 into place to prevent something that we don't want to
14 have happen. So whether it's a cap or a percentage or
15 something like that. That's something that we've put in
16 our comment letter and talked about and something I just
17 want to raise here.

18 MR. FOX: I think that's a good point.
19 Because I'm a little confused as to what the point of
20 the discussion -- right? I understand the protection
21 aspect, but I feel like we're talking two different
22 things, right? Sophistication, everything else, right?
23 I mean, I mean I feel like on one side we're talking
24 about okay, do you understand you're investing in
25 something that you could lose all your money, right?

1 That's a risk decision, right? You know. The other
2 thing is, do you even understand what the business is
3 you're investing in, what it does, you know, how it
4 works, that sort of stuff? That's a -- yeah, I mean,
5 some of the things I mean, you could need to have a, you
6 know, molecular biology degree. Who knows, right? And
7 I don't know any regulation you could, you know,
8 anticipate all the various needs. And so I guess I'm
9 trying to understand, when we talked about
10 sophistication, you have to actually understand what the
11 business is doing, or is it just simply you really have
12 to have an understanding that you're making a risky
13 investment and you need to -- you may lose all your
14 money. And yeah, I mean, I don't want to -- I mean, I
15 know it's more complicated than that. But I feel like
16 we're talking -- people are making different arguments
17 or variations of both sides of those arguments, and so
18 I'm not even sure we're saying the same thing around the
19 table, so.

20 MS. MEHTA: To -- you know, on that point of
21 sophistication, one, how many more accredited investors
22 will that bring to the table, if we were to have some
23 sort of test for sophistication? And also, you know, it
24 would be a little -- while it makes sense directly of
25 why you would allow people with certain financial

1 sophistication levels who have passed certain exams or
 2 lawyers to, you know, as that, to serve for those
 3 degrees or you know, certifications to serve as a proxy
 4 for accredited investor status. But on the other hand,
 5 you know, there are a lot of smart people out there.
 6 There are neurosurgeons and other fields that could just
 7 as easily read words. You know, they can go through and
 8 read documents. So like, where are you going to draw
 9 that line so that it's not an arbitrary line and it's
 10 not deemed to be a little self-serving when the SEC
 11 allows just lawyers and people with financial degrees to
 12 be able to make investments in these companies. Because
 13 oftentimes when you're doing diligence on a company it's
 14 more than just financial statements. It's more than
 15 reading the documents. A lot of times you need to
 16 understand, what do their customer contracts look like?
 17 Are they still in pilot phase? Do they have recurring
 18 revenue? You know, there's just a lot more. Maybe it
 19 comes down to real estate leases. So there's a lot of
 20 sophistication you might need to know, and it's not
 21 necessarily legal or financial. So, I -- I don't really
 22 see that as being a useful test.
 23 And then on the accredited investor, you know,
 24 what else could you potentially do? I mean, is there --
 25 maybe we could just have a bright line rule. Instead of

1 it being, you know, a percentage of net worth where you
 2 then have to provide all these documents to prove it, is
 3 there any comfort around saying maybe like some dollar
 4 threshold, where anyone can invest up to \$10,000,
 5 period? And that, that comes with a list of risk
 6 factors, including, you know, that they may incur
 7 losses, they may have certain tax impacts, depending on
 8 what sort of entity they're investing in, particularly
 9 if they're going to receive K-1s. You know, they need
 10 to know that up front, because that's not something most
 11 people who don't -- who aren't in the business of
 12 investing, they don't really know that. So maybe like a
 13 healthier set of disclosures, but without being
 14 burdensome to the company, you know, to come up with a
 15 list of, you know, audited financials and all the other
 16 information that they're currently required to provide
 17 to non-accredited investors.
 18 MR. SEATS: My general take on the
 19 sophistication discussion was really -- at least from an
 20 affirming standpoint was, are we even barking up the
 21 right tree? Is it the right thing, category of
 22 measurement to be thinking about? And there's managing
 23 the risk of loss. That's a whole -- I mean, it's related
 24 still, but just sort of related, versus aligning
 25 interests with others who we seem to be totally fine

1 with what their behaviors are, right? I mean, I feel
 2 like it's an important comparison, and I'm not steeped
 3 in these regulations, and so I don't know the nuance.
 4 But my perception is that a retail public market
 5 investor can put all of their net worth and more at risk
 6 readily without any sophistication test. You just check
 7 boxes and whatever, but you can go create levered
 8 positions and trade in exotic derivatives by just
 9 getting on a trading platform and clicking some boxes.
 10 And so we don't seem to have the same level of
 11 paternalism in that market as we have here and I don't
 12 know why. And maybe my instinct on why is that the
 13 fundamental underlying asset is more volatile.
 14 When you think about large public companies,
 15 like yes, you can make investing in Google be an
 16 extremely proposition, and you have to, yes, you need
 17 someone to sign off on yes, I could lose all of my
 18 money. But if you're just buying shares of Google, your
 19 changes of losing all of your money in the next year are
 20 relatively low compared to putting that same \$25,000 --
 21 right?
 22 MR. YARDLEY: Well, I just -- well, so, yeah,
 23 so part of the answer is -- and that really goes
 24 fundamentally to what used to be a very bright line
 25 dichotomy between a public offering and a private

1 investment was, at the public offering of course, you do
 2 have all of this superstructure of disclosure including
 3 ongoing disclosure and at the front end you have the SEC
 4 and the states reviewing the disclosure. And in the case
 5 of two-thirds of the states, really making a decision
 6 about whether this is a good deal or not. And of course
 7 Google was not a good deal in Massachusetts. So it's all
 8 a proxy for that. So this paternalism is there because
 9 you don't have the government looking out for you. So
 10 the question is, where do you put the fence? And nobody
 11 believes that having a million dollars equates to
 12 sophistication, but it's worked. It's worked since 1982
 13 as a bright line. And there's a little bit of well, if
 14 you have a million dollars, unless it is all your wealth
 15 -- which it shouldn't be, because you're supposed to
 16 have other assets and you're supposed to know who it is
 17 that's investing -- the -- and so I think that the
 18 \$10,000, that's a great idea, anybody can do that. But
 19 that's sort of what crowdfunding is supposed to do, and
 20 that has all the other issues about cap tables and so
 21 on.
 22 In answer, Robert, to your question, I think
 23 what I was trying to say earlier was yes, this knowledge
 24 qualifier or sophistication qualifier should be really
 25 basic, including can you read, can you understand what a

1 financial statement is, and not a whole lot more.
 2 Because the more you get beyond that, those basics, the
 3 more it depends on the deal. I have chartered, as a
 4 lawyer, I don't know, 20 banks in my life and I
 5 represent lots of banks, and I'm a shareholder of many
 6 large banks. And it's not an understatement to say that
 7 I don't understand the footnotes of those financial
 8 statements that go on for 100 and some pages. And so,
 9 yeah, I'm very sophisticated and I know how to read
 10 these things, but that -- and the other part of this is,
 11 and this is why some of the -- well, the fact that
 12 wealthy people invest in private equity funds is, a
 13 typical private equity fund looks at 1,000 investments,
 14 and they seriously look at a couple hundred, and they
 15 diligence, you know, dozens, and they make eight or ten
 16 investments a year, and a lot of effort goes into that.
 17 And as an investor who has a day job, as the Chairman
 18 says, you can't do that. So you can't really protect
 19 yourself. So what are the fences? And one is, if it's
 20 not going to be a registered offering disclosure for
 21 purchasers. I think that's where you start. And then
 22 for less sophisticated people, since we won't be able to
 23 get away from investor protection nor should we, who is
 24 helping them? Is it a registered professional? Is it a
 25 lead investor? Is it -- some of the comment letters

1 talked about if at least x percent of the investors are
 2 accredited then you should be able to have
 3 unaccredited investors who are riding their coat tails.
 4
 5 So it's -- it's going to be complicated
 6 however we get it. But we've got to get past the point
 7 of -- as I think Youngro and others have said, I mean,
 8 there's risk, and you could lose your money. So we
 9 can't overemphasize that that is a possibility. And so
 10 the investor limits, you know, they're fine, but those
 11 certainly could be harmonized. There's no reason that
 12 they should be different, with the different quasi-
 13 exemptions like Reg A and and CF.
 14 MS. GARRETT: Oh, go ahead.
 15 MR. SOLOMON: Yeah, I also think that they're
 16 different, the public markets, the private markets.
 17 Because with the public markets, in many a case, you're
 18 coming into through brokerage firm and there's this
 19 intermediary there that's being held to a standard. And
 20 you know, they have to take on through this whole thing
 21 with Reg BI, and they actually have a fiduciary
 22 responsibility and that's seen. And there's all this
 23 financial protection. You're much more towards the
 24 intermediary, for appropriateness of investment, the
 25 length of it. Even when you open up a sub Forex sub

1 account where they let you trade for free, news flash,
 2 but when you -- when you get something for free it kind
 3 of means you are the product. News flash.
 4 But you know, the amount of forms you have to
 5 fill out are -- sorry for the sidebar. But the amount
 6 of forms you need to fill out and the things you need to
 7 do in order to get access to the public market vehicle
 8 are discrete. In here what we're seeing is, you know,
 9 there is no free private investment. Well, nobody's an
 10 intermediary. And maybe that's one of the things that
 11 should be faced.
 12 Maybe we should be in a position where we hold
 13 the intermediary or fiduciary responsible for helping to
 14 create the transmission of capital from a small
 15 individual investor to a small private company. I mean,
 16 again, I think we offer two things here. One is
 17 unlocking the flow of capital for small businesses. The
 18 other is unlocking the flow of investment opportunities
 19 for small investors. And I think a third thing is --
 20 and I heard this loud and clear -- you don't have to go
 21 through New York to get everything. I mean, that's the
 22 thing I just heard, you know, very loud and clear from
 23 everybody that spoke, right?
 24 You know, if you're in Austin and you want to
 25 make an investment in Austin, why do you have to go to

1 New York to get approvals? And that's sort of the
 2 fundamental problem, as you'll find a lot of the capital
 3 continues to sit at the -- at the coast. And so if we
 4 could figure out ways to exclude the coast in this
 5 decision while creating investor protection. So you
 6 know thus far, I think maybe there are some things to do
 7 re: that. Or maybe there are some things to do by
 8 holding, you know, fiduciaries accountable or
 9 responsible for effectively screening. I don't think
 10 for a second that individuals are capable of screening
 11 private or public investments by themselves. And they
 12 will lose money, and it will be a huge issue. I think
 13 it's been a big impediment to why crowdfunding hasn't
 14 been done more. I don't know. That's sort of a
 15 response, but also a continued to push towards trying to
 16 come up with creative solutions for getting, you know,
 17 small private investors involved in the mix here.
 18 MS. GARRETT: Thank you, Jeff. Catherine?
 19 MS. MOTT: I was going to say --
 20 MS. PATODIA: This is Poorvi.
 21 MS. GARRETT: Poorvi?
 22 MS. PATODIA: Yeah, it's me. I was just going
 23 to add, you know, I -- I do agree that investors need
 24 protections, but as it relates to the definition of an
 25 accredited investor, I would say that's -- he says that

1 just because you need the definition of an accredited
2 investor, that means that suddenly there are more
3 protections for you or that you are going to somehow
4 protect yourself, versus someone else who may just fall
5 short of that definition. So I guess I'm just saying,
6 you know, it doesn't feel like those investor
7 protections are there. And so I think we all agree that
8 they need to be there. But the definition of an
9 accredited investor we're seeing today is not -- doesn't
10 seem to be really providing that protection. And so I
11 think these are almost two different issues.

12 MS. GARRETT: Thank you. Catherine?

13 MS. MOTT: So one of things I keep -- that I
14 hear -- it seems here all of us agree on is that you
15 know, we need to be able to acknowledge and sustain the
16 risk of losing all your money, so, in that, so. And I
17 get where we're at. You know, in a way I think we're
18 thinking at this on a global perspective as a, you know,
19 as if we're funds and we can -- you know, in a
20 sophisticated fashion assess the business risk and do
21 the four pages of due diligence and the technical due
22 diligence and all of that.

23 I will tell you that even the best fund
24 managers don't know all of the risk. It's new business
25 models. It's things that we've never seen before

1 sometimes. The science of it can be very, very
2 complicated to understand. So at the end of the day it
3 comes down to do you understand and can you sustain that
4 risk. Secondly, though, I don't want us to overlook the
5 value of the local people who know the person who's
6 building that company or putting that, you know, team
7 together. And it's going to make a difference in their
8 community and their ability to invest in that, because
9 they don't make enough money, to take that away.

10 I just think about the -- my little hometown
11 that I went to, and went back to, and saw this you know,
12 group of people who got together. Now they're all
13 accredited. But imagine if -- and I guess the other
14 thing I think about is, when someone is in need in that
15 community, they know how to do a Go Fund Me page, and
16 everybody comes to their need and they're putting money
17 in. And imagine if it was that simple for them to say
18 look, we can restart this.

19 There's a group of these accredited investors
20 who are trying to put their money together to invest in
21 this aluminum extrusion restart so to speak. But you
22 know, imagine if some people could put a little bit more
23 money in to help their community and invest alongside of
24 those accredited investors. And they're not accredited,
25 but they can take that risk, a certain amount of risk,

1 to say that could be really meaningful to me. I own
2 this, you know, little grocery store, and I could, you
3 know, put a little bit of my money in that aluminum
4 extrusion plant, knowing that I'm going to get more
5 customers later on, because we're bringing -- we're
6 attracting new jobs. We're attracting -- you know, I'm
7 just -- what I want us to do is I want us to find a
8 happy medium on this. But not forget about the 55
9 percent of the country that is not getting venture
10 capital. Is not -- you know. Needs that kind of
11 injection in the arm. And also, let's think about --
12 we're talking about who do we add, what -- how
13 sophisticated they are.

14 But also we're not talking about, you know,
15 the thresholds and what that means for those regions. I
16 want us to be very mindful of the fact that you know,
17 someone in the little town of Greenville, Pennsylvania,
18 of 5,000 people, is not going to be the same as someone
19 in New York City, that's what, 50 million? I don't know
20 the size of it. But let's just be mindful of that, that
21 we don't create things that make it more difficult for
22 the -- for middle America to be successful. That's where
23 I'm at.

24 MR. TORBERT: Can I --

25 MS. GARRETT: Thank you.

1 MR. TORBERT: Go ahead.

2 MS. GARRETT: I was just going to say, if I
3 can -- we have a lot of things to talk about. I want to
4 pull together some of the thoughts that we have
5 explored. First of all, Jason, I think that you did a
6 good job outlining the different tiers. One is for the
7 accredited investor definition. First of all it's what
8 are the financial thresholds. What I've heard, you
9 know, Catherine say repeatedly is let's leave -- do no
10 harm by leaving the current accredited investor
11 financial thresholds in place. That's one point. The
12 second point is, is can somebody become an accredited
13 investor by -- because they are sophisticated? And in
14 this aspect for it, I think what we're talking about is
15 sophisticated as the person, and not sophisticated,
16 necessarily, about their knowledge of the company. But
17 it's somebody --

18 MR. SEATS: Carla, on that -- on that first
19 point, one thing I did hear was, is there room for
20 localizing that?

21 MS. GARRETT: Right.

22 MR. SEATS: Because not all markets are the
23 same.

24 MS. GARRETT: Okay.

25 MR. SEATS: Yeah.

1 MS. GARRETT: I'll add that to it. So on the
2 second point about sophistication of an individual, as a
3 committee, we maybe don't get into the exact definition
4 of what that means, meaning is a JD, is it an MBA, is it
5 a Series 7 test? But as a committee, are we in a
6 position to recommend that possibly the SEC could
7 consider sophistication of the investor in determining
8 what the definition of an accredited investor is? And
9 that would be a way to narrowly expand the definition of
10 an accredited investor.

11 One of the other points that was brought up
12 is, should a test be a possibility? That could be
13 something that we think about. Another possibility was
14 opt-in although I am not hearing that that is
15 necessarily what people are in favor of.

16 And then the third thing is --

17 MR. SEATS: Wait a minute now. I had one on
18 that one.

19 MS. GARRETT: Okay.

20 MR. SEATS: Which is to mirror the level of
21 diligence that happens on public market investors having
22 access to exotic derivatives as an example. Which is
23 just me going through clicking enough boxes that I
24 understand it's highly levered and -- because I view
25 those as similar. It's a way to turn that Google

1 investment into a very, very risky investment.

2 MR. TORBERT: Or Forex.

3 MR. SEATS: Right?

4 MS. GARRETT: Yes.

5 MR. SEATS: Yeah.

6 MS. GARRETT: Yeah.

7 MR. SEATS: Or Forex is an example, yeah.

8 MS. GARRETT: And the third thing that you
9 mentioned was how do we get investors to be able to
10 invest alongside accredited investors? And so to me
11 that's actually kind of a third category, because that's
12 not putting people into the accredited investor
13 definition, but it's allowing non-accredited investors
14 ways to invest. And that would be by crowdfunding, Reg
15 A and also by what we're going to talk about this
16 afternoon, with pooled investments.

17 Do we have any consensus on the definition of
18 an accredited investor and whether or not the committee
19 believes that we can make a recommendation to the
20 committee with respect to the accredited investor
21 definition? My proposal might be is, you know, do no
22 harm by leaving the current accredited investor
23 financial thresholds in place, subject to looking at
24 them for different regions and possibly lowering them in
25 different regions. And for the commission to look at

1 revising the accredited investor definition to allow
2 individuals to qualify based on other measures other
3 than financial thresholds, such as sophistication, which
4 the SEC could come up with how they define
5 sophistication. Possibly professional credentials, work
6 experience, education, and possibly a sophistication
7 test. May I get the committee's input on whether that
8 would be a recommendation that they approve?

9 MR. FOX: There was one other thing that I --

10 MS. PATODIA: What was the -- what was the
11 other -- the opt-in?

12 MS. FOX: Sorry.

13 MS. GARRETT: Yes, Poorvi, what was that?
14 I'm sorry. Go ahead.

15 MS. PATODIA: I was just asking -- you
16 mentioned that one of the -- one of the options that was
17 discussed was an opting-in mechanism. And that there
18 doesn't seem to be a lot of support for that from the
19 committee. What was that option? What were you guys
20 thinking about for that?

21 MS. GARRETT: I think the opt-in provision is
22 really just where somebody checks a box and says that
23 they are opting in to be an accredited investor and that
24 they accept the risk. And they might not have a
25 sophistication -- be, necessarily, a sophisticated

1 investor by definition, and they might not necessarily
2 meet any of the financial thresholds, but they are
3 opting in to accept the risk and invest in an
4 investment.

5 MS. PATODIA: Got it. Thank you.

6 MR. FOX: The only thing I was going to say is
7 I think somebody threw out the idea of potentially, in
8 lieu of maybe a sophistication or in addition to maybe
9 having just like a up to \$10,000 threshold that you
10 could just make an investment. I'd be willing to also
11 have that as part of the recommendation as well, or
12 something like that.

13 MS. GARRETT: So what I was saying --

14 MR. FOX: Yeah.

15 MS. GARRETT: -- that would fall outside of
16 the definition --

17 MR. FOX: Okay.

18 MS. GARRETT: -- of an accredited investor.

19 MR. FOX: Okay. Got it. I didn't want to
20 lose --

21 MS. GARRETT: Right, no.

22 MR. FOX: -- the sight of that either, so.

23 MS. GARRETT: I think that's a great idea.

24 MR. FOX: Yeah.

25 MS. GARRETT: I just think it's a separate

1 piece of the puzzle.
 2 MR. FOX: Okay.
 3 MR. SEATS: There was a set of comment
 4 letters. This is not pooled vehicle, but there were --
 5 the comment was to allow unaccredited investors to be
 6 deemed accredited when relying on investment advice of
 7 financial professionals that have demonstrated
 8 sufficient knowledge, yada, yada. So I -- that's
 9 slightly -- that's another -- that's sophistication by
 10 proxy, perhaps. I don't know. But I just wanted to --
 11 I don't think that was spoken out loud. It's different
 12 than a pooled vehicle. But it was in a lot of the
 13 letters also.
 14 MR. YADLEY: Yeah. That was one of the things
 15 I was thinking about. I think that falls, Carla, into
 16 your third bucket of you know, ways people can invest
 17 alongside or with. On the first point, I think not
 18 necessarily annual. Less frequent would be better. But
 19 cost of living increases. I would add that to the
 20 definition. We keep the current limits, but periodic
 21 inflation adjustments.
 22 MR. FOX: Yeah. I think the one theme I think
 23 that comes through -- sorry, are you still going, Greg?
 24 Sorry.
 25 MR. YADLEY: No, I'm done.

1 MR. FOX: Oh. In the comment letters, it was
 2 definitely creating -- and the commission is perfectly
 3 suited to do this better than us, you know, objective
 4 bright line tests. I mean, I think those are working
 5 now, and I think that needs to be carried over, perhaps,
 6 you know, as we've been talking about on the
 7 sophistication side, to the point where percentage of
 8 income, percentage of assets does add some subjectivity
 9 and more diligence that I think you don't want to have a
 10 perverse effect by having something like that. So I
 11 think the clear objective standards I think will be best
 12 and facilitate and speed up things.
 13 MS. GARRETT: Thank you. Now, how about the
 14 assessment -- yes, Phil?
 15 MR. LEVEY: Can I -- can I say one thing,
 16 Carla? Sorry. Yeah, I mean, so this is what I found,
 17 opinion here, I'm actually -- I think the accredited
 18 definitions are fine. Actually, I don't know that we
 19 should be looking to create more categories around that.
 20 I'm more interested in seeing if there are ways to allow
 21 more non-accredited investors into investing vehicles.
 22 And so instead of changing the definition of accredited
 23 investors, maybe there is a broadening of the exemption
 24 where the SEC says if you have more than 50 percent of
 25 an investment in a company from accredited investors,

1 then you can have, you know, the rest of them be non-
 2 accredited investors. Because I really think we're
 3 looking to -- if I'm thinking about this the right way
 4 or we're thinking about this the right way, we should be
 5 looking for ways to have non-accredited investors
 6 partnering with people that we think are more
 7 sophisticated or that meet the sophistication test. And
 8 perhaps that gives a better screen, less likely to lose
 9 money. And folks are changing -- their position, maybe
 10 their changing the access that non-accredited investors
 11 could have to small investments, because a certain
 12 percentage of sophistication is already involved.
 13 MS. GARRETT: Yeah, Jeff. I think we agree and
 14 we think that that is -- we're probably proposing two
 15 alternatives right now. Possibly revising the
 16 definition of accredited investor, proposing
 17 recommendations on that, and also proposing
 18 recommendations next with respect to other ways that
 19 non-accredited investors can invest in investments.
 20 MR. SOLOMON: Yeah. Maybe one tactical thing
 21 to connect the bridges of those two would be expanding
 22 the accredited investor definition to include qualified
 23 venture capital funds as being an accredited investor.
 24 Because then you can -- that's a minor change to the
 25 existing structure, which then lets that be a feeder.

1 Because those can accept investments from non-accredited
 2 investors. There would be some others things you'd have
 3 to sort of tweak there too from the reporting
 4 requirements. But like little changes like that -- I
 5 don't know if that's a better pooled investment
 6 discussion. But it would be changing the accredited
 7 investor definition also.
 8 MS. GARRETT: And that is something that I
 9 know we're going to be speaking of. Because we only
 10 have a few minutes before lunch, and I do want Youngro
 11 to have a little bit of an opportunity to talk about
 12 ways that non-accredited investors access the market not
 13 through pooled vehicles that we're going to talk about
 14 or funds, but through Reg A and Reg CF. Can I just get
 15 an idea, are people -- I can put together a
 16 recommendation for later this afternoon. Are people
 17 generally in support of some sort of broadening of the
 18 definition of accredited investor, as long as we look at
 19 the other prong too?
 20 MR. GRAHAM: Yes.
 21 MR. FOX: Yeah.
 22 MS. GARRETT: Okay, thank you. Youngro?
 23 MR. LEE: Yeah. And I think some of these
 24 topics might come up again this afternoon, so we can
 25 talk about it in that context as well. But the main

1 thing that I just want to clarify and put some
 2 structure, as you think about this afternoon's
 3 discussions is, there is in fact a way for non-
 4 accredited investors to invest in private companies,
 5 full stop, that is governed by law and much be
 6 facilitated through an intermediary. So I think Jeff or
 7 somebody might have mentioned, making an assumption
 8 again that these things are happening without. No. You
 9 have to be a regulated intermediary to be able to
 10 facilitate regulation crowdfunding. Full stop. Reg A
 11 has to be approved by the SEC in order to be live. So a
 12 lot of these fraud situations that unfortunately a lot
 13 of people think about is things that are happening
 14 outside of the Regulation crowdfunding, Regulation A
 15 regime. And that is literally what I was talking about
 16 in terms of the intermediaries that are trying to do the
 17 right thing actually being penalized in practice because
 18 they are trying to comply or trying to do the things.

19 As a broker dealer, I can tell you from their
 20 perspective, we conduct regulation crowdfunding through
 21 a broker dealer. We get reviewed by FINRA all the time.
 22 We have spent substantial -- a big portion of capital to
 23 kind of facilitate this. So that's the one framework
 24 that I just would like this committee to completely
 25 understand. Regulation crowdfunding, Regulation A, is a

1 structured offering that is governed by regulation and
 2 monitored by FINRA. Full stop. And the reason why I
 3 mentioned that is because this directly implies
 4 everything we're talking about -- especially Catherine's
 5 point about local investment -- I think we're all in
 6 agreement with local investments. So as an example of
 7 how this applies to accredited investors, even
 8 accredited investors, they cannot invest freely in
 9 Regulation crowdfunding, which is the vehicle or the
 10 legal system to allow local investments, right? So
 11 every single investor -- there is no definition of
 12 accredited investors and non-accredited investors in
 13 Regulation crowdfunding. It's a pure income test. If
 14 you make under \$100,000 you can invest up to 5 percent
 15 of your income. If you make over \$100,000, you can
 16 invest up to 10 percent. But this means, even if you're
 17 an accredited investor worth \$100 million, right, you
 18 cannot invest more than 10 percent of either the higher
 19 of your income or the net worth. So think -- that
 20 doesn't make any practical sense.

21 You can be a retired person with \$10 million,
 22 and if your annual income is \$50,000 you are not -- you
 23 are allowed to invest literally nothing in a local
 24 restaurant that's raising money or a local brewery
 25 that's raising capital. So there's a very fundamental --

1 in my mind very easy kind of low hanging fruit under the
 2 existing Regulation crowdfunding, which there is a \$300
 3 million reward for deals completed in that, under that
 4 regime. So that's one thing that we don't have time
 5 right now, but as we think about the pooled vehicle,
 6 just this doesn't make common sense. How do we utilize
 7 the existing regulations that have some track record,
 8 some data, and apply that in a systematic way to address
 9 some of these problems, and just specifically, to even
 10 make it more simple. The few solutions might be one,
 11 literally increase the amount of capital that businesses
 12 can raise using regulation crowdfunding, because it's
 13 capped at a million dollars arbitrarily.

14 Number two is, how can we make the ability to
 15 invest under regulation crowdfunding more flexible. And
 16 for example that could be not limiting accredited
 17 investors to invest in regulation crowdfunding
 18 offerings. And two, have a more sensical ability to
 19 control that flow. So -- and I think Mike was here, and
 20 maybe he can talk about it a little bit. There is
 21 literally a precedent -- this is all new. A lot of
 22 states, including Texas, had investment limits of \$5,000
 23 per investment no matter what. So as long as you can
 24 invest \$5,000 per investment -- and that's because every
 25 business is different -- under the Federal Jobs Act, you

1 are capped across the entire spectrum of this law. So
 2 if you have \$5,000, the limit, if you're investing in a
 3 crazy flying car idea, and invest \$5,000, and there is a
 4 multi-million dollar revenue generating brewery that's
 5 raising money, you're topped out. You can no longer
 6 invest in that deal, because the law has said, sorry,
 7 you tapped out on your risky investments for the year.
 8 You can't invest in that brewery anymore. So those are
 9 some of the structural issues that I want to raise.

10 And the biggest point being -- I know Sara has
 11 tons of experience in it as well -- is that there is a
 12 framework that a lot of people over the last six plus
 13 years have spent time and effort. And it's startups like
 14 us and various other platforms that have spent literally
 15 tens of millions of dollars investing and creating a
 16 history of this track record, that hopefully would be an
 17 easier sell from the committee to advocate for, rather
 18 than trying to come up with a brand new structure based
 19 on any other considerations.

20 MS. MOTT: Can I add something to that, Carla?
 21 On of the things that Youngro points out very well is
 22 that, you know, once -- once they're topped out, they
 23 can't invest further. I will tell you, every business
 24 is going to need additional funding. There's going to
 25 be a need for another round. And again, through your --

1 through the crowdfunding vehicle, if you have the
2 opportunity to say hey, look, we need to get -- this
3 company needs to scale but it can't do it without
4 additional capital and it's not bankable yet; can I do
5 another round? And they're capped out. So all the more
6 reason why we need to think about those limits, because
7 they will need capital again.

8 MS. GARRETT: Thank you. It is now noon, and
9 so it is time to break for lunch. Please note the the
10 webcast will be stopped during lunch, and it will -- the
11 remote participants can rejoin at 1:00. Thank you.

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

13 MS. GARRETT: Welcome back from lunch. I now
14 call the meeting back to order. I just want to say that
15 we have a lot to get through and this afternoon we have
16 some people that also need to leave a little bit early.
17 So Martha and I are going to work on making sure that
18 the agenda flows smoothly. And so don't take any
19 offense if we try to move people along.

20 Martha, can you please introduce our next
21 agenda item?

22 MS. MILLER: Yes, our next agenda item, we
23 have got Rick Fleming, who is the SEC's Investor
24 Advocate, who is here today. Rick is the counterpart to
25 my office and I have loved getting to work with Rick.

1 He brings a breadth of experience, having served as the
2 first Investor Advocate and the only Investor Advocate,
3 so he has continued to set the bar high with everything
4 that he is doing. And he comes to this role from having
5 previously been a state securities regulator. And so he
6 has breadth of experience, having seen capital formation
7 and investor protection in the Midwest.

8 And we thought it would be helpful for Rick to
9 come in and to share a little bit about his office. He
10 also has an investor advisory committee that is similar
11 to this committee in providing strategic advice to the
12 Commission on matters relating to investor protection.

13 And a little bit about how he thinks about the
14 work that he does from a high level. This is just
15 intended as an introduction so that we can start the
16 relationship with each of you with Rick. And I had a
17 wonderful opportunity to do the same thing with his
18 office.

19 And for those who don't know, and I think most
20 all of you do, Mark Sharma, who is a member of this
21 committee, serves as the Investor Advocate's delegate to
22 this committee. And he is a wonderful value add from
23 that office.

24 So with that, Rick, welcome.

25 SEC OFFICE OF THE INVESTOR ADVOCATE

1 MR. FLEMING: Well, thank you, Martha. Thank
2 you to the members of the committee for the invitation
3 to speak, tell you a little bit about my office and what
4 we do. I also want to thank Mark for sitting in for me
5 and being my delegate to this committee. I certainly am
6 paying attention to the work that you all are doing and
7 am interested in any of the recommendations that you
8 come up with.

9 A little bit about my background that's, you
10 know, not necessarily part of the bio that normally gets
11 thrown out there. I am a former state regulator. I
12 actually grew up in a little tiny town in Kansas, Leroy
13 Kansas, population 600. So when Catherine talks about
14 the impact of small businesses on communities like that,
15 it really rings true to me. I come from a place where a
16 company with 50 jobs would be a big business, not a
17 small business. And, you know, and I'm still sort of
18 shocked at sort of what we consider a small business at
19 the SEC.

20 But at any rate, I am really interested in the
21 issues that you all talk about. In fact, when I was a
22 state regulator, you know, everybody thinks of the state
23 regulators of just being in the business of investor
24 protection. But in a small state, especially, and I
25 know Mike Pieciak can attest to this, you know, you

1 really are interested in helping the entrepreneur that
2 has some idea that might have this big impact on a small
3 community. So I have spent a lot of time talking
4 certainly to attorneys and doing CLE programs and things
5 like that, trying to help non-securities lawyers
6 understand sort of the ways that they could go about
7 helping their clients raise capital and the different
8 exemptions they could take advantage of.

9 I actually wrote an article for the Kansas Bar
10 Journal a few years ago, "Helping Small Businesses Raise
11 Capital in Kansas." And in that article, I described a
12 new exemption that we adopted at that time. It was
13 called the Invest Kansas exemption. It was actually the
14 first intrastate crowdfunding exemption. And I actually
15 was the author of that. So kind of a different
16 background than you might expect from somebody that's
17 the SEC's investor advocate. But certainly I've been
18 sort of tuned in to small business concerns for my whole
19 career and continue to be interested in that.

20 I'll tell you a little bit -- so that's my
21 background. So when I do -- when I do approach issues
22 from the perspective of investors, I try to bring that
23 perspective along with me and not sort of lose sight of
24 the fact of the benefits of these small companies, you
25 know, the way they can impact their communities, the --

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1 not just the jobs that they bring but how they really
 2 impact the entire sort of dynamic of the communities in
 3 which they operate.
 4 Anyway, a little bit about my Office of the
 5 Investor Advocate. As you can imagine, sort of my
 6 primary role is to be a voice for investors within the
 7 policymaking context. And so here at the SEC, we review
 8 all of the rulemakings that flow through and we take a
 9 look at the impact of those proposed rule changes on
 10 investors. And I can make recommendations to the
 11 Commission about whether I think they're a good idea, a
 12 bad idea or, you know, whether they need a new idea,
 13 whatever.
 14 And so we -- we have -- even though I'm an SEC
 15 employee and I report to the Chairman of the Commission,
 16 we really do have sort of an independent role in the
 17 Commission, much like Martha and her office. We're
 18 supposed to provide that independent voice for investors
 19 within the Commission. And I think the idea is
 20 basically that, you know, regulated entities interface
 21 with the Commission a lot, and so the Staff here at the
 22 Commission, the commissioners, tend to hear their
 23 concerns and needs a lot. Not so much from your average
 24 investor. So we are supposed to be helping to keep
 25 those issues, those concerns sort of front of mind for

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1 the Commission.
 2 We do have, like I say, an independent role.
 3 That's sort of underscored by a couple of things. One
 4 is again, even though I report to the Chairman, I make
 5 my recommendations to the Commission. They are supposed
 6 to respond to those recommendations within 60 days. So
 7 that sort of is a different dynamic than your average
 8 SEC employee. I also report to Congress twice a year
 9 and those reports go to Congress without any prior
 10 review or approval by anybody outside of my office. So
 11 we are, like I say, have that independent role.
 12 I do try to operate mostly more informal than
 13 formal, so we don't make a ton of sort of formal
 14 recommendations to the Commission. I go around, I talk
 15 to each of the commissioners once a month, sort of talk
 16 about what's on the rulemaking agenda, what I think
 17 about it. And it's relatively rare that we sort of go
 18 with a formal recommendation that the Commission is
 19 supposed to respond to. So that's sort of the advocacy
 20 role of my office.
 21 We also -- a second major part of our office
 22 is that we house the SEC's ombudsman. And this is a
 23 person that investors can go to if they have some
 24 concern or complaint about the SEC itself. So if you're
 25 an investor and you want to complain about your

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1 stockbroker, there is a process you go through to file
 2 that complaint. If you've done that and now you're mad
 3 at the SEC because we didn't do anything with your
 4 complaint, you can come to the ombudsman to try and get
 5 a resolution of whatever your issue might be. So you
 6 can imagine it's things like, you know, fair fund
 7 distributions that take a long time to process and get
 8 people their money back, concerns about the -- you know,
 9 the arbitration process at FINRA -- sorry -- those types
 10 of issues we hear from investors and we try to be as
 11 helpful as we can.
 12 A third part of my office is our economic
 13 unit. Dr. Brian Scholl, who's actually here, he heads
 14 up that part of our office. It has a couple of
 15 components to it. One is that we are obligated to
 16 consider the impact on investors of proposed changes to
 17 rules. So we're either looking at the economic analysis
 18 that the Commission is doing and sort of making sure
 19 that it appropriately reflects not only the costs and
 20 burdens to industry but also the benefits to the
 21 investing public. You know, we're reviewing the EA, the
 22 economic analysis that the Commission is doing and, from
 23 time to time, we're sort of doing our own bit of
 24 economic analysis and trying to provide that.
 25 Another part of our economic unit is really

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1 just research, basic, fundamental research about
 2 investors. How do people invest? How do people process
 3 information and make decisions with it? Something
 4 called decision science. You know, for a disclosure
 5 agency like the SEC, all of our
 6 -- really, almost all, I guess, of our rules are sort of
 7 premised on this idea that you give people information
 8 and let them make decisions for themselves with that
 9 information. But we know very little about sort of the
 10 basic science of how people process information and how
 11 they make those decisions. And so we're trying to
 12 really elevate the SEC's understanding of things like
 13 that so that we can do a better job of providing
 14 disclosure that really is decision useful for folks. So
 15 we're just getting started with that kind of work. We
 16 use tools like surveys and focus groups and one-on-one
 17 interviews and things like that that really help us sort
 18 of do more to be proactive in terms of getting out and
 19 finding out how investors will react to different
 20 things, instead of just sort of putting out a rule for
 21 comment and hoping that someone actually comments.
 22 The fourth thing that our office does is we
 23 support the work of the SEC's Investor Advisory
 24 Committee. So much like Martha's office, my office
 25 provides the staff-level support for that committee.

1 I'm actually a member of that committee by statute. So
2 there are a lot of similarities between sort of the
3 construct for Martha's office and mine. In fact, they
4 took a lot of my statute and just replicated it for
5 Martha's office.

6 But there are some differences. The one main
7 difference that sort of jumps out at me is that one of
8 the questions I get a lot is what's the difference
9 between the Office of the Investor Advocate and the
10 Office of Investor Education and Advocacy, which is
11 another office at the SEC? so There, really the
12 distinction is they're doing all the investor education
13 kind of activity, right? So if the SEC wants to go out
14 and tell people about, you know, different scams or
15 schemes or how to research the background of your
16 broker, that sort of thing, providing educational
17 content to folks, that's a whole other office that does
18 that. My office is really in the policy sphere, trying
19 to provide that voice for investors in the rulemaking
20 process. So that's sort of the distinction that occurs
21 there.

22 With Martha's office, I gather, she has much
23 more of sort of both of those roles. So she is doing
24 not only the advocacy piece for small business but is,
25 at least for now, doing a lot of sort of educational

1 stuff about, you know, what does the SEC do and how does
2 that relate to small businesses and, you know, what kind
3 of exemptions are out there, that sort of thing. So
4 there is -- you know, it's not exactly the same role
5 that we perform.

6 Okay, I thought I might tee up one issue which
7 actually is your discussion this morning on the
8 harmonization concept release. Because this will give
9 you an example of sort of how I interface and sort of
10 how I approach some of these issues.

11 The harmonization release, I actually filed a
12 comment letter. So I have sort of a wide variety of
13 ways that I can engage in advocacy. And in this case, I
14 did choose to do it in somewhat of a formal method by
15 actually putting a comment letter in the file. But it's
16 not sort of a formal recommendation to the Commission
17 that says, you should do this or you should not do that,
18 you know. So it's sort of this hybrid, I guess.

19 But in my comment letter, the reason I did it
20 that way is that I actually wanted to try to evoke a
21 little deeper level of analysis from the commenters in
22 terms of how changes to the exemptions might impact
23 investors. I felt like the harmonization release is
24 good. It's especially good in that it does a really
25 good job of laying out all the different exemptions in a

1 nice little compact summary. And it went through in
2 pretty good detail all the ideas that we've heard from
3 the business community in terms of changes that could be
4 made to some of the offering exemptions.

5 But I thought it was pretty shallow, frankly,
6 in terms of how it dealt with sort of the investor side
7 of the equation. So it included a couple of things in
8 there that dealt with investors. It basically asked the
9 question of, you know, are investors missing out on
10 golden opportunities by not having access to the private
11 markets? Fair question. It also sort of probed the
12 level of fraud that there may be in the private side of
13 the markets. Again, a fair question, and asked for data
14 on that.

15 Good questions. But there's such -- there's
16 so much more that we should be asking, I think, in terms
17 of how changes to the exemptions might impact investors
18 or might not impact them. And so I suggested a few
19 other things that I hoped to attract comment about. And
20 those are, you know, just sort of summarized, one would
21 be sort of the investor demand for private offerings.
22 And so, you know, one of the questions I have is, if you
23 change some of the exemptions or the accredited investor
24 definition or something like that with the sort of the
25 premise that that's going to unleash this untapped pool

1 of capital, is that really going to be true? Or are we
2 just going to wind up, you know, lowering investor
3 protections and not really getting that corresponding
4 benefit of this untapped capital?

5 And I think that's an important question that
6 we really need to think about. Because if you drill
7 into some of the demographic information that we know,
8 you know, while I wish that the -- that we could change
9 securities laws in some way that would solve economic
10 inequality in the U.S., that is just not a realistic
11 goal. If you look at the demographic data out there,
12 the lowest 25 percent of the population in terms of
13 household wealth, their median financial assets is
14 \$1,000. Okay? And that's financial assets, so that's
15 your checking account, your savings account, your
16 investment accounts, anything financial, \$1,000. So the
17 bottom quarter of the population, we're not even talking
18 about them. We're not talking about investing in
19 anything, much less private markets.

20 The next 25 percent, the median amount of
21 financial assets is \$10,000. So again, these are
22 households that are just trying to have a rainy-day
23 fund, right? They don't have money to be investing in
24 equities at all, really, much less in the private
25 market. So 50 percent of the population is just sort of

1 gone from the equation. So we're really talking about
 2 the upper 50 percent.
 3 Now, if you go to that third quartile from 50
 4 percent to the seventy-fifth percentile of households,
 5 their financial assets are more like \$60,000. So they
 6 do have a little bit of money and they're starting to
 7 invest. But generally speaking, they're investing in
 8 mutual funds, ETFs, you know, sort of the plain, vanilla
 9 stuff that you start to build your retirement. So you
 10 get above that and the -- basically, the current
 11 accredited investor definition captures like the top 10
 12 percent of households in terms of wealth. And really,
 13 there's only a wedge between about that 10 percent and
 14 twenty-fifth percentile that has enough wealth that they
 15 can sort of sensibly be investing in equities. So there
 16 is that wedge of the population. But we need to
 17 understand, that's sort of the wedge we're talking about
 18 when we talk about opening up the markets, the private
 19 markets, to individual investors. It's really just that
 20 sliver that is likely to be the candidates for
 21 attracting capital from.
 22 And if you drill down on that, you talk about
 23 -- well, of those -- of that sliver, seventy-fifth to
 24 ninetieth percentile, only one in four of those
 25 households invest directly in equities right now. And

1 that's public equities. So you have to wonder, you
 2 know, if there's -- and the median amount is \$25,000
 3 that they invest directly in equities and that's the
 4 public markets.
 5 So you've got to wonder, if they're investing
 6 in public equities at such low rates, even people that
 7 have some money, is it really realistic to expect that
 8 there's going to be a lot of demand for private
 9 investments and startups? So, I mean, it's not that I'm
 10 opposed, necessarily, to giving greater access. It's
 11 just we need to be, you know -- we need to understand
 12 sort of whether there is actually a big, untapped pool
 13 of potential capital out there and where that might come
 14 from.
 15 The second question I sort of raise is sort of
 16 the supply side of the equation. And that is, you know,
 17 there are statistics that show, you know, there's a lot
 18 of money sloshing around on the private side of the
 19 markets, PE funds, VC funds, angel investors. You know,
 20 I've talked to PE people that feel like just to, you
 21 know, use their capital, to allocate their capital,
 22 they're accepting terms that they would have considered
 23 just unthinkable not long ago. So there's a lot of
 24 money chasing a relatively small number of, you know,
 25 really good startups. Now, I'm sure there are some that

1 are being left out between the coasts.
 2 But I think it is fair to ask yourself, okay,
 3 if they can't find PE money, if they can't find VC money
 4 and they can't even find an angel group, what quality of
 5 investments are we leaving on the table for what would
 6 be the retail crowd?
 7 And then finally, I just think we need to
 8 think about sort of the challenges that investors would
 9 face in the private markets. And so these challenges
 10 are -- I mean, they're true for everybody. But they're
 11 magnified for a small-dollar investor. So obviously,
 12 you've got questions
 13 -- you know, you've got issues with liquidity in the
 14 private side of the market, you've got informational
 15 asymmetries, those types of things. But some of the
 16 discussion that you had this morning I think highlights
 17 some of these issues. I mean, a person that's
 18 participating in the private markets, there is an
 19 expectation that they're going to do some due diligence,
 20 maybe a couple of days' worth of due diligence. There's
 21 an expectation that they're going to be able to bring to
 22 bear the ability to value those assets appropriately, to
 23 price the risk, as was mentioned this morning. Those
 24 are -- those are important sort of skillsets or at least
 25 it requires a certain amount of devotion and

1 determination. And if you're talking about an investor
 2 that has maybe \$20,000 to \$30,000 of assets that they,
 3 you know, can appropriately devote to this asset class,
 4 does it really make sense for that person to devote two
 5 days to due diligence? Or, you know, figuring out the
 6 asset valuation, that type of thing. So there are some
 7 real challenges, I think.
 8 So it is not just a matter of, oh, investors
 9 might be defrauded, or, oh, investors might lose their
 10 money. I think there's a real -- there are some real
 11 important issues that we need to grapple with in terms
 12 of giving small-dollar investors access to the private
 13 markets.
 14 Now, I'm going to wind this down because I
 15 want to leave time for a couple of questions. But what
 16 a lot of this leads me to believe is if the Commission
 17 is to go down this road and try to make private markets
 18 more accessible to small-dollar investors, the way to do
 19 that would be through a fund structure. So I am
 20 interested in your discussion this afternoon.
 21 My hesitancy on the fund structure gets to
 22 more of a global concern. And that is just the public
 23 versus private markets and how the Commission is trying
 24 to sort of pursue two really competing objectives. And
 25 I think there is a lot of value in the public markets.

1 We have this rich, robust, highly liquid public market
2 with lots of information. You know, pricing is,
3 presumably, pretty good over there. And then we have
4 the private markets. And we've made it -- we -- the
5 JOBS Act, I think -- I could go into it -- made it
6 basically so it's optional, completely optional whether
7 a company goes public or not.

8 It used to be, once you got 500 shareholders,
9 you were sort of forced out of the nest of the nest of
10 the private markets into the public markets. And once
11 you became a public reporting company, you might as well
12 do an IPO, might as well list, all of that. Now, it's
13 become virtually optional whether a company ever goes
14 public. And so now we've got a situation where it's
15 costly to be public, it's not very costly to stay
16 private. Why in the world would a company ever go
17 public?

18 I think we're going to live to regret that one
19 of these days. And I do have a concern that the more
20 that we do to sort of create mechanisms for retail
21 investors to invest in early stage private companies it
22 just sort of contributes to that problem of sort of
23 undermining the public markets because we make the
24 private markets basically a place where you can get all
25 the investors you want, all the money you want, no

1 investors to invest in these types of investments. So
2 if there is no actual way for investors to participate
3 in these what you call perhaps not good businesses, how
4 do you even measure that? Right? How do you begin to
5 measure that?

6 And I think that's kind of the upside of this
7 committee, is we're trying to figure out is there some
8 acceptable test range, if you will, to plan? But I
9 think that's one of the more -- as an industry person,
10 that's one of the biggest frustrations we get from
11 investors. Because I know, good intentions, like I come
12 from the investment world as well. But the fact that --
13 and you said that 10 percent -- I think current
14 investors are actually 3 percent of the population. So
15 in that world, if it is literally not possible for
16 individuals to invest in private companies, right, how
17 do you answer your own question?

18 MR. FLEMING: So, first of all, I challenge
19 the premise. There's a lot I could unpack here. But it
20 is actually legal to invest in a private company. Up to
21 35 nonaccredited investors can get in a deal. Friends
22 and family rounds have been around forever. And there
23 is, you know, crowdfunding, Reg A, that provide
24 opportunities for the more retail investor to
25 participate in some of these earlier stage companies.

1 restrictions. So why would a company ever go public?

2 Anyway, with that, I'll leave it for a couple
3 of questions.

4 MS. MILLER: Thank you very much, Rick. And I
5 appreciate and I love hearing your perspective that
6 we've talked about, that seeing, you know, the SEC has a
7 tripartite mission which is, you know, protecting
8 investors; you know, fair, orderly and efficient
9 markets; and facilitating capital formation. And I
10 think both of us recognize the intertwined nature of
11 that.

12 MR. FLEMING: Yeah, I think so.

13 MS. MILLER: So I appreciate you being here
14 today and sharing your perspectives.

15 Welcome a couple questions

16 MR. LEE: So thank you for that perspective.
17 And you just mentioned a couple things I wanted to get
18 your opinion on. And there's an assumption in your
19 questioning or explanation that is there a demand,
20 investor demand, for these different companies, number
21 one? And then, is there even good enough startups that
22 are available to supply the investment demand?

23 So I think those are legitimate questions.

24 But I think the purpose that we're discussing in this
25 committee is that it is literally illegal for the

1 I'm actually a believer in sort of the
2 community-based offering. There are a lot of companies
3 that people would want to invest in, especially in a
4 small community, where you have really mixed motives.
5 It's not just to make a profit for yourself but it's
6 because there's only one pharmacy in that county and if
7 that pharmacy goes down, you're all going to be driving,
8 you know, 60 miles to get your medication. You know,
9 that sort of thing where there is sort of this community
10 appeal and it's local people investing in local
11 businesses.

12 You know, I think there are good reasons to
13 accommodate that. But I actually think there have been
14 accommodations made for that. The crowdfunding is one
15 example, Reg A.

16 MR. LEE: Sorry, just to be specific, what I
17 mean is there is not -- existing regulation doesn't
18 provide enough data. I think we all would agree on
19 that, there's not enough data. So that's the point.

20 When you say family and friends round, there
21 is no such thing as family and friends round. They
22 still have to be accredited investors to participate.
23 So if they're doing it, they're doing it illegally.

24 So what I'm saying is, is there a way that
25 your office or otherwise thinks there is at least some

1 forum or some exemptions or some flexibility to at least
2 gather the data? Because I think if you ask, I assume,
3 most people on this committee, there is -- the
4 exemptions that you talk about, the '35 rule, nobody
5 uses it. Right? These are not practical ways to gather
6 the data. And that's kind of sometimes the frustration
7 that we get when we're acting with investor advocacy
8 groups.

9 There has got to be some middle ground for us
10 to at least, you know, just try things a little more.
11 So that was just my general comment on the questions you
12 raise, which are very legit. But I'm -- I'm hoping that
13 there's a middle ground there that we can gather more
14 data on.

15 MR. FLEMING: Yeah. Like I say, I think --
16 well, I don't want to debate all this with you. I mean,
17 there is a naked 4A-2 --

18 MR. LEE: I completely understand what you're
19 saying, too.

20 MR. FLEMING: Even with crowdfunding, I mean,
21 it's raised some money. But I think the average raise
22 is like \$250,000.

23 MR. LEE: That's correct. Yeah, because it
24 was limited by a million dollars and individuals were
25 limited how much you can invest. And accredited

1 investors are also limited how much they can invest. So
2 that's what I'm saying. There's a lot of -- I think
3 we're on the same side of the big picture of like trying
4 to improve the capital markets.

5 But there are systematic issues in the
6 regulation crowdfunding and Reg A. It's not fair to
7 say, hey, you tried this and this works, because there's
8 literally -- the industry, the businesses and investors
9 have their hands tied behind their back. And that's not
10 a fair way to assess, hey, like people don't want to
11 invest in small businesses.

12 Or I don't know if you were here for Ross
13 Baird's conversation. The person making a million
14 dollars or less, \$250,000, they're just not going to be
15 able to get capital from the institutional investors
16 that we are going to hear in a little bit, and so on.

17 But I personally wish that the SEC investor
18 advocacy group could also take, you know, more practical
19 considerations in place in terms of just gathering data.
20 Right? We don't have to open the floodgates but let's
21 just try to see if we can gather more data by opening a
22 little more flexibility in the existing regimes.

23 MR. SEATS: I have two questions for you, one
24 easy question, one maybe hard question.

25 MR. FLEMING: Okay.

1 MR. SEATS: I thought the quartile, the way
2 you walked through that framing of the investor
3 landscape, awesome, totally loved that. I'm wondering -
4 - I mean, I think we have a shared viewpoint that pooled
5 structures help derisk these private investments in
6 important ways. So that, second, I'm wondering if you
7 think that also could apply to that second quartile? In
8 other words, not just that sliver -- the initial framing
9 sort of felt like a single issue versus pooled, because
10 --

11 MR. FLEMING: Yeah, yeah. I mean, I'm not
12 thinking in terms of cutting off, you know, strictly
13 you've got to be in the top 50 percent or whatever.
14 Because, I mean, I'm talking -- those are medians, also.
15 So, you know, there are outliers on both, both
16 directions, right? So there are people in that lower
17 quartile that have a little bit of money to invest, or
18 in that second quartile, certainly, there are going to
19 be people that have a little bit of money to invest.

20 MR. SEATS: I guess my implicit point is that
21 demand for pooled instruments might be greater than
22 demand for single issue because of that sort of dynamic.

23 And then the harder question --

24 MR. FLEMING: Probably. I mean, you've seen a
25 shift from investing in individual equities to funds.

1 MR. SEATS: Yeah, it matches the trend.
2 Right.

3 So the hard question is, if we can all look at
4 the JOBS Act having an either intended or unintended
5 consequence of decreasing the number of IPOs in public
6 companies, is there an action relative to that 500-
7 shareholder limit before public reporting? Is anyone
8 looking at that as one of the catalysts here to think
9 about?

10 MR. FLEMING: Not to my knowledge, honestly.
11 I think they should be. But I really think they need to
12 revisit that and see what the impact of that change has
13 been. Because I think that's why you're getting such
14 huge, you know, nonpublic companies, unicorns.

15 MS. HANKS: At the investor advisory committee
16 last week, there was a lot of discussion about the
17 unknowns in the private markets. We don't know how
18 private investors are doing, we don't know what the
19 return on investment is. Is anyone taking a look at
20 that? Is that something you guys could do? Is it a
21 DERA thing?

22 MR. FLEMING: Well, it's typically a DERA
23 thing. But in the -- in the request for comment in the
24 concept release, I mean, they basically threw it out to
25 the public, please come to us with data because we just

1 don't have it.

2 You know, one of the criticisms that was
3 raised last week in the investor advisory committee was
4 that the SEC put out a proposal a few years ago that
5 would have actually required some filing of some basic
6 data around private offerings and how much was raised
7 and from how many investors, that sort of thing. And
8 that was never adopted, so we still have just this
9 dearth of information.

10 MS. MOTT: Rick, there are some things like CB
11 Insights, PitchBook, PwC Money Tree, things like that,
12 that have some data. Have we ever done any studies, you
13 know, extracting data from those aggregators? I mean,
14 it would give us some -- it might not be perfect, but it
15 might give us some indication.

16 MR. FLEMING: I'm not familiar with those,
17 Catherine, but I would love to know more about that.

18 MS. MOTT: Oh, gosh, I'll introduce you to
19 them.

20 MR. FLEMING: And especially Brian. We love
21 data.

22 MS. MOTT: Those are probably three of them,
23 wouldn't you say?

24 MS. MEHTA: Yeah, but I think their data is
25 also reliant on what companies issue in their -- if they

1 MR. FOX: But essentially that there's a final
2 and, you know, you look at the capital-raising spectrum,
3 you know, there's all sorts of things, right, all the
4 way down from the very beginning companies all the way
5 up to IPOs and even beyond, right? And we've got to
6 look at all parts of the spectrum, right?

7 And so I think, as we've been thinking about
8 things, you focused on one part of it, right? The
9 unicorns and some of the issues at that part of the
10 capital markets. I want to make sure that we're not
11 losing sight of the fact that we may have companies much
12 earlier in the capital formation that aren't getting the
13 love because we have these mega-funds out there that are
14 focused on unicorns and stuff like that.

15 Would you -- I just want to make sure that
16 we're not -- you're focused on one issue and it's not
17 kind of polluting through to the rest of the issues.

18 MR. FLEMING: I mean, it probably is to some
19 extent. Because when you make tweaks to deal with one
20 end of the private markets, you're probably impacting
21 the full spectrum. And I do get less -- I mean, just my
22 personal view, I get a lot less worried about the small
23 startup business in a local community that's attracting
24 investors from the surrounding area that know something
25 about the business, they know the founders, they go to

1 file Form D's, which as we know are not a requirement.
2 It's more of a, you know, we encourage you to file a
3 Form D. And it's after the initial closing, so you
4 don't really know how much they ended up raising and how
5 many shareholders. So I think the data is as good as it
6 can be, but it is lacking.

7 MS. MOTT: I mean, that was my point, was it's
8 something to start with. It would just be, you know,
9 some indicator.

10 MR. FLEMING: Thank you.

11 MR. FOX: Rick, just one clarifying question,
12 just to make sure I understand some of the thoughts that
13 you put out there. I believe I agree with your position
14 on the 500 shareholder and some of the unicorns we have
15 and the issues we have, the need for secondary markets,
16 and this mismatch we have and these big companies,
17 right? But I'm not sure, is the issue of, well, gee, we
18 have more retail investors in private markets, is -- you
19 know, is that, in your mind, is that a singular issue or
20 is that maybe in that particular niche versus, you know,
21 lower down -- I mean, I think Martha gave a very nice
22 analogy at the beginning of the meeting and I don't want
23 to butcher your garage analogy about bikes and --

24 MS. MILLER: It was terrible to begin with, so
25 feel free to butcher.

1 church with them, whatever. You know, I have a lot less
2 worry about that than soliciting strangers over the
3 internet, you know, for some large operation, I guess,
4 with little -- with little financial information and
5 that sort of thing.

6 But it's hard to sort of --

7 MR. FOX: Regulate all --

8 MR. FLEMING: -- separate -- yeah, yeah. And
9 one of the issues we've -- I mean, to me, it feels like
10 if an offering is, you know, a few hundred thousand
11 dollars, is that really a federal problem? You know,
12 because I come from an old state regulator background.
13 And I can tell you that I could not shop a \$300,000 case
14 to the federal government and get any interest
15 whatsoever.

16 But I feel like something that's been lost in
17 this is that, you know, the business community and even
18 the small business community has pursued federal
19 regulation and preemption of the states to the extent
20 that, you know, you've sort of got this monolithic
21 regulatory structure at the federal level and less
22 ability to be, you know, I guess, creative, more
23 creative. You know, the states can be far more creative
24 at their regulatory level and, you know, they don't have
25 nearly the difficulty adopting a new exemption.

1 MR. FOX: Sometimes positively, sometimes
 2 negatively --
 3 MR. FLEMING: That's true. That's a fair
 4 point, it's a fair point.
 5 MS. GARRETT: Thank you very much, Rick.
 6 MR. FLEMING: Thank you.
 7 MS. GARRETT: We really appreciate your time
 8 here.
 9 HARMONIZATION: POOLED INVESTMENT FUNDS
 10 MS GARRETT: And so we are going to move on to
 11 our next agenda item, which is what we've been hinting
 12 at all day, the pooled investment funds. And so we have
 13 some speakers that will be joining us.
 14 So the harmonization concept release included
 15 a discussion of whether the SEC should take steps to
 16 facilitate capital formation and exempt offerings
 17 through pooled investment funds including interval funds
 18 and other closed-end funds, and whether retail investors
 19 should be allowed greater exposure to growth-stage
 20 companies through these pooled investment funds.
 21 To help provide background on various fund-
 22 related rules, the committee will hear from two experts
 23 today. The first is Richard Horowitz, who is a partner
 24 at Dechert LLP. Richard has represented both registered
 25 investment companies and private funds for more than 20

1 years. He has particular experience with alternative
 2 strategy mutual funds, such as manager of manager funds
 3 and closed-end funds of hedge funds and private equity
 4 funds. He is a co-head of Dechert's permanent capital
 5 practice and regularly advises alternative asset
 6 managers in their effort to assess permanent capital
 7 through the business development companies and closed-
 8 end funds.
 9 Welcome, Richard.
 10 And we also have with us today John Finley,
 11 who is the senior managing director and chief legal
 12 officer of Blackstone. Blackstone is an asset
 13 management business with over \$550 billion of assets
 14 under management. Those include investment vehicles
 15 focused on private equity, real estate, public debt and
 16 equity, growth equity and secondary funds. John is the
 17 senior managing director and the firm's chief legal
 18 officer and is also a member of the firm's management
 19 committee.
 20 Before joining Blackstone in 2010, John was a
 21 partner at the law firm of Simpson Thatcher and
 22 Bartlett, where he co-headed the global mergers and
 23 acquisitions group.
 24 Welcome, John.
 25 These speakers can help provide to the

1 committee a framework for those of us on the committee
 2 who are not as familiar with the legal jargon associated
 3 with investment funds and will also answer questions for
 4 us.
 5 So, Richard.
 6 MR. HOROWITZ: Thank you. I want to thank the
 7 advisory committee for having us here today.
 8 I am Richard Horowitz. I am a partner in the
 9 funds group at Dechert. Dechert has the largest
 10 registered fund practice in the United States. We
 11 represent many of the largest asset managers in the
 12 world. I am the co-head of Dechert's permanent capital
 13 group, which focuses on closed-end funds and business
 14 development companies. More on that shortly.
 15 Over the past several years, I have helped a
 16 number of alternative asset managers, both private
 17 equity managers and private credit managers, get into
 18 the registered fund space, as the private fund world and
 19 the registered fund world have been coming together over
 20 the past couple of years.
 21 We read with much interest the SEC's May
 22 concept release and we submitted our response letter in
 23 September, making recommendations on how we believe
 24 retail investors can invest in private companies through
 25 pooled investment vehicles.

1 Now, before I discuss our recommendations, I
 2 thought it might be helpful to just take a couple of
 3 steps back to take several steps forward. I thought it
 4 would be helpful to take a minute or two to discuss the
 5 three types of pooled investment vehicles that are
 6 regulated by the Investment Company Act of 1940.
 7 The first group of vehicles are open-end
 8 funds, otherwise known as mutual funds. Mutual funds
 9 are the vehicle of choice for the vast majority of
 10 retail investors, absolutely. Recent estimates are that
 11 over \$17 trillion are invested in mutual funds. Mutual
 12 funds accept subscriptions on a daily basis and provide
 13 daily redemptions. Mutual funds calculate a daily net
 14 asset value.
 15 As a result of the daily redemption feature,
 16 the SEC requires every mutual fund to invest at least 85
 17 percent of its total assets in liquid securities. A
 18 liquid security is a security that can be disposed of
 19 within seven days at the price at which the mutual fund
 20 is valuing it. Most mutual funds invest, I would say,
 21 95 to 100 percent of their assets in liquid securities.
 22 As a result, most mutual funds typically do not invest
 23 in private companies; rather, they focus on public
 24 equities, public debt, liquid broadly syndicated loans
 25 and other liquid assets such as publicly traded REITs.

1 The second type of vehicle that the '40 Act
2 regulates are closed-end funds. Unlike mutual funds,
3 closed-end funds do not have this 85 percent liquid
4 securities requirement. As a result, closed-end funds
5 can invest up to 100 percent of their total assets in
6 illiquid securities. There's about \$250 billion
7 invested in closed-end funds. Compare that to the 17
8 trillion, right, in mutual funds.

9 Most closed-end funds are listed on the New
10 York Stock Exchange or Nasdaq and therefore investors
11 trade their shares in the secondary market to each other
12 on a daily basis.

13 With no redemption feature, listed closed-end
14 funds are a solid vehicle to make private equity and
15 private credit investments in private companies.
16 However, I would say for the most part, closed-end funds
17 have been focusing more on the private credit side of
18 the equation than private equity, and I will get to that
19 in a second.

20 The listed closed-end fund market has been
21 very choppy over the past 10 years. Many closed-end
22 funds trade at a discount to net asset value. And it
23 has been difficult for underwriters of closed-end funds
24 to raise sufficient IPO proceeds to entice closed-end
25 fund sponsors to move forward with a listed closed-end

1 fund.

2 As a result, over the past few years, we and
3 others have been setting up a number of unlisted closed-
4 end funds. These are funds that are offered on a daily
5 or monthly basis. They typically provide quarterly
6 liquidity to retail investors through quarterly issuer
7 tender offers. A growing number of these funds are
8 called interval funds, which mean that they comply with
9 the provisions of the interval fund rule under the
10 Investment Company Act. And we can talk more about
11 that, if you'd like.

12 The third group again of entities regulated by
13 the '40 Act, business development companies, BDCs. BDCs
14 have been around since 1980. There is about 110 billion
15 invested in BDCs. Again, compare that to the 17
16 trillion in mutual funds. Under the Investment Company
17 Act, a BDC must invest at least 70 percent of its total
18 assets in what are called eligible portfolio companies,
19 EPCs. An EPC is a U.S. private operating company or a
20 very small U.S. public company, one with a market
21 capitalization of less than \$250 million.

22 The BDC provisions of the Investment Company
23 Act were put in place in 1980 to promote U.S. capital
24 formation for small companies. Thus you might conclude
25 that the BDC is a perfect vehicle for retail investors

1 to invest in U.S. private companies. Here again, I
2 think the answer is, yes. But BDCs for the most part
3 have focused on the income side, the direct lending side
4 of the business.

5 We have set up a number of BDCs for clients in
6 the past 10 years. I would say that almost all of them
7 make loans to U.S. private companies, not equity
8 investments. And I think there are two principal
9 reasons for this, and this applies to both the closed-
10 end funds and BDCs. Reason number one, since the
11 financial crisis, U.S. interest rates as we all know
12 have been close to zero. Investors have been desperate
13 for yield. I think I read the other day negative yield
14 sovereign debt is over \$12 trillion. It's a little hard
15 to understand.

16 The private credit investments BDCs make to
17 these small U.S. private operating companies, these are
18 below-investment-grade companies, are high-yielding
19 loans. They typically pay LIBOR plus let's say 5 or 6
20 percent. BDCs themselves can use leverage. They can
21 themselves borrow money to increase returns, with the
22 resulting dividend to BDC shareholders after fees and
23 expenses in the 7 to 9 percent range. In a zero
24 interest rate environment, BDC dividends of 7 to 9
25 percent have generated much investor demand, as you

1 might imagine.

2 Reason number two, the anti-affiliation
3 provisions of the Investment Company Act make it
4 difficult for many BDCs and closed-end funds to make
5 private equity investments in U.S. private companies.
6 Now, when I discuss the anti-affiliation provisions of
7 the Investment Company Act, I normally like to
8 distribute little bottles of Advil, too, and I apologize
9 not bringing enough for the advisory committee today and
10 I will try and keep it as simple as I can.

11 The Investment Company Act prohibits a BDC or
12 closed-end fund from engaging in a principal transaction
13 with certain affiliates. And I think that is pretty
14 clear. It also prohibits a BDC or closed-end fund from
15 engaging in a joint transaction, and here's where it
16 gets a little less clear, with certain affiliates.
17 Joint transactions are broadly defined as where a BDC or
18 closed-end fund desires to co-invest with one or more
19 affiliated private funds in the equity of a U.S. private
20 company. That co-investment arguably raises a joint
21 transaction issue for which SEC exemptive relief is
22 required.

23 Now, the good news is the SEC has granted co-
24 investment exemptive relief to a number of BDCs and
25 closed-end funds and we've obtained that relief for our

1 clients. However, that relief is not a panacea. It
 2 doesn't cover every possible scenario. And in most
 3 cases, a BDC or a closed-end fund sponsor like
 4 Blackstone wants to control the U.S. private company it
 5 is investing in. That's what private equity is all
 6 about. And so in controlling that company, the private
 7 equity sponsor will be making a number of decisions
 8 about that company, the future of that company, perhaps
 9 an M&A transaction, a disposition transaction or a
 10 recapitalization transaction, et cetera. All of these
 11 subsequent transactions could be viewed as raising joint
 12 transaction issues under the Investment Company Act,
 13 where a BDC or a closed-end fund is part of the
 14 controlling equity group.

15 Long story short, it is difficult, not
 16 impossible, for a BDC or a closed-end fund to
 17 participate in controlling equity investments in U.S.
 18 private companies. As a result, in our opinion, what we
 19 described in our response letter, one of the best ways
 20 for retail investors to participate in private companies
 21 is through closed-end funds of private equity funds. A
 22 closed-end fund of private equity funds is a closed-end
 23 fund that invests in 25 to 40 underlying private equity
 24 funds managed by the Blackstones, Bain Capitals, Apollos
 25 of the world. Each underlying private equity fund

1 invests in let's say 15 to 20 portfolio companies.
 2 Thus, indirectly, through the closed-end fund, retail
 3 investors would have investment exposure to 300 to 500
 4 portfolio companies.

5 As we have discussed in our letter, the SEC up
 6 until now has prohibited retail investors from investing
 7 in closed-end funds of private equity funds, taking the
 8 position that these funds are not, quote, unquote,
 9 suitable for retail investors. And they imposed an
 10 accredited investor standard for eligibility to invest
 11 in a closed-end fund of private equity funds.

12 Two important points here. It is unclear to
 13 me where this position came from. It is not based on
 14 the provisions of the Investment Company Act and it is
 15 not based on the provisions of the Securities Act. I
 16 don't believe it is the job of the SEC to decide which
 17 investment products are, quote, unquote, suitable for
 18 retail investors. I believe it is the job of the SEC to
 19 ensure that the disclosure about an investment product
 20 is accurate, clear and complete, and that retail
 21 investors have the relevant information they need along
 22 with their investment advisor or financial advisor to
 23 evaluate the risks and rewards of the potential
 24 investment product.

25 Institutional investors and accredited

1 investors have been investing in closed-end funds of
 2 private equity funds for many years. We are currently
 3 setting up three new closed-end funds of private equity
 4 funds for clients. The demand for these funds is there.

5
 6 I believe the time has come to permit retail
 7 investors to invest in closed-end funds of private
 8 equity funds and other closed-end funds of private
 9 funds. This would include, potentially, a New York
 10 Stock Exchange listed closed-end fund of private funds,
 11 as well as unlisted closed-end funds of private funds.
 12 The key point here is that making this change would not
 13 require any amendment to the Investment Company Act, it
 14 would not require an amendment to the Securities Act, it
 15 would not require the SEC to adopt a new rule under the
 16 Investment Company Act or the Securities Act. It would
 17 simply require a change in the SEC's informal position
 18 that these types of funds are not appropriate or
 19 suitable for retail investors.

20 Closed-end funds and BDCs have proven to be
 21 excellent vehicles for retail investors to participate
 22 in the private credit investments that they make. In my
 23 opinion, closed-end funds of private equity funds are an
 24 excellent vehicle for retail investors to participate in
 25 private equity investments in private companies. And we

1 recommend that the SEC change its informal position and
 2 permit retail investors to invest in these types of
 3 funds.

4 Happy to take any questions.
 5 MS. GARRETT: Can we hear from John first?
 6 MR. HORWITZ: Sure.
 7 MS. GARRETT: Thank you.
 8 MR. FINLEY: As Carla said, I'm John Finley.

9 I am the chief legal officer of Blackstone. And I am
 10 very pleased to be with you today and talk about
 11 alternatives, the opportunity of alternatives for the
 12 retail area. And I was also interested to hear the
 13 comments of Rick Fleming because we really are very much
 14 in agreement that this is an opportunity but it's also a
 15 risk that needs to be managed really well. It is not in
 16 the investors' interest, it is not in our firm's
 17 interest and it's not in the industry's interest to have
 18 a product be flooded into the market that is not a good
 19 product that investors don't see good returns on. That
 20 would really be extremely regrettable. And therefore,
 21 we agree, we need to be really careful how this gets
 22 looked at and how it gets into the marketplace. But it
 23 does come back to there is a great opportunity here.

24 So just to -- I did some slides and I'll try
 25 to get through them -- there we go.

1 (Slide.)
 2 MR. FINLEY: So this slide basically shows
 3 what the point all is about. And this was done by the
 4 Committee on Capital Markets Regulation, Voya, showing
 5 returns on PE performance verses the S&P. It's not the
 6 only way of looking at it; others look at it
 7 differently. But this is the case that the PE return
 8 beats the S&P over time. Because if you sort of cherry
 9 pick periods either one way or the other you can get
 10 different results.

11 And I'd say what's also really interesting
 12 about this is the volatility of private equity. And I'm
 13 talking about private equity, but I really mean private
 14 markets. You know, it could be real estate, whatever.
 15 And private equity, while we may be best known on the
 16 bigger side of the deals, also includes venture which
 17 we're not part of, growth we're getting into which is
 18 sort of the stage between, as you know, venture and
 19 private equity. So it really applies to all. So in
 20 terms of these returns, the thing that's really
 21 interesting is the volatility is actually lower in the
 22 private markets. And it's really for two reasons.

23 First of all, a private market, you value
 24 based on a DCF. So of course it's not going to bounce
 25 around like a public market. And second of all, in a

1 pretty familiar with where Jay was on this, the retail
 2 investors have less access to the market. That is for
 3 sure. Whether we want to expand that goes to again how
 4 do we manage the risk through that.

5 You will see from this chart in the lower left
 6 that the number of startups has just exploded in terms
 7 of again the expansion of the private market. So we've
 8 again come to the issue of it's a really large market to
 9 have people excluded from. To the point, the data isn't
 10 great in terms of an industry basis, this private
 11 market, how much of this demand is out there.
 12 Certainly, we're seeing, as we expand our retail
 13 efforts, anecdotally, you know, we're seeing a lot of
 14 expansion. There are stats that I saw that were older
 15 that shows that the mass affluent, which is basically
 16 100,000 to a million, is expanding quite dramatically.
 17 It was about a half a trillion in 2004. By 2015,
 18 according to Pricewaterhouse, estimated at 2.8,
 19 forecasted later again to go higher.

20 We also find from our own investments this
 21 demand. We have a product called a BREIT, which is
 22 basically a non-listed REIT. It makes commercial real
 23 estate available. But it's more income oriented than
 24 opportunistic. And it has minimum thresholds but
 25 they're lower, much lower than accredited. So it's the

1 private, you have the ability to intervene very quickly
 2 and anticipate and act in ways that you can't in the
 3 public markets. And both those things dampen
 4 volatility. So there are plenty of studies that will
 5 show that, with alternatives, not only can you get
 6 higher returns but you can reduce volatility.

7 (Slide.)
 8 MR. FINLEY: Moving along, this basically is
 9 just showing that private capital, median net RRs, and
 10 this shows private equity, private debt, real estate,
 11 infrastructure, pretty much on average exceeded 10
 12 percent. So that's pretty self-explanatory.

13 So again, you know, the why now? I won't
 14 dwell on this too much because you're all probably
 15 pretty familiar why now. And that is that the private
 16 markets have never been more robust. And that means
 17 that companies come to market at a later stage, the
 18 opportunity is not as great as it was, and the number of
 19 public companies is declining precipitously. And at the
 20 same time, we see that retail investors are under-
 21 allocated to alternative asset classes. So this will --
 22 I'll go back one.

23 (Slide.)
 24 MR. FINLEY: This was basically again sort of
 25 a restatement of where we were. Again, you're probably

1 NASAA, and so it's a 250K and then 70 or some
 2 combination. And we've raised relatively quickly on an
 3 unlevered basis 10 billion and 24 billion on a levered.
 4 And there is just tremendous demand for the product.

5 So we are seeing a lot of product, whether
 6 it's for -- a lot of perpetual vehicles out there. And
 7 we're certainly getting, as we expand through
 8 independent broker-dealers or registered investment
 9 advisers, both those firms, we're hearing demand for
 10 these alternative products. And it's not a surprise
 11 why. Look where interest rates are and look at where
 12 returns are. Yes, stock market has been up 23 percent
 13 this year. But overall, people are looking for, whether
 14 on the credit side or otherwise, a greater return. So
 15 we are seeing that demand.

16 (Slide.)
 17 MR. FINLEY: Next is showing again, you know,
 18 again, the decline in the public -- the public
 19 companies. There is no real surprise on that. Coming
 20 later to markets, as I mentioned.

21 (Slide.)
 22 MR. FINLEY: And if you look at the next page
 23 and you look at the average allocation to alternatives,
 24 so pensions 27 percent, endowments 29 percent, and
 25 individual investors less than 5 percent. So if you're

1 a registered investment adviser, you're an independent
2 broker-dealer, you're looking out for your client,
3 you're saying, gee, what should this allocation be?
4 That's really where a big driver is.

5 That even if you say, we don't want the same
6 allocation to a pension or endowment, I won't even get
7 into that, but is the percentage right and do we really
8 need that to be higher? And that's also a reason why we
9 both see an opportunity and both why we believe we're
10 seeing a lot of demand is that underallocation.

11 (Slide.)

12 MR. FINLEY: It's not just we that see it.
13 And before I get to this, you know, I was very
14 interested to read the ILPA letter that came in, the
15 Institutional Limited Partners Association, which is an
16 institutional view on the perspective and certainly not
17 a captive of private equity. And they strongly believe
18 in the benefit to investors of investing in the private
19 markets. And they continue to believe in this
20 allocation to private equity because there are yields
21 that just cannot be attained in the public markets.

22 And so that really is the essence of the
23 question. What's good enough for these institutions?
24 Is there a way to get the public markets -- is there a
25 way to get retail investors to get exactly what the

1 institutions are saying they want? And that comes back
2 to Rick. Which is, can it be done in a way that's
3 managed very safely? Institutions are not retail
4 investors, so the way that gets done is going to be
5 different. But it goes to the opportunity.

6 (Slide.)

7 MR. FINLEY: And over a period of years, this
8 is just showing that the growth of the \$10,000
9 investment over a 30-year period, just how dramatic the
10 difference is when you have that increase over the S&P.
11 So I won't dwell on that. But it is a pretty
12 interesting stat of just how dramatic it is over a
13 period of years, as someone is sort of looking for their
14 retirement or investing for their retirement.

15 This slide didn't come up; I don't know
16 exactly why.

17 But basically, what this is -- what you would
18 have seen if this were up there is what we're doing to
19 address some of the issues as we go out to the
20 marketplace to manage some of the risk. So we are doing
21 a tremendous amount of education to the registered
22 investment advisers and the independent broker-dealers.

23 We are tailoring products specifically to the retail
24 market that's designed for their needs. We are
25 investing in proprietary systems that allow us to track

1 the investment data very, very carefully, rate
2 investments. And we are working through increasing
3 employees and dedicated service platforms, all which
4 make us more effective in addressing that market.

5 We certainly, in terms of the demand, you
6 know, the private wealth, AUM raised, has gone from in
7 2011 220 million to 25 billion now. So that again is
8 showing -- now, of course, some of that is accredited
9 investors, whatever. But if you're looking at mass
10 affluent and you're looking at high net worth,
11 tremendous amount of interest in these products.

12 (Slide.)

13 MR. FINLEY: Also that's -- I didn't realize
14 it went there. So there you have it. It gives all the
15 things that came in. It is more sophisticated than I
16 was ready for.

17 So what are we thinking about? Well, the way
18 we have been thinking about it and we didn't put it in
19 our own letter but the AIC did, the American Investment
20 Council and generally supportive of their views, is
21 really -- and again, the ILPA is instructive because
22 again, it's not an industry player, it's rather a
23 customer.

24 ILPA said that, rather than direct investment,
25 they think investing through a registered fund vehicle

1 would be preferable for most retail investors and the
2 Commission should consider this model. And that's
3 really what many of -- what these proposed regulatory
4 changes are focused on. Because rather than looking for
5 the investor to sort of have to pick out the next Uber
6 or avoid WeWork, whichever way you look at it, through
7 the pooled vehicle, you get not only diversification,
8 but you get all the advantages of an intermediary to
9 providing.

10 And one which Richard mentioned right off the
11 bat, this eliminating the accredited investor threshold
12 for offering of registering of funds of private funds.
13 This is probably the most obvious way to address the
14 issue, which is that the Staff requires that offerings
15 of registered closed-end funds that invest more than 15
16 percent in private funds be limited to accredited
17 investors. And a number of commentators have encouraged
18 the SEC Staff to change that policy because that
19 basically would allow you then to have a registered
20 closed-end fund that would have a substantial investment
21 in private funds, could be diversified, you'd have the
22 intermediary and you don't have the risk of the demand,
23 you know, everybody looking for their money because it's
24 a closed-end fund, of course. You all know this.

25 So this provides one route. Others, not

1 getting in the weeds too much, easing the liquidity
2 restraints for target date funds. Target date funds are
3 terrific vehicles for long-term investing. And when
4 you're young, obviously, again, you guys know, invest in
5 something that's locked up for a while and then gets
6 more liquid as you get older. And this would facilitate
7 being able to be in illiquid assets. And finally, more
8 carry-like compensation for retail funds.

9 But also in terms of managing the risk, the
10 risk
11 -- you know, the framework of going through a regulated
12 pooled fund is, of course, one way of managing that
13 risk, managing that issue of the individual investor.
14 But we also saw commentators who focused on access to
15 experienced managers, either having managers that meet
16 scale and experience, not people that are learning on
17 the job first time in, and also having retail be no more
18 than a percentage or having the retail be invested with
19 a manager who has a tremendous institutional following.

20 I mean, that will do two things. Number one,
21 they can draft off of the institutional terms and
22 conditions. And also, if an institutional investor is
23 invested substantially, that gives one a level of
24 comfort that might not be the case if a manager only has
25 retail money. So that would be -- the suggestion is

1 funds. But I see no reason that the principles wouldn't
2 apply. We -- Blackstone is not only at the biggest size
3 investments because we have a tactical opportunities
4 fund which is opportunistic and has no minimum, makes
5 actually quite small investments. And we also have a
6 growth fund, which I mentioned, which is between
7 venture.

8 Now, we don't go to the smallest venture. But
9 I don't see any reason why venture can't be subject to
10 the same principles, as long as the same protections are
11 in place. And certainly the diversification in a pooled
12 is ideal when dealing with venture.

13 MR. HOROWITZ: My answer, similar. You know,
14 there are a number of private equity managers that I've
15 never heard of that are doing really good work investing
16 in smaller companies. And smart fund of funds managers
17 are out there looking for those managers, those private
18 equity managers, wanting to put their funds in a pooled
19 investment vehicle. So I think the answer is yes, you
20 would see -- it's one way that a fund of funds manager
21 can distinguish itself from sort of the larger, more
22 traditional -- the larger, you know, buyout fund
23 managers, is to find these smaller managers. Managers,
24 I should say, that focus on smaller companies. I do
25 think you would have a mixture of closed-end funds of

1 that the SEC should consider limiting retail access to
2 managers with an institutional investor base. And that
3 certainly would provide another layer of protection.

4 So you've got the pooled vehicle, pooled
5 vehicles that are managed by managers who manage
6 institutional money and then opening that up more to
7 retail.

8 So with that, I think Richard or I would be
9 happy to answer any questions or go into more depths on
10 these topics.

11 MR. YADLEY: Thank you both. You made very
12 complex information understandable.

13 Earlier this morning when we were talking
14 about this subject, one of the things that came out is
15 part of the scale that has been created quite
16 successfully with funds such as Blackstone is investing
17 in larger companies, later companies, you have a lot of
18 money to put to work. And a lot of the smaller
19 companies need smaller amounts of money.

20 Would you envision that funds would be created
21 with these rule changes that would invest smaller
22 amounts of money in earlier stage and developing
23 companies?

24 MR. FINLEY: My focus has been what I know
25 best. And so the focus has been on the larger scale

1 private equity funds, some larger, some smaller.

2 MR. SEATS: Gentlemen, thank you for all the
3 information. I agree it was a great walkthrough.

4 So what -- the commonality between both of
5 your framing and I think many of the comment letters I
6 think has a lot of alignment in this room, which is that
7 the way to address some of these risks is to pool
8 investments into portfolios and that you are addressing
9 some of the primary concerns there. And then to figure
10 out how do you get alignment with fiduciaries in the
11 middle.

12 I think both of your suggestions were down the
13 line of having a fund of funds approach, you know,
14 registered fund of private funds. And in one -- and it
15 has the nice feature of saying, hey, this already meets
16 the regulations but it doesn't meet the Staff sort of
17 policy position, so it's an easier -- maybe an easier
18 attack surface.

19 But the thought I have on this is, is there a
20 risk of sort of the extra layers of fees in the middle
21 of those structures? And are you choosing that path
22 because of expediency or -- I mean, in other words, can
23 you achieve the same net effect with a larger pooled
24 vehicle that has the same underlying investments versus
25 having multiple layers? And maybe another way of asking

1 that is if you need to enter a position of fiduciaries
2 as part of the sort of selling point on it.

3 MR. HOROWITZ: It's a good question. I'll
4 give you my answer. You know, I would say that a fund
5 of funds manager is providing a high-quality service in
6 evaluating the thousands of underlying managers that are
7 out there, having this complex database of performance,
8 right, that they've accumulated. And so to pay the --
9 yes, there are two layers of fees, right. There's a
10 management fee at the closed-end fund level and then a
11 management fee and a performance fee at the underlying
12 private equity fund level.

13 And I would say net of all of those fees, it
14 is -- you are getting -- an individual investor is
15 getting a diversified portfolio, a noncorrelated
16 portfolio of exposure, right, away from the public
17 equity markets that is important, I would say, for his
18 diversification, her diversification.

19 So I think -- I don't have the statistics on
20 the overall performance after fees but I think it's been
21 solid. I think fund of funds performance has been solid
22 over a long period of time.

23 MR. FINLEY: Yeah, I -- this is a great
24 question. I would have liked the question to be asked
25 without even knowing you were going to ask it. Because

1 a couple answers on it.

2 One, interestingly, if you do do a fund of
3 funds, you can't have an affiliate of the fund --

4 MR. SEATS: Richard asked for exemptive relief
5 on --

6 MR. FINLEY: Right, but if you did -- but the
7 point is, to your point about fees, you might be able to
8 get much lower fees if you had, for example, a
9 Blackstone group of funds, real estate and credit and
10 PE, and then manage that through, be able to do it much
11 more -- at a lower cost than is done today. So that's
12 one answer on the fees. Fees, you know, certainly have
13 to be managed.

14 The other is, some of the issues don't relate
15 just really to the fund of funds, like a target date
16 fund. You know, giving more flexibility to just have a
17 manager say, you know, I want to put a private equity
18 fund into this that's being managed otherwise, that also
19 is necessarily going to create a fee issue, it's going
20 to not make it work on a net basis.

21 So it's a very legitimate issue. The fee
22 issue and the net and where you are on a net basis is,
23 you know, critical. But I do believe one way or
24 another, they can be managed through based on just two
25 examples, two I just went through.

1 MR. SEATS: The underlying performance data
2 that you showed, is that levered or unlevered on the PE
3 numbers?

4 MR. FINLEY: Levered. But, you know, PE --
5 the PE, it used to be that leverage was the biggest
6 driver of PE gains. And as some of you may know, that's
7 really not the case anymore. Operating improvements is
8 really a much bigger factor in leverage. And
9 nonetheless, the volatility returns also reflect
10 leverage.

11 And little known, but if you take private
12 equity investments of similar quality to similar credit
13 of non-private equity, the bankruptcy rate is actually
14 lower on private equity than non-private equity for the
15 same level of credit quality.

16 MR. SOLOMON: Could I ask -- hi, Richard.
17 Sorry I missed you on the train this morning.

18 MR. HOROWITZ: Oh, Jeff Solomon. How are
19 you? By voice, calling in.

20 MR. SOLOMON: Yeah, can you guys just walk
21 through what would the mark to market regime be on these
22 products? Because so much of the challenge associated
23 with BDC marks, and ultimately how NAVs get reported to
24 individual investors, you know, people take a look at
25 Level 1 assets and that's really, you know, at the end

1 of the day how -- especially if you're dealing with
2 several funds in this framework, how would the mark work
3 and how would you suggest that the investor should get
4 comfortable with that regime?

5 And then a follow-up question is, if you are -
6 - well, actually answer that question first and I'll
7 follow up.

8 MR. HOROWITZ: So in a closed-end fund of
9 private equity funds, you've got illiquid private equity
10 fund investments, right, that the closed-end fund has
11 made. Those are Level 3 assets, right? The manager of
12 the closed-end fund is getting reporting, right, from
13 the underlying managers on a quarterly basis of how that
14 manager is valuing its portfolio companies. In between
15 quarters, that manager provides other information, I
16 guess I would say, about the portfolio. Meaning it's
17 calling capital, it's disposing -- it's doing
18 dispositions of portfolio companies. There is
19 information that's provided in between the quarters as
20 well to the closed-end fund manager.

21 You know, a closed-end fund, as I said, under
22 the '40 Act, has to have its own valuation policies.
23 There's a board of directors of the closed-end fund, a
24 majority of whom are independent of the adviser. That's
25 a '40 Act requirement. The board has a role to play in

1 approving the valuations, right, for the closed-end
2 fund.

3 And so I guess I would say it's certainly
4 difficult, right, for the closed-end fund manager to
5 have better information than the underlying managers
6 about those portfolio companies. But the closed-end
7 fund of funds managers that we work with have very
8 sophisticated valuation models, very sophisticated
9 databases. They are monitoring these funds and the
10 portfolio companies in these funds. And I think if I'm
11 a retail investor, I can take a lot of comfort in all
12 the work that's being done by the fund of funds manager
13 in coming up with valuations for that closed-end fund.

14 MR. SOLOMON: So my follow-up question is if
15 you're dealing with publicly traded or publicly listed
16 BDCs and they fall below the net asset value, would you
17 be proposing that there be a -- of how they can raise --
18 capital? Because I think that's always sort of, I
19 think, the -- for publicly traded BDCs. And if you had
20 mostly private equity oriented -- you know, how would --
21 how would that -- you know, how do you think that might
22 work?

23 MR. HOROWITZ: That's a good question.

24 So what Jeff is asking about, there are a
25 number of BDCs, right, that are listed on the New York

1 basis in terms of what the NAV of that closed-end fund
2 is to try and ensure, give comfort to the marketplace
3 that, you know, the underlying portfolio companies are
4 performing as we expected and so on.

5 But I certainly, you know, wouldn't be
6 surprised if the closed-end fund's stock price from time
7 to time trades at a discount to NAV.

8 MR. FINLEY: Yeah. I'd also -- you already
9 have alternatives that have the issue of valuation and
10 mark to mark. I mean, you've got alternative
11 multistrategy funds that have hedge -- you know,
12 multiple hedge fund managers that the central manager
13 has to get valuations. You have BDCs and credit for
14 alternatives where there's valuation issues of all the
15 alternative assets and, you know, investments in a
16 variety of companies. And some, you even have
17 nonaffiliated managers with some private equity that are
18 being done, whether here or abroad.

19 So it's a great question. But again, if there
20 were a will to sort of say we want to do this for the
21 investor, that kind of mechanic can be worked through.

22 MR. SOLOMON: I think you guys did a great job
23 of making a very complicated area, topic very
24 understandable, so thank you.

25 MR. LEE: My question was -- thank you for,

1 Stock Exchange. There's a '40 Act provision which says
2 if your share price is trading at below the then-
3 calculated net asset value, you cannot issue more shares
4 in that discount situation. And that provision in the
5 '40 Act is meant to prevent dilution to the existing
6 shareholders.

7 You can go -- under the '40 Act, you can go to
8 your shareholders and actually have a proxy and ask them
9 to approve a proposal to allow the BDC or closed-end
10 fund to issue shares at below net asset value and many
11 BDCs have done that from time to time in an effort to
12 say to the investors, you know, we want to have some
13 cash, we think there are good investment opportunities
14 here, we don't really -- you know, we're not bothered by
15 the fact that our stock price is trading below our
16 calculated net asset value. We want you to approve this
17 proposal. That proposal, if approved, would be good for
18 one year.

19 I would say a closed-end fund of private
20 equity funds would probably operate in a similar manner.

21 You know, how would the stock price trade? I think
22 that's the question you're asking, right? It's a good
23 question, it's a very good question. You know, part of
24 the answer to that question depends on how much
25 information, right, can be put out there on a regular

1 again, making this -- I think we're all in agreement,
2 generally, in the gist of what you were saying. But I
3 think part of this committee mission and the SEC in
4 harmonization also was not just about opening access to
5 retail investors but actually from the business
6 perspective of bringing capital to the local businesses,
7 local economies that, I'm generalizing a bit, but the
8 big firms you mentioned generally are not investing in,
9 let's just say, a local investment that was presented
10 earlier, which was a small food product company in
11 Kentucky, for example.

12 So one of the things that, while I complete --
13 agree -- and with Rick as well, on the investor
14 protection sense, of like let -- let investors, retail
15 investors, invest alongside managers, quote, unquote,
16 with scale and experience, the problem, if you will, as
17 a matter of practice, that there is no institutional
18 investor with scale and experience that has focused on
19 investing in these local, smaller investments, right?
20 Because of the systematic matter.

21 So I'm just -- obviously, there is no right
22 answer. But I just wanted to get your thoughts on, from
23 your perspective, as leaders of the investment industry,
24 how could you utilize these laws to bring capital
25 specifically to smaller businesses? I'm not talking

1 about the \$50 million small business; I'm talking about
2 the 500,000 revenue small businesses. Because I think
3 that's, if as big, if not biggest -- or at least to some
4 members of the committee, that's what the passion is, to
5 try to bring capital to those businesses.

6 MR. FINLEY: So if what you're saying is that
7 the way in which either venture or growth funds, as
8 they're operating private equity funds of which there
9 are thousands, that even with those with experience,
10 they're just not going to be making at any of those
11 levels those kinds of investments for the firms that
12 you're addressing, while I wasn't prepared to address
13 that because I thought at some of the ranges, that would
14 be still viewed as small business capital formation.
15 But I would say that I would err, at least from our
16 perspective, on having firms with scale and experience
17 as we move into an area that's new. And we can see how
18 that goes, maybe.

19 But given that we've got all these -- we don't
20 have all these, but the three intertwined objectives,
21 yes, capital formation. But we have to do it in a way
22 that's managed safely for investors. I would have some
23 concerns on that, in terms of what I would call opening
24 the gates and having retail investors have managers
25 without scale and experience.

1 Personally, not only am I concerned for the
2 investor, but I think it's terrible for the industry if
3 there is a -- the wrong players get in. We've seen in
4 certain areas where wrong players do get in and the
5 industry really gets tainted and nobody wants to get in,
6 and in the long run it actually hurts capital formation
7 when there isn't the credibility. So I would be very
8 cautious with that.

9 It may not be exactly what you're looking to
10 hear. But that was my perspective on that.

11 MR. LEE: That's actually a very legitimate
12 perspective as well. And I guess this is an open
13 question. It really is the fact -- I think that was the
14 point, right? Because of that assumption, which
15 probably is valid, statistically. But the reality is
16 there are a lot of businesses in these small markets
17 that require capital. And the flipside is there are
18 individuals that are not accredited investors that,
19 because of their local -- locality, relationship,
20 reputation, want to invest in these businesses. And so,
21 yeah, maybe the answer is under this exemption, that's
22 not the right -- there's some other way to do that.

23 MR. FINLEY: Exactly. It may not be this
24 particular pooled vehicle.

25 MR. LEE: But I think this -- this is a good

1 as a highlighting, an unintended consequence of limiting
2 it purely to an experienced -- scaled and experienced
3 manager might be again the persistent problem of capital
4 to local businesses, especially women, minority,
5 immigrant founders. Which is a huge proportion of
6 companies that are utilizing regulation crowdfunding for
7 specifically that reason.

8 So that's just one thing to highlight to the
9 overall committee, is this is very good but there are
10 other issues.

11 MR. HOROWITZ: I would add one thing. BDCs,
12 we've set up a number of BDCs for clients. Typically,
13 the BDC is making a loan to a company with, you know,
14 EBITDA of let's say 5 million to 100 million. So you're
15 right in saying even a \$5 million company is not sort of
16 the company -- in earnings is not the company that
17 you're sort of focusing on, very small companies. But
18 that BDCs do go down, I would say, to that level to make
19 loans to companies like that.

20 We did set up a closed-end fund a couple of
21 years ago for a client which buys consumer loans from
22 SoFi and Lending Tree and pools, buys thousands of them,
23 right? And it's a fund that now has about 500 million
24 in assets, so it's gaining in popularity. And so I
25 would note, I think, that there is maybe some potential

1 to pool very small loans from these kinds of marketplace
2 lenders, right, and put them in a registered fund. And
3 the schedule of investments for that fund goes on for
4 many pages because they literally have thousands and
5 thousands of small loans on their balance sheet.

6 MR. SEATS: A question related to that. The -
7 - how do you think about the tension of the disclosure
8 requirements? So in that example, these are private
9 companies, but their loan principal is in a public
10 disclosure list. And maybe in that fund of --
11 registered fund of funds structure, you've got one layer
12 of shielding on that.

13 But do you -- how do you think about the
14 tension of some of the benefits of being a private
15 company connected to the public disclosure requirements
16 of retail capital?

17 MR. HOROWITZ: Yeah, I do think that that is a
18 benefit of a closed-end fund of private equity funds or
19 a closed-end fund of private credit funds, in that the
20 investments that are presented are the underlying funds
21 that the fund is invested in, right? You don't look
22 through to the portfolio companies in those funds for
23 SEC reporting purposes.

24 And, you know, if that's important to those
25 portfolio companies, they have that level of, you know -

1 - the confidentiality, whatever, is still there.
 2 MS. MOTT: I was going to ask about
 3 concentration of PE in major cities. We see in VC 80
 4 percent of it is in three cities. But 55 percent of the
 5 angel capital is in the middle market, and 45 percent in
 6 those three major cities.
 7 How do you see that in your own -- in your PE
 8 world, if we encourage that -- so we now allow retail
 9 investors to participate? Will you get too much money
 10 maybe chasing the same deals? Would you drive down the
 11 returns? I mean, you know, when we think about this,
 12 how it's going to maybe impact the market?
 13 MR. FINLEY: That's a legitimate issue, which
 14 is
 15 -- and ILPA raised that issue, too, which is that one
 16 needs to be cautious. And they're concerned because
 17 they're saying, gee, if all this retail money comes in,
 18 are we going to drive down the returns? And therefore,
 19 that's why -- the way we look at it. On the one hand,
 20 we see that there should be some democratization of
 21 these opportunities and it's good for the investors and
 22 it's good for our industry if this is a product that's
 23 more widely available. But we have to do it in a very
 24 measured, cautious way that gives investors the
 25 opportunity for really the investors with scale and

1 logistics or a balance of some percentage of
 2 manufacturing, a percentage of logistics, a percentage
 3 of robotics. You know what I mean? Something like
 4 that, that focuses on an underserved area or something
 5 like that?
 6 MR. FINLEY: That's the way PE has really
 7 developed. So as PE started in our firm with global
 8 opportunistic funds, it then went towards either regions
 9 or industries, whether it was energy. Some of the firms
 10 specialize more, even in PE, within tech. And so that
 11 will be a natural evolution as you get bigger and bigger
 12 scale and the industry is much bigger and people are
 13 expecting to allocate more to it, if you look at --
 14 industry source and they ask managers, are you going to
 15 allocate more to private equity? The answer is, yes.
 16 And as that happens more and more, and to your point
 17 about chasing, you start to go more niche. And that
 18 will only be a continued evolution.
 19 So when you think about private equity, you
 20 really have to say, gee, Asia fund, European fund,
 21 European real estate fund, energy fund, you know, it
 22 really gets sliced up a lot for the benefit of the
 23 investor.
 24 MR. HOROWITZ: We're in the process of setting
 25 up a new closed-end fund. It's going to focus on

1 experience and institutional base. But that's part of
 2 the balancing in how much you open up.
 3 MS. MOTT: So could you -- I'm sorry.
 4 MR. HOROWITZ: I was just going to add one
 5 quick thing. When I look at the portfolio companies,
 6 let's say, our BDC clients have invested in, they made
 7 loans to these companies. These companies are
 8 throughout the United States, which is very interesting.
 9 BDC, as I said, has to invest at least 70 percent of
 10 its assets in the United States, so it is a U.S.-focused
 11 vehicle. But they have that 30 percent other basket and
 12 often are making loans to non-U.S. companies. And you
 13 are seeing very interesting companies outside the United
 14 States that they are loaning money to.
 15 I would think you would see a similar kind of
 16 distribution if you looked at those 300 to 500 portfolio
 17 companies, right, in my example in a closed-end fund of
 18 private equity funds. My guess would be you would be
 19 seeing very interesting companies in lots of different
 20 industries across the United States.
 21 MS. MOTT: So could there be an opportunity
 22 for sector funds, so to speak, that focus on regions or
 23 specific regions? So could this model work in something
 24 like that? And let's say, when we say sector funds,
 25 like maybe manufacturing and then another one in

1 distressed investment opportunities. I think that's
 2 interesting, right? Everybody is sort of waiting,
 3 right, for the shoe to drop. And, you know, it's a
 4 well-known manager. You know, lots of people around
 5 this table have heard of them and they have an excellent
 6 distressed reputation, right? And so retail investors
 7 will be able to invest in that fund. I think that's
 8 interesting.
 9 MR. TORBERT: John, Richard, can I ask you a
 10 quick question? Because we're really focused on making
 11 sure that some of these smaller regions and companies
 12 get financing. So can you help me understand?
 13 Traditionally, what happens is, as the funds
 14 get bigger, quite frankly, they keep looking for bigger
 15 and bigger deals. What incentives can we put in place
 16 that, if we allow more retail investors to put money
 17 into your funds and others, that you then begin to focus
 18 on the manufacturing effort or manufacturing fund in
 19 West Virginia or whatever region? How do I know that
 20 you guys will continue to stay in focus on those types
 21 of reasons? Or will you just go upstream like we
 22 normally see happening every single time something
 23 changes in the market in favor
 24 MR. FINLEY: But again, it may not be
 25 satisfactory because the larger firms do have minimum

1 threshold investments and they're high.
 2 MR. TORBERT: Of course.
 3 MR. FINLEY: But you do have thousands of
 4 private equity firms. And I think you could speak to it
 5 more in terms of middle market or smaller, that when the
 6 opportunity is there for returns in a neglected market,
 7 the opposite -- these big deals are flipside. The
 8 bigger firms, with the competition, they're, you know,
 9 the only ones who can do the big deals so there's less
 10 competition.
 11 But you do have areas in the market, much
 12 smaller deals that firms that aren't here and you
 13 haven't heard of, that are focused on those smaller
 14 deals and they have experience and they have a good
 15 track record.
 16 Maybe hear from Richard in terms of the size
 17 of the kinds of deals you're seeing with your middle
 18 market practice.
 19 MR. HOROWITZ: Yeah. No. Right. So Dechert
 20 has a large private equity middle market practice,
 21 right? We represent private equity managers that do
 22 buyouts, you know, in the hundred million to 500 million
 23 range, not necessarily billions of dollars. Those are
 24 small companies. They're not micro companies, right,
 25 but they are small companies. And they are companies

1 that could benefit tremendously from the expertise that
 2 these managers, right, can bring to the table to help
 3 them grow and so on.
 4 We see a number of managers focusing on the
 5 middle market, I would say small to middle market
 6 companies, because there are more opportunities there
 7 for returns. I agree with you. Right? And I think the
 8 returns will dictate where these high-quality managers
 9 look in terms of industries and sectors and all that
 10 good stuff.
 11 MR. TORBERT: Can I ask you one other
 12 question? Which is, are there any other incentives that
 13 the SEC can put in place that make companies like, say,
 14 the Riverside Company or GTCR or some of those folks
 15 that you and I know, are there incentives that we
 16 possibly can put in place that encourage them to go
 17 downstream, mid and then downstream, so to speak,
 18 structurally?
 19 MR. FINLEY: That's a good question. You
 20 know, I tend to look at the SEC as more of a disclosure
 21 and protection regime. And so it may -- I mean,
 22 certainly it should be looked at. But it may be that
 23 that's got to come from other areas in combination with
 24 giving that flexibility and that it can't really be by
 25 the SEC alone to address that issue.

1 MR. HOROWITZ: I could probably give the same
 2 answer, right. Tax benefits seem like something that is
 3 outside certainly the SEC's, you know, bailiwick. But
 4 it seems like to encourage investment flow into areas
 5 that need to grow and need to benefit from inflows,
 6 capital inflows, yes. Tax benefits, yes.
 7 MR. TORBERT: Thank you, gentlemen.
 8 MS. GARRETT: Thank you very much, John and
 9 Richard. We really appreciate all your insights today.
 10 MR. HOROWITZ: Thank you for having us.
 11 MR. FINLEY: Thank you. Enjoyed it very much.
 12 MS. GARRETT: As people said, you made very
 13 complex issues simple for those of us. Thank you.
 14 DISCUSSION
 15 MS. GARRETT: And for the committee members,
 16 now that we have had all of our speakers for the day, we
 17 can continue our deliberations and discussion on
 18 harmonization and any recommendations.
 19 You know, I might say we might want to start
 20 with what we've just heard about the pooled investment
 21 funds and what people's thoughts are in terms of
 22 developing recommendations for this committee to vote on
 23 today.
 24 MS. MEHTA: I would be interested in hearing,
 25 since it's not really part of the rules but just the way

1 the SEC has enforced that 15 percent rule of not more
 2 than 15 percent can go into illiquid assets, can any of
 3 you speak any more to why it has been that way and what
 4 -- what you are trying to protect and do you think
 5 that's working? Or is that really up for debate, to get
 6 rid of that 15 percent threshold?
 7 MS. MILLER: Eyes are on me. And so I am
 8 going to go right outside of my lane and so I'm going to
 9 keep it -- earlier, Ross said he was at the 10,000 or
 10 100,000, so we're going to go to million-foot level.
 11 But when they were talking earlier about
 12 redemption, it goes to the liquidity requirements with
 13 those funds. And so that's a threshold that's been set
 14 for that. So closed-end funds provide just different
 15 flexibility, given the differences in liquidity
 16 requirements there and the lack of redemption -- daily
 17 redemption requirements that mutual funds have. Which
 18 is why you have two very different types of funds; they
 19 have very different types of investments they can hold
 20 because they have very different ways that they interact
 21 with the shareholders and investors in those funds.
 22 Does that answer it in two sentences? Please
 23 don't make me say another one --
 24 (Laughter.)
 25 MR. SEATS: I mean, to support that point

1 though, the reality is they could have 15 percent in
2 illiquid. But the industry is 5 to zero percent in
3 illiquid. So not even approaching the 15 percent mark,
4 out of caution on ability to create -- you know, to
5 satisfy redemption. So it sort of points to mutual fund
6 constructs, not the right formulation.

7 I think the question -- the question I'm
8 interested in was similar framing but different like
9 predicate is that the policy position that doesn't
10 actually match the regulations on accredited investors
11 having access to invest in -- nonaccredited investors in
12 registered funds of private funds. Like that was the
13 one thing -- that was the point they were hitting on, is
14 this is not -- this is in line with '40 Act, this is in
15 line with all current regulations. This is sort of a
16 Staff position.

17 So I don't know if that -- did that resonate?
18 Is there -- I don't know if there's more -- if there's
19 something to talk about on that one.

20 MS. MILLER: I think it's up for debate.

21 MR. SEATS: Yeah.

22 MS. GARRETT: Just to be clear, is there a
23 Staff position right now that nonaccredited investors
24 can't invest in registered closed-end funds that invest
25 more than 15 percent of their assets in private funds?

1 Is that the current --

2 MS. MILLER: There is guidance on that, yes.

3 MS. GARRETT: There's guidance on that right
4 now. Okay.

5 MR. LEE: And also Regulation Crowdfunding
6 specifically prohibits raising -- using Regulation
7 Crowdfunding for purpose of investing in funds. So
8 that's a statutory limitation.

9 MR. SEATS: I mean, I could throw out there
10 that
11 -- I mean, we could debate the scope of this committee
12 and how much like changing that guidance actually
13 affects small business capital formation. But all of
14 that aside, I think the argument is an extremely logical
15 argument in terms of democratizing access for investors
16 into that particular asset. So I -- you know, it
17 resonates with me, I guess would --

18 MR. LEVEY: Yeah, it sort of -- it's one of
19 the two prongs of what we've been talking about. And I
20 think it resonates with me, too, and it would have all
21 the protections that are there and that were referenced.
22 And I would be in favor of opening up to Main Street
23 investors, nonaccredited investors, that. But then I
24 think we ought to talk about the access to capital
25 prong.

1 MS. GARRETT: I was just going to summarize.
2 I mean, if we want to then talk about also the other
3 ways that smaller companies can raise money other than
4 through these large, pooled investments, it sounds to me
5 like there may be a recommendation that the SEC
6 eliminate the requirement that only accredited investors
7 can invest in registered closed-end funds that invest
8 more than 50 percent of their assets in private funds,
9 and therefore allowing nonaccredited investors to invest
10 in those funds. Would you guys like to take a vote on
11 that at this time?

12 Okay, a motion.

13 PARTICIPANT: Motion.

14 PARTICIPANT: Second.

15 MS. GARRETT: Okay, all in favor.

16 (A chorus of ayes.)

17 MS. GARRETT: Opposed?

18 (No response.)

19 MS. GARRETT: Okay, thank you. So that motion
20 passed, thank you very much.

21 And I think now we can also get to you talking
22 about pooled investment vehicles. But I think it's also
23 important to talk about ways to get money into smaller
24 companies, smaller markets and different means to do
25 that.

1 MS. HANKS: On that topic, I mean, I think
2 what we just voted on is great for the investors. But
3 that's not going to take the money down. As we've seen,
4 when they're talking about small companies, they are not
5 talking about the Blue Fish Thing Company. Sorry, I'm
6 vegetarian; I don't eat them anyway. So but that
7 company. That company could really do with investments
8 from pooled vehicles.

9 And if we could use Reg CF, as Youngro says,
10 there's a statutory prohibition. But Reg CF and Reg A,
11 if there was a way to use them for micro, nano, whatever
12 we want to call them, investment vehicles, I think
13 that's a way of getting money to those companies.

14 MS. GARRETT: Can you explain that just a
15 little more fully, what you would propose?

16 MS. HANKS: Yeah, so there is a prohibition.
17 And of course, we'd have to address the fact that there
18 is a statutory prohibition on using the regulations for
19 investment companies. So maybe we can, I don't know,
20 define around investment companies some way so that
21 Regulation CF could be used for an issuer that, under
22 other circumstances, would be deemed to be an investment
23 company because it invests in investment securities of
24 companies who are raising funds under Reg CF or Reg A.
25 Does that make sense?

1 You like that one, or --
2 MR. LEE: No, no, absolutely. This is a
3 broader point. And I really wanted to, if possible,
4 because we have limited time, kind of what the somebody
5 talked about. We really try to focus on solutions.
6 Because we all know what the problems are.

7 And when we think about solutions, it really
8 is the fact there is defined bodies of work, including
9 the SEC Staff has worked so hard to come up with
10 different examples, that if we just tweak a little bit
11 here and there, it can -- it's not going to, obviously,
12 solve all the problems but it does a big chunk of it.

13 Like, for example, I would love to hear like
14 Jason kind of talk about his perspective. Because like
15 -- or Jason -- for example, like there are reputable
16 managers that we all know. Like, clearly, Jason is
17 investing in different things, as Blackstone. Right?
18 So that's a good thing. We kind of make the assumption.

19 But in other words, how do we create
20 incentives for Jason to invest into these smaller
21 businesses, because he has a reputation and so on and so
22 forth. So, yeah, the issue, of course, can be tax
23 benefits and things like that.

24 But I think, for example, if we change the
25 rules of Regulation Crowdfunding slightly. So, number

1 one, what Sara said, making -- allowing Jason to
2 potentially utilize Regulation Crowdfunding to bring
3 capital from nonaccredited investors to his funds,
4 right? Eliminating the investor restrictions -- sorry,
5 investment restrictions, so he's not tapped out by
6 somebody saying, hey, I got \$2,000 and I'm done, even
7 though I have \$20 million in the bank, because that's
8 what the rules are saying. Or even things like I can
9 get compensated on different ways than what the
10 investment is supposed to be generating.

11 So again -- I don't want to get too technical
12 in this session. But, for example, Regulation
13 Crowdfunding prohibits compensation to the actual
14 registered intermediaries unless you're getting paid in
15 the exact same securities that's being sold. Right?
16 And there's no performance fees, either. So there's no
17 incentive created to the individual or the firm that's
18 willing to make the capital and time and investment to
19 go downmarket and invest in these small markets which
20 selfishly I'm saying that's what NextSeed does because
21 the team believes in that as a philosophy, for no other
22 word.

23 But there's no structural incentive to
24 encourage that, other than saying, hey, like, do it if
25 you want to. There's no economic incentive. That's one

1 of the biggest reasons why the Regulation Crowdfunding
2 industry hasn't increased, in my opinion. Because there
3 is no incentive for anybody with the talent or the
4 capital or wherewithal to be able to do it, to actually
5 make money off it. And that's a very existential
6 question for the entire investment crowdfunding
7 industry. Because the system and the laws literally
8 prohibit that kind of economic incentives.

9 So, Jason, I just use you as an example just
10 because of your company. But I'd love to get your
11 perspective on these issues.

12 MR. SEATS: That's fine. I mean, I definitely
13 could expand on that. But I -- I mean, the risk is to
14 me that still feels like it's on the investor side of
15 the marketplace. Right? I mean, where my head goes, I
16 mean, you heard from our guests pointing out that there
17 is the 35 nonaccredited investor limit. You can take
18 that. But we all know why that doesn't happen. And I
19 think one of the ideas of thinking about using pooled
20 vehicles to help address that would be to figure out how
21 to pool those investors in a way so that they can plug
22 in with a different sort of disclosure requirement.

23 So there's some pooling that could happen
24 below. They're talking about pooling fund of funds.
25 You could also pool all the nonaccredited investors into

1 one vehicle. You treat that vehicle as a qualified
2 purchaser or whatever else, create the right disclosure
3 adjustments there and now all of a sudden -- those are
4 small tweaks. And we already have vehicles we can pool
5 them into.

6 We could go deep on that. I just want to make
7 sure that we're not just having a different -- like a
8 smaller dollar conversation, it feels like, when -- that
9 conversation. Because is that still addressing the use
10 of that aggregation of capital, right?

11 MR. FOX: To just make sure I'm understanding
12 what you two guys are saying, I think I'm hearing you
13 say, hey, I got the brewery in Houston that's looking to
14 raise money. And I'm probably getting this wrong. But
15 I'm posting them on my website with their details and
16 they're raising money.

17 You're actually saying, instead of actually
18 advertising the brewery itself, I'm actually going out
19 and saying, you know, I'm Jason, here's my background, I
20 want to raise some money to go invest in local
21 businesses in the Houston and greater Texas marketplace.
22 Here's our background. I want to raise some money and
23 I'm going to invest it. Here's the type of investments
24 we're going to get into. Here's my background, right?
25 And we're going to go invest it. And you don't have to

1 necessarily be an accredited investor because of my
2 background, right, and I'm going to have my own money in
3 this thing and everything else, right? And therefore,
4 you don't necessarily have to be an accredited investor;
5 you just invest directly into my investment vehicle,
6 right? We go make these investments. And so we don't
7 have to necessarily separately fund raise for the
8 brewery. If that's a good investment, you'll just make
9 that investment, right, through your fund.

10 I think that's what I'm hearing you say,
11 right? I just want to make sure that I'm, in my own
12 words, that I'm articulating the two different --

13 MR. SEATS: You got it. And I would think
14 about the gap between where these guys are playing. And
15 the need we see is how do we think about new fund
16 formation in local markets.

17 And Youngro has got a different approach,
18 which is the virtual local market of the digital market.

19 You know, same difference, though. Like how do you
20 create new fund managers --

21 MR. LEE: Robert, just to clarify, what I'm
22 saying is -- you have it exactly right. And what I'm
23 saying is, if you believe if, let's just say the direct
24 investment is too risky. Let's just assume that's true,
25 even though, you know, not everybody agrees with that.

1 I will tell you, I hadn't frankly focused on
2 this idea of using BDCs, because I never thought about
3 the idea of just tweaking the BDC, the '40 Act
4 definition. That's actually a relatively easy thing to
5 do also.

6 Now, what Blackrock will be doing with it is
7 probably nothing like what we would want to have happen
8 in terms of capital formation and local to local or in
9 the middle of the country. Maybe it will, maybe it
10 won't. But it doesn't mean that the idea is a bad idea;
11 the idea is actually a pretty good idea that others can
12 take and figure out ways to raise money from individual
13 investors for local investment using that format.
14 That's actually a pretty easy change, in my opinion.

15 MR. SEATS: Yep, totally agree. And it
16 doesn't have to be a BDC. If you could pool
17 nonaccredited into an entity that can be defined as an
18 accredited investor or qualified purchaser, then you can
19 use the venture exemption for the pool, and you don't
20 have to go register the firm.

21 MR. SOLOMON: That is also true.

22 I mean, I just had the situation where my son
23 -- my son, who is not accredited, is trying to figure
24 out how to pool most of his friends together to make
25 investments in shows they think will ultimately make it

1 But if we assume that pooled vehicle, we can live with
2 that.

3 What I'm saying is that Regulation
4 Crowdfunding provides an existing mechanism to allow
5 that overnight, literally. If you change literally
6 "and" to "or" and then allow pooled vehicles.

7 MR. SOLOMON: Yeah, that is true. And so one
8 of the things that I thought, you know, we'll try a
9 distinction here between what we're talking about and
10 what Blackrock does. You know, the Blackrock
11 presentation is a very big -- they are so big and they
12 think about things in such a brute force way, they're
13 not exactly connected to the day-to-day what's happening
14 in individual communities, as much as they say they
15 speak for the retail investor.

16 But the point that they made, both of them
17 made, which was you can use existing regulations with
18 small tweaks in order to target and focus on small
19 funds. So if we can figure out ways to use the BDC
20 mechanism to raise small commingled vehicles for
21 investors that aren't necessarily accredited, that's a
22 mechanism that we can use to essentially raise money on
23 your platform, Youngro, or any other crowdfunding
24 platform that effectively allows there to be a fiduciary
25 responsibility that fits in there.

1 to Broadway. That's a different thing. But I will just
2 say what I learned through his eyes of what he needed to
3 do in order to raise \$5 million from a group of friends
4 to invest in shows not in New York with this idea of
5 bringing them -- like, he can't do it. And he needs me
6 to essentially sponsor that as an accredited individual
7 so that the pooled vehicle becomes accredited.

8 It doesn't make any sense to me that that's
9 what the rules are intended to do.

10 MS. MEHTA: I think you still have the
11 problems of investor protections, though. Because it's
12 just like investing in a fund. And then it's like, you
13 know, it's hard to get liquidity out of a fund if
14 there's a long investment cycle. You tend to have
15 recyclable capital. It's -- I just think you might have
16 the same -- you might confront the same issues.

17 MR. SEATS: Yes, but -- and through the lens
18 of minor tweaks, there is a structure called a qualified
19 venture capital fund which already exists, already can
20 accept --

21 MS. MEHTA: You mean the venture capital
22 operating exemption?

23 MR. SEATS: No, no, the qualified venture
24 capital fund. The limitation is 10 million in total
25 raise.

1 MS. MEHTA: Okay. Yeah, yeah, yeah. Okay.
 2 MR. SEATS: But you can take nonaccredited
 3 investors and invest in exactly the same venture
 4 opportunities. And so within that vehicle, you already
 5 are exposing the retail nonaccredited market. And so in
 6 terms of minor tweaks, you can take that vehicle. You
 7 say that vehicle is a qualified purchaser, if it's over
 8 5 million. Now, that can be pooled into a venture-
 9 exempt fund, it's a larger fund, and you can carve off a
 10 slice of -- right? And if you limit it -- if you
 11 increase either the number cap from 250 or the dollar
 12 cap, you could pool more people into that, right?
 13 So I -- look, it's just an idea. But I'm just
 14 -- it's an alternative to the BDC structure which is
 15 potentially much heavier from a regulatory standpoint.
 16 MS. MOTT: So the question around that is,
 17 that was created through legislation. Whether or not we
 18 can address it here, I don't know. Because I think the
 19 10 million cap and the 250 investors was legislated
 20 recently.
 21 MS. MILLER: It feels like you're looking at
 22 me again. This seems to be the theme of this afternoon.
 23 No, you're not -- I mean, I would say to the
 24 committee, as you're thinking about these issues, I
 25 think one, there's a natural, I think, inclination to

1 try to find the one solution to the really big problem.
 2 With the diversity of companies and ways they're
 3 raising capital and types of investors, I think, one,
 4 there's a lot of different issues along the capital
 5 trajectory and pipeline. And one issue, whether it is
 6 closed-end funds or whether it is talking about
 7 crowdfunding, that doesn't fix the entirety of it.
 8 So I don't think the committee should set as
 9 its objective to find the one solution this afternoon,
 10 but to rather pinpoint the various different solutions
 11 and then, you know, some of those solutions could be
 12 implemented by the SEC. Some of those may require
 13 congressional action. And I think that you each have a
 14 microphone here as a part of this committee to make
 15 recommendations and to think strategically about what
 16 the marketplace needs and to not worry about the
 17 mechanical minutiae of how you actually accomplish that.
 18 There's a lot of technical, brilliant minds,
 19 many of whom are in this room and listening that can
 20 figure out those pieces. But to think more
 21 strategically about where the rules and the playbook
 22 needs to go as opposed to how the players are going to
 23 ultimately play the game once the rulebook is written.
 24 Does that make sense?
 25 MR. SOLOMON: Can I just add one other thing?

1 And I apologize for jumping in so much remotely, but
 2 I'm going to have to jump in a minute.
 3 The amount of money that has been raised, I'm
 4 not sure the committee knows this, but the amount of
 5 money that has been raised in BDC format over the last
 6 10 years for direct lending is a crazy amount of money.
 7 It's dwarfed every other asset gathering mechanism
 8 because of the search for yield. And when you think
 9 about the utilization of BDCs primarily lending, so
 10 direct lending BDCs, as opposed to private equity style
 11 BDCs, it has been one of the great distribution, I
 12 think, gold rushes of all time. Whole firms were
 13 created off the back of this.
 14 And the reason why -- you know, I hadn't
 15 really focused on why people weren't really using BDCs
 16 for private equity. What I'm saying is, there's a --
 17 that mechanism is a relatively straightforward mechanism
 18 -- make sure we're doing everything we can for investor
 19 protection. But the reality is, I guess, for me this is
 20 an ah-hah moment.
 21 Like, I hadn't really focused on this idea
 22 that using BDCs for some of the things that we think are
 23 really critical might be a relatively straightforward
 24 mechanism for unlocking the flow of capital. I'm going
 25 to have to explore them a little bit more. But it seems

1 to me that's a pretty -- that is an instrument that
 2 retail investors actually understand incredibly well
 3 because they've been investing hand over fist in debt
 4 instruments for the last decade.
 5 MR. YADLEY: Sounds great. So here's another
 6 -- another general idea in response to Martha's
 7 challenge there.
 8 So this morning we talked about different ways
 9 to add to the accredited investor definition by looking
 10 at knowledge. And that's one of the things in the
 11 earlier recommendations that Carl is putting together.
 12 And we talked about, although I'm not sure we reached a
 13 consensus on investment levels, except there were a
 14 couple of things. They should be harmonized and maybe
 15 it should be investment by investment as opposed to you
 16 get your one shot to put your \$2,000 out there.
 17 And beyond that, creating pooled opportunities
 18 with some proxy for vetting or analysis. As I said this
 19 morning, you can't really expect a normal person who
 20 works to be able to evaluate companies the way paid
 21 managers do. So a fund that's created by a registered
 22 investment adviser or other professional with
 23 responsibilities that -- who's regulated and has
 24 fiduciary obligations to the investors would be one
 25 path. Another path might be a lead investor or

1 investors. Not sure that they should have liability for
2 that, that they're doing it in some sort of independent
3 way. Maybe there has to be some relationship between
4 that lead investor and the other investors. And then a
5 third path would be a certain amount of accredited
6 investors, a majority of accredited investors, and then
7 that now allows tagalong not accredited investors.
8 That's a concept.

9 MR. FOX: I guess I'll pile onto that if that
10 was a potential proposal. I like the first part of it,
11 especially the idea of the proposal of having as a
12 proposal for the committee to consider, you know, for
13 the SEC and others to look into for, you know, this idea
14 that, you know, one way to get nonaccredited investors
15 into the marketplace is that basically, you know, some
16 sort of professional can
17 -- you know, some sort of regulation can be put in
18 place, you know, for a fund, some sort of pooled
19 investment vehicle that can be managed, whether it's
20 BDC, qualified venture. I don't think we have to get
21 into the sausage making, right, in terms of what it is.

22 MS. MILLER: No offense to our vegetarian.

23 MR. FOX: Yeah, sorry. Yeah, soy sausage,
24 right. Beyond meat, here.

25 You know, but -- anyway, I like that idea, in

1 terms of, you know, one way to get nonaccredited
2 investors into the marketplace if they're interested, if
3 they're out there, however it is, or even if they're
4 accredited investors and they want to get into a
5 diversified pool, right, because I think there's also
6 this issue of accredited investors that really aren't
7 investing, right? And they may also want to get into
8 this as well. You know, I like that idea.

9 I'm not sure about this thing about, well,
10 gee, if it's a majority of accredited investors, have
11 tagalong and stuff. Because it just seems like, just
12 because you've got a bunch of them, I'm not sure exactly
13 what that does for you and, you know, I'm not quite sure
14 what, you know, just because there's a bunch of them
15 whether that's good for the rest of them. Maybe
16 somebody could, you know, talk to me more about why
17 that's a good thing or not. I'm just not sure exactly
18 why that's good or bad. But I just didn't follow that
19 one, but I like the first part of it.

20 MR. LEE: Hank, could I volunteer you to kind
21 of share what you shared during lunch? Because I think
22 this is all great from the investor perspective. But I
23 really want to keep focusing also on really the business
24 perspective because, right, the purpose of this
25 committee wasn't just, oh, let's get yield to

1 nonaccredited investors. It really was as much as
2 anything else, bring capital to small businesses. And I
3 think that's the one thing that -- I mean, that's my one
4 -- I hundred percent support any changes to pooled
5 investment vehicle to make it flexible.

6 But I think Jason raised that same point or
7 question or Hank raised that to the speakers. Just that
8 probably isn't going to get to the issue of actually
9 pushing the capital down to the local businesses and
10 small communities. So I just wanted to kind of get your
11 perspective on that.

12 MR. TORBERT: You mean in particular the story
13 I told earlier?

14 MR. LEE: Just, I mean, your own company and -
15 -

16 MR. TORBERT: Yeah, I mean, one, I'll give you
17 an example of a company called Dixie Beer in New
18 Orleans, which is pretty well known. It closed some
19 time ago. And over the last, say, 10 years, they tried
20 to restart consistently. This is a brand that's pretty
21 well known throughout the South, notably the New Orleans
22 region, and could have easily restarted earlier if they
23 had access to smaller investors. I mean, this is -- you
24 know, it's one of the best-known brands.

25 Finally, in the last year, it's restarted

1 because of the investment of a billionaire family. That
2 is it. But if there was a way or a vehicle of some type
3 that could have easily taken investors from the area,
4 from the region, whichever, potentially it could have
5 restarted overnight. If we can create vehicles that
6 allow us to do that, I think you'll find a whole new
7 creation of business and economic development throughout
8 the region. That's the problem that I see.

9 And also, as someone who operates a business,
10 same thing. We're pretty well known. But I will tell
11 you, when talking to some private equity firms, we're
12 too small and not worth the time or effort. Even if
13 they do have access to capital, it's just not worth
14 their time. But if we pooled local investors who know
15 us and not only the people who know us in the sectors in
16 which we operate, it would not be hard for us to pull in
17 probably a substantial number of investors.

18 MR. SEATS: Yeah, to my ears, I feel like --
19 like I'm trying to sort and categorize this. I think
20 there's three different dynamics that we're speaking to.
21 One is this idea of local investor feedback loops.
22 What are the right structures that will facilitate that?
23 Could be digital, could be intrastate. There's lots of
24 ways. Right? That's one.

25 Second is one idea that Ross brought up, is

1 there something in between debt and equity? Is there
2 some other type of investment structure that hits a
3 better sweet spot of small business that currently isn't
4 able to find capital through traditional sources?

5 That's the second bucket.

6 And then I think there's a third bucket, which
7 is the macro movement of largescale asset managers,
8 which these guys spoke to. Right? And the dynamic
9 there, I feel like the hundred-pound elephant in the
10 room is the dynamic there is JOBS Act and companies
11 staying private longer and the flow of capital towards
12 larger pooled vehicles which then flows to larger
13 investments. And then just the side effect of that is
14 away from smaller pooled vehicles and smaller
15 investments. You roll that dynamic forward for
16 whatever, nine years or, whatever, eight years and we
17 get to where we are.

18 I think those are three different lanes. Like
19 they feel like three different things. But we sort of
20 talk over on all of them, you know. And I guess maybe
21 just to sort of posit for the room, I don't know which
22 of those three is the ripest for us to try and think
23 about what are suggestions we can make or something, you
24 know -- I don't know. I have no proposal. This was --
25 I am just categorizing there's three buckets there in my

1 mind. On the locality, is there a different way to
2 invest that we're missing, and then go back in time, if
3 we didn't have JOBS Act, what would the world look like
4 right now.

5 MR. FOX: But I think, Jason, there's a -- to
6 Martha's beautiful analogy this morning, there's a whole
7 garage of tools of, you know, bikes and everything.
8 And, I mean, if I could go back to this, you know,
9 professional pooled vehicle, right? I mean, you know,
10 whether it's a better crowdfunding site, right, or
11 whether it's just a thing where we could have kind of a
12 broker or an attorney network or something, right? You
13 could have a registered investment adviser in New
14 Orleans that could say, hey, you know, I'm -- I've met
15 the credentialing and I can go out and raise capital,
16 right, to go set up to raise the 5 million bucks I need
17 to -- that we need to get Dixie Beer off the ground, or
18 whatever it is. Then I think we can solve -- I mean,
19 and if it's more money, there's a lot of different ways.

20 I just feel like, you know, to me, I think
21 what we need -- there are some gaps. Right? But I
22 think that there are, you know -- we can't lose sight of
23 the fact that capital is being raised every day, too.

24 MS. MILLER: Can I just jump in? Because I'm
25 going to take that analogy and I'm going to reuse it and

1 I'm going to reuse it terribly. But here we go.

2 So as you think about kind of, we have all of
3 these different vehicles that you can take. And as we
4 were talking about, I think, Youngro, to your question
5 of, Hank, how do we think about this from the
6 perspective of companies that are raising capital? If
7 you use my terrible garage analogy, most people don't
8 start out in the morning and think, I'm going to take a
9 bike ride today. They think, I'm either going to take a
10 bike ride for exercise, or it's a clear day and I can
11 bike to work, or I'm going to get in the car because I
12 have a trip that's further out of town.

13 The destination, how far you need to go and
14 your capabilities for it are what drive it, as opposed
15 to you randomly selecting the vehicle that sounds nice
16 that day. And I think that a lot of what is easy to do
17 in the securities world is to get hyper focused on
18 designing great vehicles and to not think about where
19 the passenger is ultimately going and choosing to drive
20 and where do they need to be.

21 So as we think about this, I would encourage
22 people to step even further back from some of the
23 different nuance of how do we tweak different -- you
24 know, should we be tweaking this fund or that fund
25 structure and instead think about, kind of, if you're a

1 company, the first thing you're thinking about is how
2 much money do I need? That's the first thing you
3 usually think about. You have a dollar amount that you
4 know you need. The next thing is, who can I raise it
5 from, figuring that out. And then how do I reach them,
6 what are the tools to reach them?

7 And generally, only after you've figured those
8 elements out do you actually start thinking about
9 regulatory exemptions and what are the obligations
10 within each. And so I think if we can kind of reverse
11 engineer the way that we're thinking about it and
12 thinking about how much money do you need goes into do
13 we have the ability to raise the right amounts across
14 the different exemptions we have? This really goes to
15 the broader picture of harmonization.

16 Can you raise what you need using the tools?
17 Can you go the distance on that vehicle as it's
18 designed? Does it have a limitation on it that doesn't
19 make sense for how far you need to take it?

20 And the next one is looking at the investors,
21 can the right people that you have access to actually
22 support you on that path? And then what tweaks do we
23 need to make sure that that is a more efficient journey?

24 That's how I think about it. I don't know the

1 extent to which that's helpful. But I think that draws
 2 it back to why we are actually talking about accredited
 3 investor. It goes directly to who do you have access to
 4 as often your kind of first line investors? The pooled
 5 vehicles that we're talking about are often -- they're
 6 not the first dollars into a company. They're very
 7 valuable at a different point in the journey. It's not
 8 that they're not important. I think that we just have
 9 to be thinking about the holistic picture of how
 10 companies are raising capital. That is what
 11 harmonization goes to, is looking at from first dollars
 12 to IPO, what does that path look like across the exempt
 13 framework to allow you to raise what you need?

14 MS. MOTT: A lot of companies never go to IPO.
 15 And so I'm glad you brought that up.

16 Where I see the biggest gap in the market is
 17 in that point where you're trying to scale beyond the
 18 region, you're trying to get into the next, you know,
 19 the next region. Or you're trying to export your
 20 products and services. And the classic example of
 21 success in venture capital most of the time really is
 22 merger and acquisition, not IPO.

23 And so the other thing I want to bring up is,
 24 as we think about this, I just -- I'm really sensing I
 25 need a lot more time. But is that a lot of people who

1 is general solicitation and offers and the focus away
 2 from that and to purchasers and -- because that's
 3 matching and accessibility and 506(c) has not been used
 4 as much as people thought, presumably because of the
 5 verification. But maybe that's not it.

6 I've had -- sort of before we even got to the
 7 verification, a client that tried to find investors for
 8 a pretty appealing, romantic kind of investment. Not
 9 that kind of romantic. But, I mean, like -- and
 10 couldn't find the interest from people that he didn't
 11 know.

12 So I don't know if that's it or not. But
 13 certainly we could debug a bugaboo, or we might find
 14 that that's a way, especially on local deals, for people
 15 to be able to communicate. And that would help under
 16 506(b) and 4(a)(2).

17 MS. GARRETT: Sara, did you want to talk a
 18 little bit about that?

19 MS. HANKS: Yeah, well, on the subject of
 20 offers, since we've only got a short amount of time,
 21 I'll be brief. But just to sort of go back to the
 22 beginning of the regulation of offers, since 1933,
 23 Section 5 of the Securities Act has said, if you make an
 24 offer or sale of securities, that offer or sale has to
 25 be registered or exempt.

1 are managing venture funds are operators, they're not
 2 RIAs. These are people who -- in the funds that I look
 3 at and I see that I aspire to are the ones where they
 4 have a group of people who act as entrepreneurs in
 5 residence or mentors or whatever to help that company
 6 navigate the growth issues that they're going to have,
 7 deal with their strategy, you know, manage the obstacles
 8 and try to conserve cash while you're -- while you're
 9 doing this because you're going to make mistakes.
 10 That's the point where I see we need the most amount of
 11 money.

12 I mean, it's like we're great, we get started
 13 with crowdfunding, we get started with angels, that kind
 14 of thing. But where we really need to take this company
 15 is the next level. And you -- what they're trying to do
 16 is get -- you know, compete with Silicon Valley and
 17 Boston and New York City. And too much money is chasing
 18 -- I mean, they're all chasing the same deals, which is
 19 why they're in the situation they're in right now with
 20 unicorns and things like that.

21 So I guess when we say this, when we look at
 22 the different tools that we might have in our toolbox,
 23 what could really address that major gap is what I'm
 24 thinking about.

25 MR. YADLEY: So one of the responses, Martha,

1 That means that the U.S. is kind of an outlier
 2 compared to pretty much everybody else in the universe
 3 in regulating just making an offer by everybody. That
 4 offer has to have an exemption applicable to it at the
 5 time that it's made. And that has the result of
 6 regulating what you can say and who you can say it to
 7 and what else you have to deliver in terms of
 8 information at the time of the offer. And as all of
 9 these offers have moved onto the internet, that's got --
 10 that's had an impact on the delivery of information and
 11 how do you get information into the hands of investors
 12 at the time that you're supposed to?

13 One of the problems that we're seeing is, when
 14 you put together the fact that everything is an offer,
 15 still -- and I love quoting this Securities Act release
 16 because it's one of the few things around here that's
 17 older than I am. October 1957, there is a statement
 18 that says, what is an offer of securities? It is
 19 anything that conditions the market. Anything that
 20 makes people kind of interested in the offering that's
 21 going on.

22 So starting with the point that everything is
 23 an offer and then going on to the point that every offer
 24 has to be registered or exempt at the time it is made.
 25 Bringing this forward 62 years, we're now in the

1 situation where I've got clients who are saying, okay,
2 we want to publicize the offering on TikTok, real case.
3 Or we want to publicize the offering within the
4 videogame. We're a videogame company and we want to be
5 able to, in the videogame, say do you like playing this
6 videogame? If you like playing this videogame, you
7 should buy the shares, which are available on Regulation
8 CF.

9 Because at that time you have information
10 delivery requirements, it means it's incredibly
11 difficult to comply with the regulations. And so one of
12 the proposals that at least that I would urge is maybe
13 we don't focus on regulating the offer. It would be
14 possible to say that if you -- if the sale is compliant
15 at the time of sale, then the offer gets to be exempt at
16 the same time.

17 Another thing, I just want to throw in here --

18 MS. GARRETT: Sara, real quick, because I
19 think we have two people that need to leave. And if the
20 committee wanted to, we could do a quick recommendation
21 in terms of the accredited investor definition before
22 people leave?

23 PARTICIPANT: Yeah, let's do it.

24 MS. GARRETT: So what I've written down from
25 earlier today is that the committee makes the following

1 recommendation with respect to the accredited investor
2 definition: To leave the current accredited investor
3 financial thresholds requirements in place subject to
4 the SEC adjusting such thresholds possibly downwards for
5 certain regions of the country, and to index the
6 financial thresholds for inflation on a periodic basis,
7 and to look into revising the accredited investor
8 definition to allow individuals to qualify as accredited
9 investors based on measures of personal sophistication,
10 which could be bright-line rules for being an accredited
11 investor by sophistication, which could include -- sorry
12 -- professional credentials, work experience, education
13 and/or sophistication test.

14 Can I have a motion or would you like a
15 discussion on that. Or a motion?

16 MS. MOTT: So moved.

17 MS. GARRETT: Okay. And all in favor?
18 (A chorus of ayes.)

19 MS. GARRETT: And all opposed?
20 (No response.)

21 MS. GARRETT: Thank you.
22 Sara.

23 MS. HANKS: That was pretty much it for the
24 offer regulation. Although the one thing that we should
25 consider is if you are going to deregulate offers, does

1 that automatically mean that you are now throwing out
2 all prohibitions on general solicitation? Not everybody
3 sees it the same way.

4 I think that if you're deregulating offers,
5 you are inherently deregulating manner of offering
6 limitations. But not everybody sees it that way. So we
7 should be specific when we address it.

8 MS. GARRETT: Thank you.

9 So we have a handful of other, I mean, points
10 that we've talked about. We've talked about the pooled
11 investments. We haven't come to the recommendation on
12 that yet. We've talked about the crowdfunding; we've
13 talked about regulation of offers. Is there anything
14 specific that anybody would like for me to propose as a
15 recommendation?

16 MR. SEATS: I mean, the regulation of offers
17 feels like a general consensus item to me. I don't
18 know, maybe it's not. Are there -- every time it's come
19 up, I feel like we all sort of have the same orientation
20 on that one. I don't know. No?

21 MS. HANKS: Certainly on this committee. The
22 other committee --

23 MR. LEE: Just to be clear, when we say no
24 regulation, there's still, no matter what, there's
25 antifraud laws, there's inherent rules that govern --

1 like, you can't lie, no matter what, right?

2 So I think it's really, what Sara was
3 explaining as an example, for example, Regulation
4 Crowdfunding, I think you an only say -- it's called a
5 tombstone rule. You can say certain things and you
6 can't explain anything. So every other month, we get a
7 call from FINRA and it's like this offer had this other
8 word about, you know, the terms or whatever. You're not
9 allowed to say that. So I'm sure they don't want to
10 spend the time reviewing that. I'm sure a lot of
11 platforms, they sure don't want to go through that.

12 But that's an example of, right, like what's
13 the point? When the ultimate thing is, if you buy, then
14 you better have complied. And if you didn't buy, then
15 who cares?

16 MS. HANKS: And all of that compliance
17 can take place at the time of sale. You can dictate
18 that prior to sale, there must have been delivered all
19 of the things that need to be delivered. You can also
20 dictate, as you say, antifraud doesn't change at all.
21 If you lie, you're liable for it, exempt or not. And
22 you just make sure that the delivery of information
23 happens at the time -- prior to the time of sale.

24 MS. GARRETT: It sounds like what we're saying
25 that we would recommend that the SEC look at revising

1 the exemptions across the board to focus consistently on
2 investor protections at the time of sale, rather than at
3 the time of the offer, so that the offer would be
4 exempted. Okay.

5 So we don't have a quorum, but we did propose

6 --

7 MS. DAVIS: Is anyone still on the phone?

8 (No response.)

9 MS. DAVIS: Okay, we don't have a quorum
10 anymore.

11 MS. GARRETT: What were you -- is there a way
12 to

13 MS. MILLER: So one of the things that I was
14 briefly whispering to Carla is this is a big issue.
15 There's a lot of -- I think we've talked about a lot of
16 weighty topics and I think most people think like they
17 are still processing a lot of it. And we do have the
18 option to reconvene between now and our next meeting,
19 telephonically. That is very much so an option if we
20 would like to do so. So I just -- I offer that up as
21 something that is available. It would be something that
22 would be accessible. Members of the public would be
23 able to listen into the call. It would comply with the
24 same sunshine and other requirements for it. So I just
25 share that as an option, so that people don't feel the

1 offers and sales. Because I do think general
2 solicitation is too broad as it is. I know we've
3 discussed it before. But things like, you know, pitch
4 competitions and conditioning the market is very broad.

5 And so I do think that needs to be addressed. But
6 whether to get rid of it altogether, I don't know that -
7 - I'm certainly not ready to make that decision without
8 digesting more information. So I would just vote to
9 table that for now.

10 MR. LEVEY: And from my perspective, having
11 just taken a company public, you know, just how that
12 could affect some gun jumping and conditioning the
13 market in the context of an IPO and all of the precedent
14 that's there on that topic. I just -- not being an
15 expert in this area, necessarily, how would any changes
16 there affect, you know, or have any unintended
17 consequences on sort of gun jumping rules in general?
18 Or would it, you know, eliminate them in total?
19 Possibly.

20 MS. GARRETT: Okay, thank you.

21 And since we don't have a quorum, we can't
22 vote on these items. So I think it would be a good idea
23 to continue the meeting and have an interim meeting, if
24 people are interested in that, where we could discuss
25 some of these ideas a little bit more fully. And Martha

1 pressure to come to consensus on longstanding topics.

2 Yes, Mark.

3 MR. SHARMA: Thanks, Martha. I would like to
4 add to that. And based on my experience with the
5 Investor Advisory Committee, I would like to remind this
6 committee that you do have access to the Staff of the
7 SEC and all the experts in the building. So to the
8 extent that there are unanswered questions you think it
9 would be helpful to have a briefing or a phone call with
10 certain Staff, that is something we can arrange for you.

11 COMMISSIONER PEIRCE: And I would just add to
12 that that, again, what's most valuable to me as a
13 commissioner is to get your views on what it's like in
14 the real world. So sometimes when you do talk to the
15 Staff, you might get drawn into the legal nuances. But
16 what we really need to know is what are the practical
17 obstacles you're facing in the real world? And Martha,
18 I think, laid this out really well.

19 We can worry about then trying to deal with
20 how does that fit into our regulatory and statutory
21 framework. But knowing what you're running into and
22 what doesn't make sense to you is really valuable to us.

23 MR. LEVEY: I think --

24 MS. MEHTA: I think -- sorry. No, I mean, I
25 would love to table the decision on whether to separate

1 can advise us how to do that.

2 MS. MILLER: We will be in touch.

3 WRAP UP AND ADJOURNMENT

4 MS. GARRETT: With that, we can either
5 continue talking about some of the items, or we could,
6 you know, decide to adjourn for the day because we have
7 lost some members of the committee.

8 MS. MILLER: I did want to make sure we did
9 one bit of news about one committee member. Did you
10 want to share that?

11 We have one committee member who has changed
12 employers and the 8-K is out. Terry McNew has been
13 lured to a new wonderful position. And so with that new
14 position, he has resigned from MasterCraft Holdings as
15 well as from this committee.

16 I just wanted to make sure we thank him for
17 his service on the committee. He certainly brought a
18 colorful and spirited perspective from the perspective
19 of a small manufacturer in Tennessee, which we have
20 appreciated. We wish him well in his next venture.

21 MS. GARRETT: Thank you very much.

22 MS. DAVIS: And I have one piece of admin.
23 Everyone probably noticed, and we put this on the web,
24 too, that we had a PowerPoint from the Federal Reserve
25 Bank of New York that has a lot of stats from their

1 small business credit survey in 2018. A lot of the
2 stats are somewhat similar to what Kauffman presented
3 but there is even more in here. And we invited them to
4 come participate today and present, but they were not --
5 they had a scheduling conflict.

6 So we thought the stats were worthy of
7 people's eyes and so we wanted to pass it out and put it
8 up as part of the record.

9 MS. GARRETT: Okay. Well, thank you very
10 much. Our next meeting will be a telephonic meeting,
11 which we will schedule. And then our next in-person
12 meeting will be February 4 here in Washington, D.C.
13 Thank you, everybody, for your participation and, with
14 that, I move to adjourn the meeting.

15 (Whereupon, at 3:24 p.m., the meeting was
16 adjourned.)

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1 REPORTER'S CERTIFICATE

2
3 I, Beth Roots, reporter, hereby certify that the
4 foregoing transcript is a complete, true and accurate
5 transcript of the matter indicated, held on
6 __11/12/2019_____, at Washington, D.C. in the
7 matter of:

8 SMALL BUSINESS CAPITAL FORMATION.

9 I further certify that this proceeding was recorded by
10 me, and that the foregoing transcript has been prepared
11 under my direction.

12
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14 Date: 11/12/2019

15 Official Reporter: Beth Roots
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1 PROOFREADER'S CERTIFICATE

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In the Matter of: SEC'S SMALL BUSINESS CAPITAL
FORMATION MEETING

File Number: OS-1112

Date: Tuesday, November 12, 2019

Location: Washington, D.C.

This is to certify that I, Christine Boyce
(the undersigned), do hereby certify that the foregoing
transcript is a complete, true and accurate
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proceedings of the meeting.

Proofreader's Name) (Date)

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