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GOVERNMENT-BUSINESS FORUM ON  
SMALL BUSINESS CAPITAL FORMATION

**RECORD OF PROCEEDINGS**

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1 P R O C E E D I N G S

2 MR. LAPORTE: Good morning, everyone, both those  
3 physically present here at the SEC auditorium in Washington,  
4 D.C., and those who are virtually present through the webcast  
5 of these proceedings.

6 My name is Gerry Laporte. I am Chief of the Office  
7 of Small Business Policy in the SEC's Division of Corporation  
8 Finance, and I am here to call to order the 28th annual SEC  
9 Government-Business Forum on Small Business Capital  
10 Formation. This event is being conducted under Section 503  
11 of the Omnibus Small Business and Capital Formation Act of  
12 1980.

13 Before we begin, on behalf of all the SEC staff and  
14 Commissioners who will be appearing on today's program, I  
15 want to give the -- I wanted to say that the views that they  
16 express are their own, and don't necessarily represent the  
17 views of any other member of the SEC staff or Commissioner or  
18 a member of the Commission, itself.

19 This is the third year we have conducted the SEC  
20 small business forum on the third Thursday in November during  
21 Global Entrepreneurship Week. Today we join people gathering  
22 around the world in 90 or so countries to support and discuss  
23 the benefits of entrepreneurship.

24 Also, the third Thursday in November is celebrated  
25 in France especially, but throughout the world, as a

1 Beaujolais nouveau day. Under French law, this is the first  
2 day that the current year's Beaujolais vintage can be sold  
3 commercially. It's difficult to try to work this into our  
4 program, especially since we're in a federal building, where  
5 the serving of alcohol is prohibited.

6 But those of you who are interested in exploring  
7 this aspect of the day could think about joining us after the  
8 proceedings. And today at 5:30 we are going to have a  
9 networking reception next door in Union Station. Directions  
10 are in the program.

11 At this point, I would like to introduce you to the  
12 Director of the SEC's Division of Corporation Finance,  
13 Meredith Cross. In case you're not familiar with Meredith's  
14 many accomplishments, a copy of her biography is in the  
15 program booklet that you have. Meredith rejoined the SEC's  
16 Division of Corporation Finance as Director last year, after  
17 an 11-year absence, during which she practiced law in the  
18 private sector. She was a member of the staff of the  
19 division for eight years previously, serving in increasingly  
20 important capacities, until she became Deputy Director.

21 As a member of the staff of the Office of Small  
22 Business Policy, Meredith keeps us on our toes, because she  
23 is very familiar with the issues that we deal with on a daily  
24 basis. Meredith?

25 MS. CROSS: Good morning. Thank you very much.

1 Welcome everyone. This is a terrific event, and a topic that  
2 is very important to the Division of Corporation Finance and  
3 to the Commission, as a whole. We very much appreciate you  
4 all being here today, and sharing your experiences and  
5 insights with the Commission and with the public.

6           It's my pleasure now to introduce Commissioner Troy  
7 Paredes to open this forum. Commissioner Paredes joined the  
8 SEC in 2008. Before his appointment he was a tenured  
9 professor at Washington University School of Law in St.  
10 Louis, where he taught and researched, primarily in the areas  
11 of securities regulation and corporate governance.

12           Commissioner Paredes has researched and written on  
13 numerous topics important to many in this audience, such as  
14 private placements, the psychology of corporate and  
15 regulatory decision-making, alternative methods of  
16 regulation, comparative corporate governance, and the law of  
17 business of commercializing innovation. He is co-author of  
18 a multi-volume securities regulation treatise with Professors  
19 Louis Loss and Joel Seligman.

20           Before joining the faculty of Washington  
21 University, Commissioner Paredes practiced law at prominent  
22 national law firms, handling a variety of transactions in  
23 legal matters involving financings, mergers and acquisitions,  
24 and corporate governance.

25           Commissioner Paredes's intense interest in small

1 business capital formation provides him with a strong basis  
2 for understanding the unique challenges faced by those of us  
3 who work in this area. Without further delay, I introduce to  
4 you Commissioner Troy Paredes.

5 COMMISSIONER PAREDES: Thank you, Meredith, for the  
6 kind introduction. I am, of course, very pleased to welcome  
7 you today, whether you are with us in Washington or  
8 participating by webcast, to the 2010 SEC Government-Business  
9 Forum on Small Business Capital Formation. This forum  
10 provides an important opportunity for the private sector and  
11 government to examine how best to promote small business.  
12 The stakes are considerable. For we all stand to  
13 gain from the new jobs, innovative ideas, and vigorous  
14 competition that enhance our standard of living when  
15 entrepreneurship flourishes and small business thrives.

16 It is gratifying to see that once again we have  
17 been fortunate enough to bring together an impressive group  
18 of individuals to share their ideas, perspectives, and  
19 experiences on this topic, which is of such great  
20 significance to our economy. I want to thank all of those at  
21 the SEC, most notably Gerry Laporte and Meredith Cross, for  
22 their efforts in organizing this event. And I also want to  
23 thank our distinguished panelists for making time in their  
24 busy schedules to participate today.

25 Before this gathering gets underway, I would like

1 to take a few moments to offer some personal thoughts,  
2 thoughts that I hope complement what you will hear from the  
3 panelists, and that provide a further glimpse into why I  
4 think we need to place greater emphasis on encouraging small  
5 business. I should underscore that my personal views do not  
6 necessarily reflect those of the SEC or any of my colleagues  
7 on the Commission.

8           Small business fuels economic growth, generating  
9 valuable opportunities for investors, entrepreneurs,  
10 employees, and consumers. Start-ups and maturing enterprises  
11 drive innovation, provide opportunities for investors to earn  
12 higher returns and accumulate wealth, and spur job creation.  
13 Companies that today are household names can trace their  
14 origins to entrepreneurs and innovators of earlier periods  
15 who had the wherewithal and backing to start and grow a  
16 business.

17           In providing our economy with cutting edge goods  
18 and services, new and smaller companies, in turn, pressure  
19 more established firms to run themselves more effectively.  
20 The market discipline of competition, in other words, holds  
21 large incumbent enterprises accountable. Not only do we  
22 benefit from the range of innovative products, productivity  
23 gains, and new jobs that small businesses offer, but we  
24 benefit because larger firms must be even more responsive to  
25 the demands of stakeholders to remain competitive.

1                   This is only part of the picture, however.  Smaller  
2   companies also face distinct challenges and hurdles, some of  
3   which are rooted in regulatory requirements that can unduly  
4   burden small business.  The out-of-pocket financial cost of  
5   complying with the regulatory obligations can be difficult to  
6   bear.  In addition, regulatory compliance requires a  
7   commitment of time and effort that otherwise could be  
8   dedicated to running the business.

9                   Smaller enterprises may not have excess human  
10  resources to distract from day-to-day operations.  Put  
11  simply, the disproportionate strain of regulation on small  
12  business can create a barrier to entry or expansion.  It is  
13  important to keep this in mind during our rule-makings,  
14  because more established firms might not resist regulatory  
15  demands that they can bear, but that the larger firms'  
16  smaller competitors cannot similarly shoulder.  Hearing from  
17  small business during the rule-making process, therefore can be  
18  very instructive.

19                  The practical challenge for securities regulators is to strike  
20  a balance that avoids unduly stifling the formation and fostering of  
21  new and smaller businesses.  Drawing appropriate regulatory  
22  distinctions - such as between smaller and larger firms - and  
23  scaling regulatory demands accordingly help strikes this  
24  balance by guarding against over-burdening enterprises that  
25  do not present the kinds of concerns that, on balance, may

1 warrant more costly regulation, and for which the costs of  
2 regulation may prove to be disproportionate. Put differently,  
3 rejecting a one-size-fits-all regulatory approach when possible  
4 in favor of calibrating the securities law regime to account for  
5 different cost-benefit tradeoffs under different circumstances  
6 is prudent.

7           This basic intuition undergirds the following counsel that I  
8 take as a member of this Agency - namely,  
9 that the SEC should actively consider ideas  
10 for tailoring securities regulation to ensure a measured  
11 approach is taken with respect to smaller enterprises, so  
12 that we do not lose out on the benefits their activities  
13 offer us.

14           When it comes to capital formation in particular,  
15 investors can benefit when a regulatory regime is tailored to  
16 provide smaller companies prudent relief from undue  
17 regulatory demands. Efficient capital formation, for  
18 example, not only benefits the companies raising funds, but  
19 can provide investors with more attractive investment  
20 opportunities.

21           Fortunately, the federal securities laws have long  
22 recognized the need to be measured, as there is a tradition  
23 of scaling federal securities regulation in important  
24 respects to provide small businesses relief from select  
25 burdens that may be especially onerous for them.

1                   But more can and should be done to refine the  
2 regulatory framework to better fit the regime to firms of  
3 different sizes and at different stages in their life cycles.

4           It is in the advancement of this effort that the Commission  
5 has convened this forum annually since 1982. Today's panels  
6 and discussions promise to be informative and dynamic - just  
7 as they are every year.

8           The morning's first panel will discuss how certain  
9 provisions of Dodd-Frank could impact small business. From  
10 the second panel you will hear a range of insights and  
11 observations on small business capital formation from a host  
12 of interested parties.

13           This afternoon, breakout groups will engage such  
14 topics as private placement and M&A brokers, private  
15 offerings, and the regulation of smaller public companies,  
16 all important topics of discussion. Discussing these and  
17 other topics is a good start. My hope, however, is that, as  
18 an Agency, the Commission will move beyond talking about  
19 small business capital formation, and will take additional  
20 concrete steps that actually foster it.

21           Again, thank you for participating in the 2010  
22 forum. Unfortunately, my schedule does not allow me to sit  
23 in throughout the day's proceedings. But I very much look  
24 forward to reviewing your recommendations, and to reading the  
25 report that the SEC staff will prepare on the day's

1 proceedings. Thank you very much.

2 (Applause.)

3 MS. CROSS: Of course I was going to thank him; now  
4 he's gone. Thank you, Commissioner Paredes.

5 We are now ready to begin our first panel  
6 presentation, or discussion, entitled, "Selected Dodd-Frank  
7 Provisions Relating to Securities Regulation Impacting Small  
8 Business." The idea for this panel came from the forum  
9 planning committee. The planning committee includes members  
10 from the SEC staff, other federal regulators, state  
11 securities regulators, and leading small business and  
12 professional organizations concerned with capital formation,  
13 as required by the authorizing legislation for the forum.

14 The committee asked this panel to report on  
15 provisions of the Dodd-Frank Act that either direct the SEC  
16 to consider scaling regulations to reflect the  
17 characteristics of smaller companies subject to the  
18 regulations, or otherwise have a direct impact on small  
19 business capital formation.

20 So, the committee, with the assistance of SEC  
21 staff, identified several Dodd-Frank provisions that  
22 satisfied those descriptions. We also identified  
23 knowledgeable people from the SEC and the private sector who  
24 are prepared to talk about these provisions.

25 Professional biographies of all these panelists are

1 included in your program booklet, so I won't go into much  
2 detail about their backgrounds. If you're not sitting here  
3 with a paper copy of the program booklet, but watching on the  
4 webcast, you can find the program booklet posted on the small  
5 business page of the Commission's website.

6 Our first mini-panel of our first panel is on the  
7 provisions of Dodd-Frank that directly affect private  
8 placements under rule 506 of the SEC's regulation D. As most  
9 of you probably know, rule 506 is relied upon by thousands of  
10 small businesses every year to raise needed capital in  
11 private placements.

12 Our panelists are Jerry Laporte, chief of the  
13 office of small business policy in the division of  
14 corporation finance at the SEC, which administers our  
15 Regulation D program on a daily basis, and Alan Berkeley, a  
16 partner at K&L Gates in Washington. Alan is a dean of the  
17 private placement bar who has chaired the ALI-ABA program on  
18 private placements held each spring for the past -- for more  
19 than 25 years. I understand Gerry will go first.

20 MR. LAPORTE: Thank you, Meredith. We want to talk  
21 to you today about two provisions of the Dodd-Frank Act that  
22 have important implications for private offerings conducted  
23 under Rule 506 of Regulation D. As most of you probably  
24 know, and as Meredith mentioned, Rule 506 provides a safe  
25 harbor or assured exemption under the private placement

1 exemption in Section 4(2) of the Securities Act for securities  
2 offerings in unlimited amounts to 35 or fewer accredited  
3 investors if no general solicitation or advertising is used.

4           This -- estimates are that about \$1 trillion in  
5 capital is raised under Rule 506 every year, both on behalf  
6 of many -- much of it on behalf of small business from angel  
7 investors and others.

8           The House version of the Financial Markets  
9 Regulatory Reform Bill, which passed in December 2009, didn't  
10 contain any provisions directly affecting Rule 506 offerings.  
11 When Senator Dodd floated his initial version of the Senate  
12 bill, however, it contained two prominent provisions relating  
13 to Rule 506 offerings.

14           One provision would have required the SEC to adjust  
15 the accredited investor standards that apply to Rule 506  
16 offerings for inflation, which would have approximately  
17 doubled them, since that's the \$200,000 in annual income  
18 standard, or \$300,000 with spouse, or \$1 million in net  
19 worth -- those are the current standards, and they were  
20 adopted in 1982, and inflation has accounted for about --  
21 would account for about a 100 percent increase in those  
22 standards.

23           The other provision in Senator Dodd's original  
24 proposal would have permitted the states to require  
25 registration of Rule 506 offerings, which they haven't been

1 permitted to do since 1996, although the states have been  
2 permitted to require state notice filings, assess fees, and  
3 enforce anti-fraud rules in Rule 506 offerings.

4           Small business proponents were somewhat alarmed by  
5 these two provisions of the original Dodd proposal. After a  
6 brief legislative detour in the Senate, these provisions  
7 became Sections 413(a) and 926 of the Dodd-Frank Financial  
8 Reform Bill. They became so because there was an amendment  
9 adopted on the Senate floor, a bipartisan amendment sponsored  
10 by pro-small business Senators from both parties. Instead of  
11 requiring adjustment of all the accredited investor monetary  
12 standards for inflation, as the original proposal would have  
13 done, Section 413(a) merely requires the value of the  
14 investor's primary residence to be subtracted in determining  
15 whether the investor meets the \$1 million net worth standard.

16           The new standard was effective upon enactment of  
17 the Dodd-Frank Act on July 21st of this year, and we are now  
18 working on new rules to reflect the new net worth standard,  
19 subtracting the value of the primary residence in SEC rules.

20           Another provision of the Dodd-Frank Act, Section  
21 418, continues to require adjustment for inflation of the 1.5  
22 million net worth standard and the definition of qualified  
23 client under the Investment Advisers Act. As many of you  
24 know, this provision applies if investment advisers want to  
25 charge performance fees to the funds that they advise, and

1 all of them do.

2           The Investment Adviser Act provision was not part  
3 of the Senate bipartisan pro-business amendment, so the  
4 Commission will need to determine how the different net worth  
5 standards applicable to accredited investors and qualified  
6 clients intersect. We realize this could complicate already  
7 complicated subscription agreements and securities offerings  
8 by venture capital and other private investment funds.

9           In addition, the second of the provisions that I  
10 mentioned before in the original Dodd proposal, instead of  
11 permitting the states to require state registration of Rule  
12 506 offerings, Section 926 merely requires the SEC to adopt  
13 bad actor disqualification standards for Rule 506 offerings,  
14 similar to the bad actor disqualification provisions that now  
15 apply to Rule 505 and Regulation A offerings under SEC rules.

16           The new disqualification standards, unlike the  
17 current Rule 505 and Regulation A standards, must provide for  
18 disqualification of persons involved -- if the persons  
19 involved in the offering are subject to certain state bars  
20 from engaging in the securities business and related fields,  
21 if those persons are subject to state orders issued within 10  
22 years of the offering based on anti-fraud violations, or if  
23 those persons have been convicted of crimes in connection  
24 with a purchase or sale of a security or the making of a  
25 false filing with the SEC.

1           The Commission is required to adopt these new bad  
2 actor disqualification rules by the first anniversary of the  
3 Dodd-Frank Act, which is July 21, 2001 (sic). We are now  
4 busy on working rule-making proposals to implement Section  
5 926.

6           And, finally, Section 413(b) of the Dodd-Frank Act  
7 requires the SEC to review its accredited investor standards  
8 every four years, starting in 2014, to make sure that they  
9 don't grow outdated. Section 413(b) also authorizes, but  
10 doesn't require, the SEC to review the accredited investor  
11 standards before 2014.

12           Since a previous section of the Dodd-Frank Act,  
13 Section 412, requires the GAO to study the accredited  
14 investor standard, at least for private funds, over the next  
15 3 years, it's doubtful whether, given all the other  
16 Dodd-Frank rule makings we're going to be engaged with and  
17 implementing over the next few years, it's doubtful that -- I  
18 think -- that the SEC will have time to review the accredited  
19 investor standards while the GAO's study is ongoing in the  
20 next three years. Alan?

21           MR. BERKELEY: Well, thanks, Gerry. Gerry used the  
22 term a few minutes ago that the small business community was  
23 "somewhat alarmed" by the initial provisions in Senator  
24 Dodd's proposal. That's one of the great understatements in  
25 modern American history, I think. It's probably fairer to

1 say that the effect of an immediate adjustment in the net  
2 worth or income standards for 506 offerings would have sent  
3 the small business capital formation industry into quite the  
4 tailspin.

5           And while we can all sit and have wonderful  
6 intellectual arguments about the inflation since 1982, and  
7 that, you know, today's million dollar -- 1982's million  
8 dollars is today's \$2 million or \$2.5 million, I also think  
9 that the need and the essential requirement that we encourage  
10 small business capital formation requires, in some respect,  
11 not leaping to an immediate adjustment -- and we do have four  
12 years now -- but maybe also, as some have suggested, taking a  
13 look at whether the financial net worth tests are really the  
14 place to go when you're trying to figure out who are  
15 appropriate investors in -- for small business capital  
16 formation.

17           When you look through the comments that the  
18 Commission staff received on some of the proposals and some  
19 of the commentary, you see reference to a number of  
20 alternatives in terms of how we judge who is a qualified, or  
21 an appropriate, if you will, investor in these transactions.

22           And as Commissioner Paredes said a few minutes ago,  
23 we really do need to be out there, pushing for the innovative  
24 small companies to get off the ground and get their initial  
25 capital put together. And if we're going to restrict them

1 strictly on a dollars test, maybe that's not really the place  
2 to go, and maybe we ought to be looking to other ways to  
3 decide who can bear the risk of the investment, and whether  
4 it's really the government's position, or whether -- to sit  
5 there and say, "You're not an appropriate investor in a 506  
6 offering, or in any particular securities offering."

7           So, there are folks out there who take the position  
8 that we ought to just have a standard which would say, "Can  
9 you bear" -- "Do you understand? Can you bear the risk of  
10 the investment? Is a fraud standard sufficient protection  
11 for the investor in a small business?" And maybe when we  
12 think about scalability, we ought to look at the bottom of  
13 the scale and say there are some transactions which simply  
14 are below the radar screen, and should remain below the radar  
15 screen, either depending upon the amount of the investment or  
16 on the ability and willingness of somebody to bear the risk  
17 of the investment.

18           So, I think of it as something that requires a  
19 measure of rethinking, and with great relief, frankly, that  
20 we didn't see Congress sitting there, telling us that \$2.5  
21 million was the right number, where it had been \$1 million of  
22 net worth for the past 30-some-odd years.

23           Another thought that I have that -- Gerry mentioned  
24 the Commission's rule and the requirement to remove the home  
25 from the calculation of net worth for the purposes of

1 determining an accredited investor. It leaves a number of  
2 questions that some have commented on, one of which was,  
3 well, can you -- you know, put a mortgage on your house, get  
4 the cash to get over the \$1 million mark, which is a little  
5 bit cute, but I suppose one could figure out a way to do  
6 that.

7 I think, in the course of going forward with  
8 rule-making and interpretations, there are some questions  
9 which do bear some attention. One of them is the  
10 grandfathering concern, and that is whether -- how we are  
11 going to deal with the fact that somebody may have an  
12 investor in round one or in tranche one of an investment, and  
13 had counted on having their home count toward their  
14 accredited status, and that person now cannot count the home  
15 toward their accredited status, loses the ability to be an  
16 accredited investor, and is in a difficult, if not  
17 impossible, position with respect to the second tranche of an  
18 investment.

19 You have a similar concern if you had an accredited  
20 investor which was relying on the provision that says all of  
21 the members of the institution or the group are accredited  
22 investors, and what happens if one of those people who had  
23 been an accredited investor falls out as a result of the  
24 change of the ability to include the home in the calculation.

25 So, I do think there are some technical kinds of

1 issues that have to be addressed at some point, with respect  
2 to the application of the rules, and how we go forward with  
3 them.

4           One fear that I have -- and it relates both to the  
5 net worth tests under 413, and as it is applied, and frankly,  
6 segues over to my concerns with 926 with regarding bad  
7 actors -- is whether, by -- putting it candidly -- by  
8 cranking up these rules, whether we're going to force  
9 investments back out of the certainty and the comfort we have  
10 had in Regulation D back to reliance on Section 4(2), without  
11 attentiveness to meeting the requirements of the safe harbor  
12 provided by Reg D.

13           You know, I think we have all taken great comfort  
14 over the years that, if we do it right, we're comfortable  
15 doing private placements. We are comfortable raising money  
16 for small and not-so-small companies using Reg. D and Rule  
17 506. The more constraints we put on those rules, the tighter  
18 we get them, ostensibly in the interest of investor  
19 protection and saving people from their own folly, the more  
20 likelihood it is -- the more likely I think it is that  
21 business will continue to be done, but it will be done under  
22 a different rubric, and very likely just as a pure 4(2)  
23 offering.

24           I have observed over the years, I think, that  
25 different parts of the country seem to think of doing private

1 placements differently. I don't know if I'm getting any nod  
2 from Meredith, but my observation over the years was that  
3 some parts of the country did 4(2)'s, and other parts of the  
4 country did 506's, and it really didn't matter what the deal  
5 was. It was how the lawyers were looking at the transaction,  
6 and how they approached it. And it wasn't that they were  
7 trying to avoid some provision of 506, they were really doing  
8 about the same thing. They just called it something  
9 different.

10 I have some concern that, as we look at 413, as we  
11 look at 926, we are going to find ourselves going outside the  
12 regulatory scheme under Regulation D, and seeing a lot more  
13 4(2) offerings. And I think that would be unfortunate, because  
14 I think Reg. D has provided a lot of consistency and  
15 certainty, and a certain measure of an ability to keep our  
16 arms around what is going on. And I would hate to see it  
17 eroded.

18 Let me make one other comment which Gerry didn't  
19 touch on, which I just thought was interesting. Dodd-Frank,  
20 in 915 talks about an investor advocate. And it's a  
21 fascinating concept that may be a mixed blessing for a whole  
22 lot of folks in and outside of this building.

23 But I do think the idea that there will be, under  
24 Dodd-Frank, someone appointed to be a Commission staff person  
25 who will be an investor advocate offers the small business

1 community -- and other communities, but particularly the  
2 small business community -- a really strong and good  
3 opportunity to be involved on a regular basis in the kind of  
4 rule-makings and the kind of thinking that goes on inside  
5 this building with respect to the particular community that's  
6 involved in small business and small business capital  
7 formation.

8           And it's something I would love to see the various  
9 committees push for, maybe even get it in place sooner,  
10 rather than later, with an opportunity to have an advocate on  
11 the staff, if you will, who can be there and be present, rule  
12 by rule, and idea by idea. I did not in that provision it  
13 has to be someone who hasn't been on the staff in the past  
14 several years -- I think two years -- before appointment,  
15 which is interesting, in terms of getting some fresh blood  
16 and fresh viewpoints. But it's something certainly worth  
17 considering.

18           The only other point that I would make is that the  
19 bad boy -- excuse me, bad person -- provisions --

20           MS. CROSS: Bad actor.

21           MR. BERKELEY: Bad actor provisions -- that's --  
22 politically correct is bad. Bad persons is not politically  
23 correct.

24           MS. CROSS: Bad actor.

25           MR. BERKELEY: Okay, sorry. My apologies to all

1 concerned. It's only been bad boys since 1982 or  
2 thereabouts, but you know -

3 MS. CROSS: Legislation kept referring to them as  
4 "the felons."

5 MR. BERKELEY: The felons, yes. Well, this is a  
6 minor improvement, then.

7 (Laughter.)

8 MR. BERKELEY: The bad boys -- bad actors  
9 provisions are a definitional nightmare. And I think it's  
10 something that we need to be extraordinarily attentive to, as  
11 this pushes forward.

12 I am very concerned that you could wind up giving  
13 back to the states what the final provision of Dodd-Frank did  
14 not give to states, which was the end of preemption, because  
15 you will wind up -- could very well wind up with a  
16 proposition where one administrative proceeding or one action  
17 in one state could disqualify a bad actor from the entire  
18 country and federal -- and the federal provisions dealing  
19 with capital formation. And that's a little bit scary,  
20 because the states have very different standards, very  
21 different approaches. And it could be -- wind up really  
22 undoing what Congress decided not to do when it finally did  
23 pass Dodd-Frank.

24 I will also comment, just in closing, it -- the bad  
25 actors provision has a history, of course, for other -- for

1 505 and for other provisions -- and it's often been an issue,  
2 in settling enforcement proceedings, to get a waiver of the  
3 disqualification, particularly if you're dealing with a  
4 reasonably sized brokerage firm that had a violation, you  
5 know, somewhere, and suddenly, in settling that, in agreeing  
6 to the injunction or whatever the administrative proceeding  
7 was, suddenly they are bad actors and would be disqualified  
8 from doing a variety of things in the offering process.

9           And it's been fairly standard to seek to get a  
10 waiver of those bad actor provisions in settling those  
11 enforcement cases. If the bad actor provision is extended,  
12 as some have suggested, and is as broad as some have  
13 suggested and sought, it's going to be an absolutely  
14 nightmare, in terms of the resolution of enforcement cases  
15 for the brokerage industry, and it's something that, again,  
16 will need to be addressed because it's an issue that comes up  
17 with great frequency in settlement cases. I think that's it.

18           MS. CROSS: Thank you very much, Alan. We look  
19 forward to getting comments when we get the rule proposals  
20 out there. These are all important issues for us to  
21 consider. We are dutifully working through the calendar of  
22 getting the Dodd-Frank rule-makings out. So these will be  
23 coming, and it will be important for us to hear from you all  
24 when they're out.

25           There is also an email box in advance of

1 rule-making where you can send in comments. And so, if you  
2 go on our website, there is a Dodd-Frank section. And we  
3 encourage comments before we put out the rules, because they  
4 help us shape the rules. So please give us -- you know, keep  
5 your cards and letters coming. We really benefit from the  
6 views of the public in advance of our rule-making and during  
7 our rule-making.

8           So, next we are going to move to our second set of  
9 panelists who will talk about three disclosure and corporate  
10 governance provisions in the Dodd-Frank Act that specifically  
11 direct the SEC to consider the impact of the proposed rules  
12 on smaller public companies.

13           Our panelists are Tom Kim, who is the Chief Counsel  
14 in the SEC's Division of Corporation Finance, and Greg  
15 Yadley, a partner in the law firm of Shumaker, Loop &  
16 Kendrick, in Tampa, Florida. Greg is the former Chairman of  
17 the Small Business Issuers Subcommittee of the American Bar  
18 Association's federal regulations securities committee, and a  
19 real pro about small business.

20           I understand Tom is going to go first.

21           MR. KIM: Why don't I start with say-on-pay? As  
22 many of you know, Section 951 of Dodd-Frank requires  
23 companies to provide their shareholders with a vote to  
24 approve the executive compensation pay to executives, a  
25 separate vote to decide how frequently shareholders should

1 get the say-on-pay vote, and finally, a vote to improve  
2 golden parachute arrangements. And this is required for  
3 meetings starting on or after January 21st of next year.

4 This statute also requires the disclosure, in clear  
5 and simple form, of golden parachute arrangements and merger  
6 proxies.

7 The statute really does provide that the Commission  
8 can exempt a class of issuers from this requirement. And in  
9 determining whether or not to make an exemption, the statute  
10 directs the Commission to take into account, among other  
11 considerations, whether or not the requirements  
12 disproportionately burden smaller companies.

13 We proposed rules in October of this year, and our  
14 proposed rules would not exempt smaller issuers from the  
15 say-on-pay voting requirements, or from the disclosure  
16 requirements. And in the Commission's view, as stated in the  
17 proposing release, shareholders -- an advisory vote on  
18 say-on-pay would be significant for all shareholders,  
19 including those of smaller companies, and that the view is  
20 that investors in smaller companies would have the same  
21 interest in voting on executive compensation, and in having  
22 clear and simple disclosure of golden parachute arrangements  
23 as they would in large issuers.

24 So, we have crafted our proposals, in our view, to  
25 minimize the cost to smaller reporting companies. As I said,

1 the requirement is to approve the compensation paid to  
2 executives as disclosed in Item 402 of Regulation S-K. Our  
3 proposed amendments would not change the scaled executive  
4 compensation disclosure requirements that we have for smaller  
5 reporting companies. And these scaled requirements  
6 recognized the fact that the comp. arrangements for smaller  
7 companies are typically less complex than they are for larger  
8 companies.

9 Another aspect of our proposal is that we would  
10 require companies to disclose in their CD&A what  
11 consideration they gave to the prior year's shareholder  
12 votes. Because smaller reporting companies do not -- are not  
13 required to have CD&A, they are not required to make this  
14 disclosure.

15 With respect to the disclosure requirement for  
16 golden parachute arrangements and merger proxies, our  
17 proposed rules would apply equally to all companies, and our  
18 preliminary view is that they would not disproportionately  
19 burden smaller companies for, again, the reason that they  
20 tend to have less complex comp. arrangements than larger  
21 companies.

22 In our proposal, we have asked whether we should  
23 exempt, either fully or partially, smaller reporting  
24 companies or some other category of small companies from some  
25 or all of these requirements. And we have also asked whether

1 our requirements would be unduly burdensome, or -- and we  
2 have also asked whether or not there were any other steps we  
3 should take to reduce the burden on smaller companies.

4 So, as Meredith noted, we are looking forward to  
5 comment. We are in the comment period now for this proposed  
6 rule-making. And we look forward to receiving them.

7 MS. CROSS: I think the comment period ends -

8 MR. KIM: Soon.

9 MS. CROSS: -- Tomorrow. Something like that.  
10 Because they're trying to get rules done in time for the  
11 meetings that are in January, so people are already making  
12 their filings.

13 But get your letters in fast. We do have to get  
14 moving quickly on it. I will note, as Tom said, that we  
15 didn't propose -- the Commission didn't propose to add really  
16 any new disclosure burdens as a consequence of these rules.

17 We -- for example, the golden parachute provisions  
18 could have -- we could have gone in and said everybody has  
19 got to provide lots more golden parachute disclosure in their  
20 annual meeting proxy, which would have been quite burdensome.  
21 And the Commission specifically decided at the proposing  
22 stage not to do that, and instead have those only in the  
23 merger proxies, basically when the company is getting ready  
24 to exit. So, we are hopeful that, the way this is crafted,  
25 the disclosure burdens are not significant.

1           The question, really, is do shareholders of all  
2 companies need to have this vote, or should it be limited to  
3 a category? And so I think that's really the -- that's the  
4 tough issue for public comment.

5           MR. YADLEY: I think Meredith's last comment really  
6 is the critical one. Disclosure is good. More disclosure is  
7 better. Too much disclosure is confusing. And you have to  
8 read it and understand it. And the Commission staff  
9 certainly is under the gun in responding within these very  
10 tight time frames, so it's important for all of us to make  
11 our views known.

12           The fact of the matter is that executive  
13 compensation is not really the burning issue for smaller  
14 reporting companies. What investors really care about is the  
15 profitability of the company and, in many cases, the  
16 survivability of the company. It's been a tough climate for  
17 everyone. People are doing more with less. And the focus  
18 really is on the business.

19           The other focus is on liquidity. Investors want  
20 smaller public companies to grow, so that there will be more  
21 shares out there, and they will have a more active market.

22           Excessive compensation, in my experience, isn't  
23 really a big deal with smaller companies. They don't have  
24 that much money. The boards manage it, and that's really not  
25 where the abuses are.

1           I guess the other point I would make is that, as  
2 Tom said, compensation isn't that complicated for most  
3 smaller public companies, and it's really not a big deal to  
4 just add a couple more items to your proxy statement. But it  
5 is a big deal, because it is two more items.

6           And it takes people's time to do it. And most of  
7 the public companies that I represent don't have a compliance  
8 person. They have somebody who is responsible for  
9 compliance, but that individual is also typically involved in  
10 finance and accounting and reporting. The CFO is involved in  
11 operations and M&A and part of that management team at the  
12 top that's involved in pretty much everything. So it's just  
13 another thing that people don't have time for, or they have  
14 to pay their lawyers to do. And people ask me, "Well, how is  
15 business?" Well, business is okay, because there is still  
16 work to do. But people are unhappy about paying me more for  
17 things that they don't see the value of.

18           So, I am not sure that this is an issue that's that  
19 important for this class of companies. If it is, maybe two  
20 votes is one vote too many. Perhaps there could be a vote --  
21 and many of us in the ABA, including my successor in the  
22 Small Business Issuers Committee, Anne Walker, have talked  
23 about -- perhaps one vote with a set period. Every three  
24 years, for example, and get input that way.

25           Another great benefit would be to delay

1 implementation if the Commission decides that this is an  
2 important disclosure issue, and that investors should have  
3 the ability, as part of the corporate governance, to make  
4 their views known. Let smaller companies wait. Let's see  
5 how larger companies implement the say-on-pay. And it may  
6 also in this first year, when analysts and proxy advisers  
7 have so many filings to look at -- I would sort of hate to  
8 see smaller reporting companies get stuck at the tail end,  
9 and there is no time to analyze it, and maybe the  
10 recommendations that will come out won't really be in the  
11 best interests of the company.

12 In terms of golden parachutes, you're right.  
13 You're not discriminating against smaller reporting  
14 companies. But there is a new table in 402(t), and tabular  
15 disclosure is a requirement to do something which means  
16 people have to understand it and get familiar with it. And  
17 in the context of the deal, again, the deal has been  
18 negotiated and it's just another thing to do.

19 Final point I guess I would make would be to thank  
20 the Commission for recognizing that a prescriptive rule  
21 regarding say-on-pay votes discussion really is not perhaps  
22 that beneficial without a full CD&A.

23 And as the Commission staff notes, even smaller  
24 reporting companies are required to make good disclosure,  
25 which means all disclosure that would be important to an

1 understanding of the information presented -- and 402(o) does  
2 require smaller reporting companies to do that, so that the  
3 investor will be able to understand the summary compensation  
4 tables. So, I think that is good, and it's important, and  
5 it's enough.

6 Another topic that Tom and I are going to comment  
7 on has to do with compensation committees. Section 952 of  
8 the Act requires most public companies to have compensation  
9 committees that are comprised of solely independent  
10 directors. And independence will be described in new rules  
11 developed by the securities exchanges. But, at a minimum,  
12 they need to take into account other fees that the director  
13 has received, or compensation for services other than as a  
14 director, and whether the director is an affiliate.

15 The Dodd-Frank Act also requires that compensation  
16 committees of a listed company, through exchange rules,  
17 consider the independence of advisers to the committee, be  
18 that compensation consultants or lawyers or other advisers.  
19 Meredith, in a recent speech, said that in order for the  
20 Commission to get the rules out on time so that they can be  
21 adopted before meetings after July 22nd, a proposal will be  
22 out soon. She also stated that, similar to the  
23 Sarbanes-Oxley audit committee legislation, there are  
24 similarities here. So that's maybe a pattern that the staff  
25 will use in putting together rules in this area.

1                   She noted there are some differences in contrast to  
2   SoX.  Everybody has to have an auditor.  Compensation  
3   committees are not required to have compensation consultants.  
4   And they certainly are not today required to have independent  
5   compensation consultants.

6                   An issue that will be important is this idea of an  
7   affiliate, and whether, for example, a large stockholding  
8   will disqualify you from service on the committee.  As you  
9   know, under the SoX legislation and the rules for audit  
10  committees, an affiliate of the company would not be  
11  considered independent for purposes of serving on the audit  
12  committee.

13                   Compensation area is a little different.  There  
14  are a lot of large shareholders who are not control  
15  shareholders -- classic case being a portfolio company of a  
16  private equity firm, or a firm that has venture capital --  
17  and there are directors on the boards of those companies who  
18  are pretty interested in everything, including compensation,  
19  and very involved in that.

20                   And hard to see why their objectivity would be  
21  compromised, simply by virtue of their holdings, for purposes  
22  of compensation.  I'm not sure that they really are  
23  compromised for purposes of financial reporting, either.  But  
24  certainly you can make that case.

25                   But with respect to compensation, I think the money

1 investors, the professional investors, have the same interest  
2 as any other investor in ensuring that you have good  
3 management who is fairly paid, and that pay corresponds to  
4 performance.

5 In adopting the new rules, Congress has said, as  
6 they did with SoX, that there should be a time for allowing  
7 companies to come into compliance. So there will be some  
8 transition there.

9 Tom, I don't know if you have anything to add on  
10 that. Thanks.

11 MS. CROSS: So, are we ready for the next panel?  
12 Thank you so much. That's very helpful. And I think that  
13 your comments about particularly the large shareholders and  
14 compensation committees I think is a particularly important  
15 point that I can tell you the staff is currently talking  
16 about. Because since they used words so much like the SoX  
17 audit committee language, you know, that's something we've  
18 got to think about.

19 But I had the exact same concern when I read it, so  
20 it's something we are talking about internally, and trying to  
21 see, you know, what, if anything, to propose or request  
22 comment about in that area.

23 Okay. So the third panel subject is smaller  
24 companies and Section 404(b) of the Sarbanes-Oxley Act. Our  
25 first panelist on this topic is Brian Croteau, Deputy Chief

1 Accountant in the SEC's Office of Chief Accountant. Greg,  
2 who you just heard from, will also speak on this topic.  
3 Brian, are you going first?

4 MR. CROTEAU: Great. Thank you very much,  
5 Meredith.

6 What I would like to do this morning is just make a  
7 few remarks with respect to reporting on internal control  
8 over financial reporting under Section 404 of SoX, and talk a  
9 little bit about the impact Dodd-Frank had on that reporting.

10 The Dodd-Frank Act, as you undoubtedly have heard  
11 by now, exempted non-accelerated filers from complying with  
12 the provisions of 404(b) of the Sarbanes-Oxley Act, which is  
13 the auditor attestation portion of the SoX 404 reporting  
14 requirements. Subsequent to that, in September, the  
15 Commission adopted final rules to update its rules to  
16 implement that exemption. And, as a matter of trivia, that  
17 was actually the first rule-making the Commission completed  
18 that was required by the Dodd-Frank Act, the first of what  
19 would be many more to come, as you are hearing.

20 The Commission had obviously previously postponed  
21 Section 404(b) attestation requirements for non-accelerated  
22 filers numerous times, such that the first audits would not  
23 have been required until fiscal years ending on or after June  
24 15, 2010. And so, based on the timing of Dodd-Frank,  
25 non-accelerated filers were not ever required and will not be

1 required to have the audit attestation component of the  
2 internal controller financial reporting.

3 Financial statement audits are, of course, still  
4 required. And management of non-accelerated filers will  
5 continue to be required to report under SoX 404(a) on their  
6 own, with respect to the effectiveness of internal control  
7 over financial reporting. That's something that  
8 non-accelerated filers have been doing since 2007.

9 I thought I would make just a couple points, or a  
10 few points, on the September Commission release, just to  
11 highlight a couple things that might be important.

12 First, management reports are now considered filed  
13 for fiscal years ending on or after June 15th of 2010 versus  
14 furnished. Under the transitional rules, the idea was that  
15 management's reports on 404(a) would be considered furnished,  
16 rather than filed, until such time as the audit requirement  
17 kicked in. And, since the audit requirement will not kick  
18 in, the rules that the Commission issued in September now  
19 makes those reports filed.

20 The second point is that the disclosure that  
21 management makes regarding the effectiveness of controls no  
22 longer is required to make any reference to the auditor  
23 attestation. Under the transitional rules before the audit  
24 requirement was going to kick in, companies had to indicate  
25 that the auditor attestation was not included, and why it was

1 not included. That disclosure is no longer necessary, given  
2 the rules no longer require -- and won't require -- the  
3 auditor attestation.

4           And then the last point on the September  
5 rule-making to make is that there is a reminder in the  
6 release about the importance of management conducting their  
7 evaluation in an appropriate way, and a reference back to the  
8 Commission's interpretative guidance that was issued back in  
9 2007.

10           The Commission's rules are clear, that there are  
11 multiple ways that companies could conduct an evaluation of  
12 ICFR. But conducting one in accordance with the  
13 interpretative guidance in 2007 is one way to ensure you have  
14 satisfied the requirement.

15           And so, I think it's important to think about, from  
16 time to time, refreshing management's approach in thinking  
17 about whether it's consistent with the interpretative  
18 guidance issued back in 2007.

19           Aside from the exemption, a couple of points out of  
20 Dodd-Frank on 404. The SEC and GAO were both tasked with  
21 completing additional studies with respect to 404(b), the  
22 audit requirements. For the SEC's study, that study is due  
23 in April, and it's a study as to whether the Commission could  
24 reduce the compliance burden of the audit requirement again  
25 for companies with a public float between \$75 and \$250 million,

1 and whether doing so would have an impact on encouraging  
2 additional listings in the U.S. for IPOs.

3           The Commission did issue a release on October 14th  
4 seeking public comment in a number of areas to help with this  
5 study, and I would certainly encourage people to take a look  
6 at that release. There were 23 different areas which we are  
7 seeking public comment in, but certainly you could comment on  
8 any of those that you feel are appropriate, or that you've  
9 got information that would be useful to this study.

10           But again, the study is one of market cap -- or  
11 public float, I should say -- of 75 to 250 million, and  
12 focused on, really, whether there are ways to reduce the  
13 compliance burden of just the audit requirement section.

14           The GAO study -- oh, by the way, that release  
15 indicates that the comment period closes on December 6th.  
16 The GAO has a study that is due in three years, so they have  
17 got a longer period of time to conduct their review. And  
18 theirs relates very specifically to the non-accelerated  
19 filers that have been exempt from 404(b), and study such  
20 topics as whether issuers that are exempt have more  
21 restatements, whether there is a different level of cost of  
22 capital, whether those exempt should have disclosure about  
23 the lack of the auditor attestation, and whether the cost and  
24 benefits to issuers -- what are the costs and benefits to  
25 issuers that have voluntarily complied, which, of course, is

1 certainly acceptable. Companies can today choose to  
2 voluntarily include an auditor attestation, even though not  
3 required. So again, their study will be expected three years  
4 from now.

5           So, I think those are probably the highlights.  
6 With that I will let Greg make some remarks.

7           MR. YADLEY: Well, thank you, SEC, for continuing  
8 to push out the effectiveness for the smallest public  
9 companies. And thank you, Congress, for recognizing that the  
10 cost of compliance for smaller reporting companies simply  
11 aren't worth the benefits.

12           It's true that accounting standard five has helped  
13 a lot. It took a while for the accounting firms to get  
14 beyond one-size-fits-all, not surprisingly -- not describing  
15 any bad motives -- but, you know, there is a way of doing  
16 things, and fraud is fraud, and therefore, you apply the  
17 techniques that you know. But certainly the focus on risk,  
18 focus on materiality, tailoring and testing to real risk,  
19 allowing auditors to rely on the work of others have all been  
20 very good things.

21           I think the difficulty in this area has been what  
22 fraud has been prevented. Our national security measures,  
23 you know, how many things haven't happened because we have  
24 all been inconvenienced by airport searches. But this is  
25 particularly important, I think, for us to provide the staff

1 with responses to their requests for comments.

2 I think the GAO study is going to be very  
3 important, because the source of a lot of information about  
4 what's happened are the accounting firms, and they have a  
5 vested interest in more work. So I'm not sure that a lot of  
6 information is going to come out now.

7 With the companies that I represent, it's really  
8 hard to find that there have been serious material  
9 weaknesses. I mean there just haven't been that many. There  
10 have been lots of issues that have been worked through, and  
11 they have always been worked through. I think management and  
12 boards of smaller companies listen to the auditors. They  
13 used to be able to listen to the auditors a lot more when  
14 auditors were more like partners.

15 But they still come in, management still has to  
16 assess and report on internal controls. The auditor still  
17 reviews internal controls as part of the financial statement  
18 audit. And, again, in my experience, audit committees  
19 comprised of solely independent directors are listening, and  
20 they are taking steps.

21 So, I don't really think that there is that much  
22 value in the 404(b) for companies that go up to 25 million --  
23 \$250 million in market cap. But I'm not sure that we're  
24 going to get much more than anecdotal information at this  
25 time. But even that's important. So please respond to

1 comments.

2 MS. CROSS: Great. Thank you very much. So now we  
3 will move to the last component of this panel, which is a  
4 discussion of the exemptions of advisers to venture capital  
5 and small business investment company funds from Dodd-Frank  
6 provisions requiring registration of private investment fund  
7 advisers.

8 David Vaughan is an attorney-fellow in the Division  
9 of Investment Management who has played a key role in the  
10 division's response to Dodd-Frank, and he will introduce the  
11 subject. Brian Borders, a lawyer in private practice in  
12 Washington for many years, will comment. Brian represents  
13 the National Venture Capital Association on our forum  
14 planning committee. David?

15 MR. VAUGHAN: Thank you. I will talk a little bit  
16 about the changes to investment adviser registration and  
17 exemptions for advisers to venture capital funds, primarily.

18 I think one of the interesting things about these  
19 advisers is they are themselves often small businesses, but  
20 they also provide a lot of funding to small businesses. So  
21 there is a couple of different aspects about them that are  
22 impacted by small business in general.

23 For those of you who aren't familiar, today most, I  
24 would say, venture capital funds and smaller investment funds  
25 tend not to be registered under the Investment Advisers Act.

1 And that's a result of the fact that, under the Advisers Act  
2 currently, if you have fewer than 15 clients you don't have  
3 to register with the SEC.

4 Some other conditions apply that are fairly easy  
5 for them to comply with. And each fund is one client. So if  
6 you have fewer than 14 venture capital funds, you're not  
7 registered. They are potentially subject to registration at  
8 the state level, but many states provide exemptions for them.

9 Interestingly, while this exemption may have  
10 originally been to cover small businesses, small investment  
11 advisers, if you only have 14 clients and they're all  
12 individuals, you probably don't have a very big business.  
13 But because it applies at the fund level, and the fund  
14 business kind of grew up after 1940, when the exemption was  
15 brought in, it actually applies to many very large  
16 businesses.

17 People tend to focus on the hedge fund business.  
18 But even venture capital funds -- of which there are probably  
19 at least 50 or so advisers, and have over a billion in assets  
20 under management -- can claim the exemption, as long as they  
21 have fewer than 14 funds at any one time. And that is -- you  
22 know, typically venture capital funds tend to have a  
23 relatively limited number outstanding at any given time.

24 That all changes with Dodd-Frank next July. And  
25 that is the exemption, that exemption, is replaced by an

1 exemption which, you know, in some ways is more tailored to  
2 the size of the company, but judges the size of the adviser  
3 based on how many assets it's managing, not how many funds it  
4 happens to have, even if they're huge.

5           And so, the exemption for 14 clients or less is  
6 going away. But it is replaced by a couple of other  
7 exemptions which would be of interest to people. One is for  
8 any adviser that solely advises licensed small business  
9 investment companies. So if that's the only business the  
10 adviser has, they're simply exempt from adviser registration.  
11 The funds themselves, of course, are subject to licensing and  
12 a level of regulation of the Small Business Administration.

13           Another exemption is for advisers who solely advise  
14 venture capital funds. Now, the definition of venture  
15 capital fund is not in the statute, and the SEC is directed  
16 to come up with that definition. And, in fact, the proposal  
17 of that definition is on the calendar for tomorrow, about 24  
18 hours from now.

19           I can't comment on a proposal that hasn't been made  
20 yet in any kind of detail, so you will have to tune in again  
21 tomorrow to find out all the details. But we can talk a  
22 little bit about how the exemption works, and how it fits in  
23 to the statute. But tomorrow is the real show.

24           In the testimony -- it was interesting on Capitol  
25 Hill as this went through Congress -- originally, the

1 Administration proposed no exemptions. So no exemptions for  
2 any strategy, so venture capital would have been in to  
3 adviser registration. Adviser registration -- or exemptions  
4 came in for venture capital and private equity fund managers  
5 during the legislative process. Ultimately, the private  
6 equity exemption did not make it through the legislative  
7 process, although it had passed the Senate.

8           But there is another exemption which also impacts  
9 small businesses in the sense that if you're a private fund  
10 adviser -- so any unregistered fund, so not mutual funds,  
11 whether they're private equity, hedge funds, or venture  
12 capital funds -- and you manage less than \$150 million in  
13 assets, then you're also exempt under the new statute.

14           So, if you look at a venture capital firm investing  
15 in small companies, there is really two exemptions that might  
16 be available to them. They could be a venture capital  
17 adviser, because their funds all meet the definition that  
18 will be proposed tomorrow, or they simply have less than \$150  
19 million in assets under management.

20           And we think, based on the data we see from the  
21 National Venture Capital Association and others, is that that  
22 exemption really covers quite a few -- by at least head  
23 count -- of the advisers out there, because we think  
24 something like 60 percent of all venture capital advisers are  
25 under the \$150 million. And so they really have the two

1 different exemptions that might apply to them.

2           There will also be some rules proposed tomorrow  
3 that will interpret some of the terms of the \$150 million  
4 exemption, so there are certainly details to work out. But  
5 the two exemptions might work together for adviser who are  
6 themselves small or invest in small companies.

7           One of the things to keep in mind with adviser  
8 registration and the Dodd-Frank's amendments to the Advisers  
9 Act is nothing about these amendments really simplify the  
10 Investment Advisers Act. It's gotten more complicated, not  
11 so much that these new exemptions come into replace the old  
12 exemption, or there are multiple ones. That's somewhat more  
13 complex, but probably something people can get their arms  
14 around. The complexity comes in in the question of who the  
15 adviser registers with, compared to the federal government  
16 versus the state governments.

17           Currently, if you're an investment adviser, and you  
18 have less than \$25 million in assets under management, you  
19 are subject to state regulation. And that means that if a  
20 state where you have your home office has an investment  
21 adviser statute, you don't register with the SEC.

22           And, in fact, you can't register with the SEC.  
23 Your home state may require you to register, may not require  
24 you to register, at their option. But you don't really --  
25 you don't have the option or the obligation to register with

1 the SEC, except for in Wyoming, which has passed an advisory  
2 statute, so you have federal regulation there. But every  
3 other state, you are subject to state regulation, whatever  
4 they have decided to do.

5           During the legislative debate, there is a lot of  
6 debate about raising that limit to \$100 million. Had more to  
7 do, I think, with the allocation of resources between the  
8 state and the federal government, and how large the advisers  
9 were, and whether they were more properly the subject of  
10 local regulation or federal regulation.

11           Ultimately, what Congress decided to do was to  
12 create a new category of advisors, those between \$25 and \$100  
13 million, who are required to register with their home state,  
14 if their state requires them to register, and subjects them  
15 to examination.

16           If in their home state they are not required to  
17 register, or their home state does not examine them, then  
18 they have to register with the SEC -- unless, of course,  
19 they're exempt. So, if they're exempt under one of the new  
20 exemptions because they advise only venture capital funds, or  
21 less than \$150 million under management, they're again  
22 exempt.

23           So there is sort of a two-step process they will  
24 have to look at: the federal/state split; which jurisdiction  
25 are they properly regulated by; and then, if they end up with

1 SEC regulation, is there then an exemption available.  
2 Interestingly, if they claim the federal exemption but a  
3 state requires them to register -- maybe not their home  
4 state -- they would actually have to register with that  
5 state. And that would not get them out of SEC regulations.

6 So, the complexity here has been increased quite a  
7 bit by the statute. And hopefully, the rules proposed will,  
8 to the extent possible, try to bring some more clarity to  
9 that, understanding there is a fair amount of complexity.

10 Just one more point on these advisors that are  
11 venture capital advisors and advisors with less than 150  
12 million under management. Unlike today, where an exempt  
13 adviser is essentially completely out of SEC jurisdiction  
14 unless they commit fraud -- we can always go in with a  
15 subpoena and look at an adviser if we have reason to suspect  
16 there is something fraudulent going on, particularly a tip or  
17 a complaint of some kind, for example. But, other than that,  
18 we can't require them to report to us or keep any records.

19 The statute contemplates that anybody relying on  
20 the venture capital exemption, or the exemption for less than  
21 \$150 million under management, could -- will be subject to  
22 record-keeping and reporting requirements with the SEC, as to  
23 be defined by the Commission.

24 And so that's another aspect here where, while  
25 they're exempt, they're not really completely out of the

1 Advisers Act, as exempt advisers are today in a way that is  
2 new. That concept had not previously existed in the Advisers  
3 Act, so it's a brand new concept, that somebody who is exempt  
4 from registration would, nonetheless, have reporting  
5 requirements.

6 MR. BORDERS: Well, thank you, David. That's a  
7 thorough review of what the statute requires. I recognize  
8 that I can't ask you too many questions, or I can't get too  
9 many answers about what is in the proposal coming up on  
10 Friday.

11 First of all, I think a comment on process. The  
12 NVCA's perspective is that the -- David, you and your  
13 colleagues have been extremely open and have done a  
14 significant amount of outreach in terms of trying to get the  
15 definition of venture capital right.

16 Since this is the small business capital formation  
17 forum, those of us who participated many times have dealt  
18 primarily with registration and regulation of private company  
19 or private offerings in public companies, small public  
20 companies. And we have looked at venture capital as  
21 primarily a source of the capital that those companies and  
22 entrepreneurs are seeking. This is an interesting turn, now  
23 that we're looking at venture capital as a subject of  
24 regulation, an attempt to define venture capital out of  
25 regulation.

1           And it's interesting that the 2004 rule-making that  
2     the SEC completed on registration of hedge funds actually  
3     came to the same conclusion, that there ought to be an  
4     exemption for venture capital. The congressional intent,  
5     obviously, in Dodd-Frank is that -- it recognizes the capital  
6     formation role of venture capital, and also recognizes the  
7     compliance burden of Advisers Act registration, and a desire  
8     not to burden venture capital -- burden the capital formation  
9     function.

10           There -- and of course, one of the important things  
11    that we on the outside will be looking at with the venture  
12    capital definition is not just that it accurately capture  
13    venture capital now, but that it not be so specific and so  
14    inflexible as to constrain the development and innovation of  
15    venture capital. It's one of the things that we have to  
16    recognize, I think, that venture capital in America is a  
17    unique entity. It doesn't really exist elsewhere. And we  
18    want to certainly maintain that role of venture capital.

19           It's interesting that you note that 60 percent of  
20    venture capital firms are small firms. And, of course, those  
21    are the firms that may one day be the large, the top tier  
22    venture capital firms in the future. So it would be  
23    interesting.

24           To the extent you can, can you talk a little bit  
25    about the consideration, the -- not just the congressional

1 intent, but also the SEC statutory role with respect to  
2 promoting capital formation, and how that worked into both  
3 your view, your observation of the legislative process, and  
4 the rule making?

5 MR. VAUGHAN: Sure. As I say, I'm somewhat limited  
6 in what I can say -- and don't take this as a prediction of  
7 what's going to be voted on tomorrow -- but if you look at  
8 the legislative process, historically there have been other  
9 attempts, or other provisions put into the Adviser or the  
10 Investment Company Acts, or part of the securities laws that  
11 regulate people who invest money for other people, to try to  
12 promote venture capital investing and capital formation over  
13 the years.

14 There is the business development company  
15 provisions, there is, of course, the SBIC provisions, and  
16 other provisions like that. And if you look at the  
17 congressional history during those debates, there was a lot  
18 of focus on capital formation, which is not surprising. That  
19 was a lot of what was talked about during those legislative  
20 hearings, and things like that.

21 In the Dodd-Frank debate, there was a lot of focus  
22 on systemic risk, because this was obviously being considered  
23 in the context of a much broader, much longer statute, which  
24 has a lot of focus on systemic risk. So it's interesting to  
25 look at the testimony the NVCA representatives gave, and the

1 debates during the legislative process on the Hill, where  
2 they certainly describe venture capital, and the capital  
3 formation, and the job creation, and things like that, that  
4 people traditionally talk about with venture capital  
5 investment.

6 But they also talked about the lack of systemic  
7 risk, that venture capital funds aren't active in the public  
8 markets, they don't use leverage and things like that, that  
9 people tend to think of when they think of systemic risk.  
10 And systemic risk has not really been a focus in the past.

11 It's sort of a new thing for the federal regulators  
12 to look at sort of outside the banking community. And so it  
13 was an interesting additional consideration that Congress  
14 seemed to be thinking about as they were thinking about this  
15 venture capital exemption.

16 The other things that you need to think about in  
17 defining venture capital is, from the legislative history,  
18 you know, hedge funds were not exempted. You talk about the  
19 prior rule, where there is an attempt to capture hedge funds,  
20 but not venture capital and private equity. Here, hedge  
21 funds were a fairly major focus of congressional intent, I  
22 think, on the registration.

23 The private equity funds did have an exemption  
24 which then went away, so presumably that means there is an  
25 idea that the exemption would be for venture capital and not

1 private equity. The name obviously indicates that, as well.  
2 So there is a lot of those sort of considerations.

3 I think what -- we are certainly looking forward to  
4 the comments on this. I think certainly trying to capture  
5 venture capital, as opposed to capture hedge funds, is a very  
6 different exercise. I think, ideally, a rule like this would  
7 be simple enough to serve the purpose, but understandable  
8 enough that people don't have to spend days with their  
9 lawyers trying to understand whether they qualify or not.

10 So, there is certainly a balance to strike there,  
11 but we definitely look forward to comments on it. I am sure  
12 there will be a lot of constructive input.

13 MS. CROSS: Thank you so much. We are exactly on  
14 schedule, this is remarkable. We are now -- I would like to  
15 thank everyone for their fine contribution. It was a  
16 terrific panel, I think. And we very much look forward to  
17 considering these thoughts as we go forward with all of our  
18 rule-makings.

19 We are now going to take a 10-minute break while  
20 the members of the second panel come up and seat themselves  
21 on the stage. And then we will reconvene at 10:25 am. Thanks.

22 (A brief recess was taken.)

23 MR. LAPORTE: Before we start the second panel  
24 discussion, I would like to recognize the staff of the office  
25 of -- SEC's Office of Small Business Policy, who are

1 responsible for putting together this program.

2           First of all, there is Tony Barone, who I see  
3 standing in the back of the room, who did a tremendous job  
4 being a primary -- doing the primary organizational work for  
5 today's program. We all owe him a real debt of gratitude for  
6 all the details he has attended to.

7           Secondly, Kevin O'Neill and Johanna Losert -- I see  
8 Johanna is standing back there; Kevin was here before, I'm  
9 not sure what happened to him, but many of you who have been  
10 here before know him -- they are also professionals on our  
11 staff, attorneys who supported the efforts of Tony and the  
12 rest of us who put together the program.

13           We have Karen Wiedemann, who recently joined our  
14 office as an attorney-fellow, leaving a partnership in the  
15 London office of Fried Frank law firm. She has already  
16 proved herself invaluable to our office, and she is becoming  
17 familiar with the heritage of this forum on small business  
18 capital formation.

19           Netta Williams, I don't think she is here. Some of  
20 you saw Netta when you approached the desk this morning. She  
21 is our administrative assistant, has done a lot of work in  
22 support of the program. Michael Poelman, I don't -- I just  
23 saw Michael. He is our law student intern from American  
24 University who has given us a lot of help.

25           Last, but not least, I guess Mauri Osheroff has left.

1 She had a conference call she had to participate in. She is  
2 not actually in the Office of Small Business Policy, but she  
3 oversees the work of our office as an Associate Director of  
4 the Division of Corporation Finance, and who has provided a lot  
5 of support for this program this year and over the years.

6 Our second panel today consists of presentations  
7 from people -- representatives of private organizations that  
8 have an interest in small business capital formation. We  
9 have, I guess, 10 or so panelists, some of whom have  
10 submitted written statements.

11 The written statements were available, I think, on  
12 tables as you -- it's not -- it's just a white book with the  
13 written statements. Those of you who are listening to the  
14 webcast can view the written statements on the SEC's webpage.  
15 Click on "small business" down in the red box, the lower  
16 right-hand corner of the SEC web page, and you can get to the  
17 statements that have been submitted.

written

18 We also have some written statements that have been  
19 submitted that were by organizations that were invited to  
20 present -- make oral presentations today, but elected to just  
21 submit a written statement instead of making a  
22 presentation -- that's the American Bankers Association and  
23 the FEI, Financial Executives International -- are not here,  
24 but they did make a written statement. So those, their  
25 written statements, are available on the webpage and on the

1 tables in the back.

2 I think we are ready to go with the panelists. We  
3 have decided to ask them to -- we didn't want to set  
4 priorities here, so what we did is we took the names of the  
5 organizations, and we are going to have the panelists make  
6 their presentations by alphabetical order of the name of the  
7 organization that they represent.

8 First of all, we have Ann Yvonne Walker, who is a  
9 partner at Wilson Sonsini Goodrich & Rosati, the law firm in  
10 Silicon Valley, California, who is representing the Business  
11 Law Section of the American Bar Association. Ann?

12 MS. WALKER: Thanks, Gerry. It's interesting to be  
13 first because, as a "W," I am usually last when they go to  
14 alphabetical order. So, I guess it pays to be a member of an  
15 organization that starts with "A."

16 I want to thank the SEC staff of the Office of  
17 Small Business Policy for inviting me. This is a great  
18 opportunity to exchange ideas about things that can help  
19 promote small business capital formation.

20 As I think Gerry alluded to, and as is in my bio, I  
21 am currently the Chair of the Small Business Issuer  
22 Subcommittee of the Federal Regulation of Securities  
23 Committee of the Business Law Section of the American Bar  
24 Association. And I can speak in that capacity, but I really  
25 wanted to go a little bit beyond that.

1           So, in preparing my remarks, I also talked to the  
2 Chair of the Business Law Section's Middle Market and Small  
3 Business Committee -- Greg Giammittorio -- to the Chair of the  
4 Middle Market and Small Business Task Force on Small Business  
5 Securities -- David Lynn -- and also to the Co-Chair of the  
6 Private Placement Broker-Dealer Task Force, which is a joint  
7 task force between the Middle Market Section and the Business  
8 Law Section -- excuse me, and the Federal Regulation of  
9 Securities Section -- we're both part of the Business Law  
10 Section -- and that's Greg Yadley, who was up here in the  
11 prior presentation.

12           So, all of these are entities from the ABA Section  
13 of Business Law. But I do want to say, close to the way that  
14 the SEC has to make the disclaimer, I am not allowed to make  
15 comments on behalf of the ABA or the Business Law Section, or  
16 any of these different parts of it.

17           However, I would like to refer you to our written  
18 comments, not in these materials, but whenever the SEC puts  
19 out a proposal that touches on federal regulation of  
20 securities or on middle market and small business, but  
21 particularly on securities matters, the Federal Regulation of  
22 Securities Committee of the ABA almost always puts together a  
23 comment letter, a written comment letter. We spend many  
24 hours on them, and we really try to make some good  
25 recommendations, in terms of which things in the proposal are

1 good ideas, which maybe could be improved a little.

2           So, please consider those to be our written  
3 statements. Any particular area you're interested in where  
4 there is already an SEC proposal, you should find an ABA  
5 comment letter available on the SEC website.

6           So, in general, I wanted to say that I am very  
7 pleased that the SEC is sensitive to the plight of the  
8 smaller companies. And it's great that they always go  
9 through a process to think about whether there should be an  
10 exemption from particular provisions for smaller reporting  
11 companies, for example.

12           I would like to encourage the staff and the  
13 Commission, though, to, even if they get to a decision that  
14 perhaps a complete exemption may not be appropriate for  
15 smaller reporting companies for a particular disclosure  
16 obligation, let's say, I would encourage them to always think  
17 about phasing in regulations. It's very difficult, as Greg  
18 Yadley alluded to earlier, for these companies to muster the  
19 troops to respond to new disclosure obligations. They pretty  
20 much have their hands full responding to the existing  
21 disclosure obligations.

22           So it's very helpful to the smaller companies if  
23 they can sort of stand in the wings for a couple years, and  
24 see what the bigger companies do, get an idea of how to get  
25 your arms around a particular new disclosure. So, I would

1 just commend that to the staff and the Commission, to  
2 definitely consider that, even if exemption is not  
3 appropriate.

4 I wanted to quickly make just a couple of specific  
5 recommendations that I think various committees and  
6 subcommittees of the ABA feel fairly strongly about. Our  
7 time is limited, so I'm not going to go into any great  
8 detail. But the first one I wanted to mention was a  
9 recommendation that has actually been on the list of  
10 recommendations from the forum since 2006, and that is that  
11 we need to implement the ABA Private Placement Broker-Dealer  
12 Task Force Report. It's an excellent report. I commend it  
13 to you to read. It's very thoughtful, has some fabulous  
14 ideas in it.

15 Unfortunately, we have had a bit of trouble getting  
16 traction on them, as you can guess, since we have been -- the  
17 report came out in 2005, and it has been on the list --  
18 usually high up in the list -- of recommendations from this  
19 forum each year thereafter.

20 I think that if you go back you have a copy of last  
21 year's recommendations in the booklet that was available to  
22 you when you entered. And if you look at numbers three,  
23 four, and five, number five is -- specifically says we should  
24 implement the report. Three and four are particular aspects  
25 that we believe are especially important.

1                   And this -- obviously, this kind of undertaking  
2 will require the SEC staff to engage with state regulators,  
3 also. Because, as was described in the prior panel, there is  
4 sort of an interlocking between the federal regulation and  
5 the state regulation when you are talking about investment  
6 advisers, broker-dealers, those types of professionals.

7                   So, unfortunately, it is probably not something  
8 where the SEC can make a proposal and adopt it and wave the  
9 magic wand and have everything go away, because I doubt that  
10 they ever would want to preempt state regulation of  
11 broker-dealers. So it will require some coordination, and we  
12 realize that that's difficult.

13                   The second thing I wanted to mention is you're all  
14 aware that in late 2006/early 2007 the SEC made a number  
15 of -- adopted a number of initiatives that were designed to  
16 help the smaller companies. And one of them was to expand  
17 the availability of Form S-3 registration statements for primary  
18 offerings by issuers that had a public float of less than \$75  
19 million. That was a wonderful thing, and we are very happy  
20 that was done.

21                   However, there is a limitation that we think should  
22 be reconsidered. Right now, it's limited to companies with  
23 exchange-traded securities. And we think it would be  
24 extremely beneficial, and not detrimental -- beneficial to  
25 the companies and not detrimental to the investors -- if that

1 were expanded to include reporting companies that are current  
2 in their filings, but that don't have a class of securities  
3 registered on an exchange.

4           As I like to say, those companies need love, too.  
5 They need financing, too. And what I have seen happen,  
6 especially since 2008, is there are a lot of companies that  
7 used to be fairly big, high-flying companies, and then all of  
8 a sudden, when the economic crisis hit, we looked at their  
9 market cap, and suddenly they're smaller reporting companies.

10           And you know, they go, "Well, wait a minute. But  
11 we're a big company, but our market cap is so small that  
12 we're limited in what we can do with a Form S-3. And, by the way,  
13 we just got delisted by NASDAQ because we couldn't meet one  
14 of their requirements." So, it is an area where I think  
15 there are more and more companies that fall into those  
16 categories, and they could really use the help.

17           The last thing I wanted to mention --  
18 second-to-last thing; you will give me the hook if I'm too  
19 late -- is say-on-pay. I just wanted to reiterate that, as  
20 Greg Yadley said on the last panel, the -- we do think that  
21 the say-on-pay proposals are -- need to have a little bit  
22 more of an accommodation for the smaller reporting companies.  
23 We're hoping for a complete exemption from the golden  
24 parachute vote provisions and, in particular, the chart in  
25 402(t).

1           But we are also hoping that, rather than have to  
2 have two new votes -- the say-on-pay vote and the frequency  
3 vote -- that the SEC would say, "Look, these are smaller  
4 companies. Let's just have them do a say-on-pay vote every  
5 three years. They don't have to go out and get a  
6 say-on-frequency vote. And let's not have them not do that  
7 until 2013." So, again, as I said before, they can sit and  
8 watch and see what the big companies do.

9           So, that's going to be, I hope, reflected in the  
10 ABA comment letter which, as I told Meredith, we are  
11 literally burning the midnight oil to get that in as soon as  
12 possible.

13           Final parting thing is -- and this is a little bit  
14 on the more radical front, perhaps -- we have -- we, in the  
15 ABA, we think about these issues -- have really been hoping  
16 for a long time that there would be a more in-depth  
17 examination of why we are regulating offers at all.

18           Why is -- what's harmful about an offer which  
19 doesn't result in a sale? And in particular, we think that  
20 there should be a way to permit general solicitation for  
21 private placements, as long as the people who end up actually  
22 purchasing are accredited investors.

23           I wanted to hearken back to a -- what to me is a  
24 very famous speech in the early 1990s by Linda Quinn. And  
25 she was very much ahead of her time. And she made a

1 presentation to the ABA fall meeting of federal regulation of  
2 securities, and her point generally was -- I cannot be as  
3 eloquent as she was -- but was that we should not be  
4 regulating offers. Let's just regulate the sales. Let the  
5 offers take care of themselves.

6           So, I think we would like to bring that radical  
7 thought back to the forefront. And with that, I will be  
8 quiet.

9           MR. LAPORTE: Thanks, Ann. For people who may have  
10 come in or tuned in at the beginning of this, the second  
11 panel, I probably should have reintroduced Meredith Cross and  
12 David Vaughan, who were also on the first panel -- and that's  
13 why I didn't introduce them before -- but they are fellow  
14 staff members of the SEC. Meredith is Director of our  
15 Division of Corporation Finance, and David is an Attorney-  
16 Fellow in the Division of Investment Management, who are  
17 sitting here to listen to these presentations on behalf of  
18 the SEC and its staff.

19           Our second presenter from a private organization is  
20 Marianne Hudson, who is the Executive Director of the Angel  
21 Capital Association.

22           MS. HUDSON: Thank you, and good morning. I want  
23 to thank the SEC, and particularly Gerry Laporte and his  
24 staff, for inviting us to comment.

25           Let me talk just a little bit about angel

1 investing. I think that Alan Berkeley and Gerry did a nice  
2 job this morning of talking about them and some of the  
3 issues. But angel investors are working at the probably  
4 lower end of private offerings, in terms of amounts.

5           But we find that right now they are making  
6 investments on an estimated annual basis of somewhere between  
7 \$20 billion and \$30 billion a year, or 30,000 to 50,000  
8 companies every year. And the majority of those are start-up  
9 and very early-stage companies, where the investments are  
10 somewhere between \$100,000 and \$2 million a year. By our  
11 estimates, they provide 90 percent of the outside equity for  
12 start-ups. So after the entrepreneurs have spent all their  
13 own personal resources and their family and friends, 90  
14 percent of those resources are coming from angel investors.

15           We also think about start-up companies and their  
16 importance to the economy, and this is probably why the  
17 Senate and Congress in general didn't make some of the  
18 changes that Gerry and Alan talked about this morning.

19           Where -- the angels are really working with a lot  
20 of these early-stage companies that, by the estimates of the  
21 Kauffman Foundation, are creating all of the net new jobs in  
22 this economy over the last 25 years. Angel investors are  
23 providing all of the funding for these companies.

24           Of course they're coming from a lot of different  
25 resources. But by our estimates, angel investors are pretty

1 important to those small companies that are creating a lot of  
2 innovation and jobs in our economy. And I think, you know,  
3 Congress agrees.

4 Most of my comments are going to be, really, that  
5 Regulation D and Rule 506 work very, very well for angel  
6 investors. But we know that the SEC needs to make some rules  
7 related to Dodd-Frank. And, of course, you know, we wouldn't  
8 be right if we couldn't at least make one other suggestion.

9 So, you know, with Dodd-Frank, we really do hope  
10 that the changes that -- and the rules -- that SEC needs to  
11 make on our congressional intent, particularly related to  
12 accredited investors, to make sure that the pool of capital  
13 for entrepreneurs and innovative start-ups are really  
14 available.

15 So first, in the area of net worth, you know, we  
16 note that Congress made pretty much no changes to the  
17 accredited investor standards, except for the removal of  
18 primary residence from the million dollar net worth. And  
19 we -- I think as you think about any changes, the one comment  
20 we have seen relates to the value of the home, and  
21 particularly those who are under-water.

22 To the extent the Commission can develop clear  
23 rules that don't punish individuals for negative value in  
24 their homes, we believe small businesses will be better off.  
25 In other words, don't debit non-recourse deficiencies of

1 under-water mortgages from the calculation of net worth  
2 exclusive in the principal residence. Keep in mind that,  
3 under the laws of many states, mortgage debtors are often not  
4 liable for such deficiencies.

5 We also hope you will continue to honor the lack of  
6 change that Congress made to the net worth -- or, I'm sorry,  
7 the annual income requirements. As Alan mentioned this  
8 morning, if you were updating for inflation over the last 28  
9 years, annual income would at least double from \$200,000 to  
10 \$400,000 or more for individuals.

11 We believe that that kind of inflationary increase  
12 would knock out many, many investors. It's difficult to look  
13 at the right statistics for that. But if you just look at  
14 tax return data, the pattern would be devastating, as many as  
15 a half or more that are there.

16 And, in particular, we think that those changes  
17 would happen in rural areas and I guess what I would call the  
18 non-coastal areas, where the cost of living and salary  
19 increases are higher. We would sure want to make sure that  
20 the entrepreneurs are able to attract capital, start, and  
21 grow in all parts of the country.

22 The Dodd-Frank law obviously requires four-year  
23 reviews of the accredited investor definitions. And one  
24 thing we would just highlight is congressional intent was, as  
25 you were looking at those reviews, keep in mind not only

1 protection for the investor, but the importance and in light  
2 of the economy. And so we want to make sure that these  
3 companies that are creating all the jobs -- and a lot of the  
4 innovation in this country -- continue to be able to get the  
5 kind of capital that they need.

6 We will note that we think it's still important to  
7 protect for fraud, but that there are very few complaints  
8 related to angel investing, as a subset of all private  
9 offerings. So we really do believe that angels take care of  
10 the bad actors, bad boys, whatever you want to call them, in  
11 the entrepreneurial community.

12 And so, we really think that it's important that  
13 you keep in mind -- or at least balance -- the impact that  
14 angels have on the economy and small businesses against the  
15 other important things for protecting investors.

16 We really don't think that there is a lot of  
17 relationship between extreme wealth and good angel  
18 investment, at least in the context of angel investing. What  
19 we have really found is that the best angel investors are  
20 those who understand start-ups, are willing to take those  
21 risks, and have the background to provide the mentoring that  
22 those kinds of companies need to grow.

23 And, in fact, by our own estimates, if we think  
24 about, in light of the economy, perhaps it's even true that  
25 you could reduce the definitions for net worth and annual

1 income when you're thinking about future requirements. We  
2 would even go so far as to say that we think that the  
3 original requirements for accredited investor requirements  
4 for angel investing, anyway, were probably too high, and  
5 we're just starting to catch up.

6           If I could just make one comment related to the bad  
7 actors in Section 926 in the Dodd-Frank Bill, is that we do  
8 want to make sure that the rule-making continues, the federal  
9 preemption regulation of these investments. Companies really  
10 do need consistent regulation, state by state. Our informal  
11 research shows that the majority of the kinds of investments  
12 that our investors make include multiple states, because  
13 syndication between individuals and between angel groups is  
14 incredibly important.

15           Just one other area we want to comment on, which is  
16 the area of general solicitation of private offerings, at  
17 least related to angel investing. You know, times are  
18 changing now. A lot of folks are beginning to use list serves  
19 and social networks to at least let people know that they are  
20 looking for investments.

21           And some areas are really attracting some very  
22 well-regarded angels, like Angel List. Our thought might be  
23 that if you're thinking about changing the rules to deal with  
24 this new technology for communication, it would be  
25 interesting to not focus on the type of communication that's

1 out there to hear about potential offerings, but instead make  
2 sure that there are, you know, reasonable means to ensure  
3 that the communication was just to accredited investors.

4 We also note that secondary markets -- ways for  
5 angels to gain liquidity on some of their investments -- are  
6 starting to become important to angels. We just want to make  
7 sure that there are no rule changes, so that the private  
8 companies would not be able to provide this kind of  
9 liquidity. Just want some consideration there.

10 Thank you very much, and we are happy to answer  
11 questions later.

12 MR. LAPORTE: Thanks, Marianne. Our next speaker  
13 is Shelly Mui-Lipnik, who is the Director of the Emerging  
14 Companies and Business Development Section of the  
15 Biotechnology Industry Organization, which most of us know as  
16 BIO. Shelly?

17 MS. MUI-LIPNIK: Thank you, Gerry, and thank you for --  
18 SEC and the staff -- for inviting us to comment today.

19 So, I thought one of the best ways for me to talk a  
20 little bit about what's going on with the emerging biotechs  
21 is just give you a little overview of the state of the  
22 industry, and then maybe just very broad -- or of two  
23 recommendations that we have. And I know we have breakout  
24 sessions later that we can go more into detail.

25 So, I thought the best way to talk about the state

1 of the industry is just talk about what's going on in the IPO  
2 markets in 2010 for emerging biotech companies, and also  
3 follow up with what happened in 2007 versus 2010 with the  
4 current public companies that are out there. We have been  
5 tracking it here in-house at BIO. We have some statistics  
6 just following these companies to see what's happened to  
7 them.

8           And also, talk a little bit about the fate of the  
9 companies that are still around and they have one year left  
10 of cash. So I have some statistics, but I also want to give  
11 some anecdotes as I walk through this, and also talk about  
12 what's really going on with early-stage biotech companies.  
13 Because when we look at biotech companies, when we talk about  
14 early stage, we always talk about phase two and earlier. And  
15 I think sometimes people get confused. So I wanted to just  
16 highlight that a little bit, as well.

17           So, starting from the IPO window in 2010, my  
18 understanding is that there has been 17 biotechs that have  
19 filed U.S. IPOs. And of these, 29 percent of them have been  
20 undervalued. Like, so they have been undervalued by 29  
21 percent. So it's not been very robust, the IPO market. And  
22 my understanding of the three that have been -- they  
23 performed higher than expected -- that one was actually  
24 acquired. So that's my understanding of what's going on with  
25 the IPO markets currently in 2010.

1           And of the U.S. biotech companies that are in  
2   existence, in 2007 we had 394 biotech public companies. And  
3   as of second quarter 2010 we had 294. And of the 294, 25  
4   percent of these companies had less than 1 year of cash on  
5   hand. So, as you can see, we have 100 less public biotech  
6   companies, and we're talking about the small companies.

7           So we did some analysis to talk about, in general,  
8   what was the fate of 131 companies back in 2009 that had 1  
9   year left of cash, and we found that 10 were acquired, 19  
10   went inactive. And of the 102 that are active, they  
11   basically have been in survival mode. And we have seen that  
12   41 percent of them had layoffs, 40 percent have used PIPEs,  
13   and then some have gone the route, as well, public offering  
14   route. And of those, 88 percent of them were actually  
15   later-stage. So phase three and later. And usually in phase  
16   three and later you're already in a collaborative deal with  
17   the big pharma, which is another way of financing. So, the  
18   early stage companies weren't really able to tap into -- it  
19   wasn't an option for them.

20           Also, what's interesting is that a lot of our  
21   early-stage companies, as I mentioned before, that are in  
22   phase two and earlier, a lot of these companies, they -- all  
23   the money from venture capital and also IPO was really not  
24   towards them. So here is another statistic. In 2007, 6.8  
25   billion of VC went to early-stage funding versus 2010, it was

1 only 4.8 of VC went to early stage. So those, like, phase  
2 two and earlier companies. And then, as for IPO money, in  
3 2007, 2.9 billion went -- IPO money went to early stage. And  
4 in 2010 it was 1.2.

5 So, I think from what we see, and from my board  
6 members and member companies telling us, is that there is  
7 really no appetite right now for very early-stage high-risk  
8 investments. And that's something they have always talked to  
9 us about, working with the SEC on trying to get the IPO  
10 markets going, and also helping these already public  
11 companies, as well.

12 And also, I mentioned earlier that licensing deals  
13 are another form of -- way to get financing for a lot of  
14 these early-stage companies. And that's not really been an  
15 option for the early-stage companies. Because what's going  
16 on is that when we looked at -- in 2006, large pharma was  
17 doing licensing deals. It was a 595 licensing deals. And in  
18 2010 there has only been 302. And some of these deals, they  
19 start them but they never go through because it takes a  
20 while. It's literally a lot of money.

21 So that's, in general, what's going on with the  
22 industry. And I thought I would highlight some  
23 recommendations that our companies have come to us that would  
24 be helpful for smaller biotech companies.

25 From a tax perspective, I know that making the R&D

1 credit permanent is very helpful, just so the investors in  
2 general have some certainty. And then the second one was a  
3 therapeutic credit program that was enacted this last spring,  
4 which basically gives a tax credit which people can elect as  
5 a grant. So that's been very helpful, giving some financing  
6 to these companies that are in survival mode, as I discussed  
7 earlier.

8           And also from a securities regulation perspective,  
9 we think the \$75 million permanent exemption from 404(b) has  
10 been a great start. We do believe that the public float  
11 exemption needs to be higher, and that -- my understanding is  
12 public biotech companies have cited Sarbanes Oxley compliance  
13 as one of the reasons for delisting on exchanges. They have  
14 mentioned that in the footnotes of their financial  
15 statements.

16           And also, BIO supports the SEC study on the 404(b)  
17 compliance with public floats of \$250 million market cap or  
18 less. And another thing that was part of, I believe, last  
19 year's recommendation report was the changes to Rule 12(b)-2.  
20 That's something that I think would be very helpful for our  
21 companies, and we hope we can discuss it further during the  
22 breakout session.

23           So, I look forward to questions. And thank you,  
24 Gerry.

25           MR. LAPORTE: Thank you, Shelly. Our next speaker

1 is David Hirschmann, who is the President and CEO of the  
2 Center for Capital Markets Competitiveness at the U.S.  
3 Chamber of Commerce. David?

4 MR. HIRSCHMANN: Gerry, thank you very much for  
5 including us today, and thanks to Meredith Cross, David  
6 Vaughan, and the SEC for taking time during an extraordinary  
7 difficult and challenging period in the Commission's history  
8 to really consider the impact on small business. This  
9 forum is important, and we are glad to be included.

10 In fact, we were created as a dedicated team at the  
11 Chamber after Sarbanes-Oxley, when the Chamber realized that  
12 while there were specific issues in Sarbanes-Oxley,  
13 particularly for -- in terms of the cost-benefits that needed  
14 to be addressed, that in our view the implementation of that  
15 taught us the lesson that we needed to get engaged in making  
16 sure there was a more modern, more effective, efficient,  
17 innovative approach to rule-making generally, and that we  
18 modernize the regulatory structure that served this nation  
19 well for 75 years, but had not kept up to date with the  
20 times.

21 In pulling together this panel, I think you have  
22 done -- you have made the first point I wanted to make very  
23 well, and I really want to make three points: one is just  
24 the diverse sources of capital that small businesses rely on  
25 in this country, we believe that's an asset; second, to talk

1 about the cumulative impact on regulation on smaller  
2 companies -- sometimes we tend to look at the regulations  
3 just one at a time when, in fact, from a compliance  
4 standpoint, it's the pancake effect that really impacts  
5 decision-making; and finally, I've got a couple of specific  
6 recommendations in terms of Dodd-Frank implementation that I  
7 think complement what we heard this morning.

8           You know, if you look at this panel up here, we've  
9 got diversity of types of capital for small business  
10 represented pretty well. But if you looked at all the  
11 financial regulatory structure, all the federal and state  
12 agencies, and tried to have a representative for each one of  
13 the capital formation segments of our economy. I think we  
14 could fill this entire auditorium. So it's probably a good  
15 thing that you focused on the ones most relevant to the SEC.

16           And that is a real strength for the American  
17 economy. Every business is different. The point we like to  
18 think about is whether it's your uncle lending you some money  
19 to start a small business, who probably relies on whatever  
20 savings he was able to make and invest in capital markets, to  
21 just about any source of capital, it's all tied to the public  
22 markets. Private markets enable the public markets, and  
23 public markets enable the private markets.

24           And these are all inter-related. And I think the  
25 danger here is that as we try to modernize our regulatory

1 architecture and close much-needed gaps in regulation, which  
2 I think is a goal of Dodd-Frank, a goal that virtually all of  
3 us share, that we can't lose sight of the fact that closing  
4 gaps is a good idea.

5           But one-size-fits-all to regulation would not solve  
6 the problem. You really need a regulatory structure that  
7 avoids directly or indirectly picking winners and losers  
8 among types of capital that are available for small business.  
9 A rule that might make perfect sense in one area just does  
10 not work, and would really extinguish one of the sources of  
11 capital represented here at this table. So, that makes your  
12 job much more complicated, as you try to get the rule-making  
13 right.

14           The SEC should also consider the impact on smaller  
15 financial firms, as well as on the small business capital  
16 formation needs of all businesses, as it implements  
17 Dodd-Frank. Smaller financial firms simply can't afford to  
18 hire an army of compliance staff.

19           Somebody said this morning that, you know, at small  
20 firms the compliance person wears three hats. Well, in  
21 smaller public companies that's probably no longer an option.  
22 But nor is it the case that they can hire an army of  
23 compliance staff to really keep up with this.

24           So, both of those points, and in particular the  
25 point about the pancake effect of regulation, lead to our

1 conclusions. And they are simple. First, the SEC has done a  
2 good job of considering the delayed applicability or  
3 otherwise exempting smaller public companies, where  
4 appropriate, from rule making. Dodd-Frank provides specific  
5 statutory deadlines in some cases, but in most cases leaves  
6 enormous discretion to regulators in how they do that.

7           The only point I would make is the standard  
8 shouldn't be is it useful for smaller public companies. At  
9 some level it may be. Or even as the cost benefit. The real  
10 question is, is it essential? Most small businesses that are  
11 members of the Chamber look at every expense and say, "Is it  
12 essential?" Because anything that isn't essential gets in  
13 the way of survival and growth.

14           We want transparency, we want to create a culture  
15 of compliance, even in smaller companies. The Chamber's  
16 general view is that small companies want to grow up to be  
17 big companies.

18           So, you know, delaying all the compliance is not  
19 the right answer, either. But particularly when you look at  
20 the cumulative effect of regulation on small business, I  
21 think that the Commission should err on the side of really  
22 asking itself, "Is this regulation essential? Does it need  
23 to happen now? Is there a benefit to delaying so that  
24 smaller firms can learn from the experiences of larger firms?  
25 Can it be scaled back?"

1           And even though the SEC is not required to do a  
2 formal analysis of all proposed rules, to really listen to  
3 small businesses, to bring in small businesses, to listen to  
4 what the SBA's Office of Advocacy says, and to err on the  
5 side of caution as Dodd-Frank is implemented.

6           My second recommendation is that the SEC should  
7 consider increasing the disclosure threshold for smaller  
8 public issuers from the current \$75 million, and index that  
9 threshold going forward. I know it was increased from \$25  
10 million to \$75 million in 2007. But for many companies, a \$75  
11 million market cap really misrepresents and is not high  
12 enough to really do the job that I think is intended here.  
13 So it's probably time to re-evaluate that.

14           Some of our members, in preparing for this,  
15 suggested to me -- in fact, one of our board members  
16 yesterday suggested to me -- that maybe it's also time to  
17 think about whether there are other metrics that might be  
18 more useful for other companies, where -- you know, that  
19 market cap doesn't always equate to size of company, and that  
20 there might be some other metrics that might allow the  
21 exception to more appropriately cover a wider group of  
22 companies.

23           My third recommendation is that the SEC should  
24 consider increasing the \$5 million offering threshold under  
25 Regulation A that allows for simplified registration, or an

1 exemption from registration. This \$5 million threshold has  
2 never been indexed or increased since that level was set, I  
3 believe, in 1980.

4 I looked through all the recommendations from last  
5 year, and there are a number of others that we would strongly  
6 support, as well. So maybe my final recommendation is I  
7 think this session is -- and this forum is incredibly  
8 important, and I know the SEC has a tall order in  
9 implementing all the requirements under Dodd-Frank, and I  
10 know that, despite that, it will do a good job of trying to  
11 listen to comments.

12 But we can't just forward -- particularly if we try  
13 to advance the American economic recovery -- to just get  
14 Dodd-Frank rule-making right. We also have to think  
15 proactively and prospectively. And there are a number of  
16 positive recommendations in last year's report.

17 I'm sure some will come out of today's session that  
18 are worth acting on, as well, and that would expand and make  
19 more robust the types of sources of capital available to  
20 growth companies, particularly as start-ups and smaller  
21 growth companies, that would strengthen the types of capital  
22 that each of the representatives at this table provide. And  
23 while we -- we need to make time, and the Commissioners  
24 should find a way, to calendar some of those offensive  
25 opportunities to expand capital formation and make time to do

1 that, as well. Thank you very much.

2 MR. LAPORTE: Thanks, David. Our next speaker is  
3 Kevin Hogan, who is the Executive Director of the Investment  
4 Program Association. Kevin?

5 MR. HOGAN: Thank you, Gerry. On behalf of the  
6 IPA, I do want to add my thank-you for this opportunity to  
7 participate in today's forum.

8 The IPA, the Investment Program Association, is a  
9 trade association of the financial services industry, and  
10 it's the leading advocate of the inclusion of direct  
11 investments in a diversified portfolio. Our mission is to  
12 advance the unique benefits of direct investments, like  
13 non-traded or non-listed real estate investment trust,  
14 non-listed REITs, oil and gas partnerships, and equipment  
15 leasing, and also includes the service providers and the  
16 broker-dealers who support and promote these programs.

17 A core principle of ours is our focus on education.  
18 You know, we are committed to a more educated consumer, more  
19 educated financial advisor and financial intermediaries, and  
20 more educated regulators. And through several key  
21 initiatives over our association's lifespan, we have  
22 accomplished this goal. And including recent initiatives  
23 like a new investor guide that we have just made available  
24 for consumers, an American college developed a CE educational  
25 program for financial advisors.

1           And, you know, we continue to, we believe, build a  
2 reputation of collaboration and support with regulators with  
3 our association and our membership. And we have been  
4 privileged to have active participation at our conferences by  
5 representatives from FINRA, the SEC, and state regulators.  
6 And this has created an environment, we feel, of  
7 collaboration, of mutual trust, as we really address the  
8 critical industry issues, similar to what we are doing here  
9 today.

10           Now, small business capital formation is a  
11 significant benefactor of the direct investment industry  
12 through efficient equity markets. And the way I tend to look  
13 at this -- and in that efficient equity markets -- is almost  
14 an equity markets continuum of sorts.

15           And it starts with a qualified investor who then,  
16 through a financial intermediary, a financial advisor who  
17 looks to add these products, our products, in a diversified  
18 portfolio, they access the products through product providers  
19 or product sponsors who ultimately provide, you know, through  
20 those products, provide needed capital for things like, you  
21 know, everything from health care to commercial real estate  
22 ventures, oil and gas, energy exploration, and equipment  
23 funding for small businesses.

24           And while our -- you know, while complete -- we're  
25 in complete agreement of, you know, the regulation that --

1 and the fundamental principles of solid regulation and  
2 comprehensive and sound oversight, you know, we feel that  
3 it's critically important that by providing some of these  
4 regulatory oversights, that we eliminate impediments to  
5 capital formation and create legislation that is  
6 complementary, and not duplicative, and avoiding, in  
7 particular, the unintended consequences that can affect this  
8 efficiency of this continuum that I described, and thus,  
9 again, the downstream capital formation for small businesses.

10 Now, to that effect, or with that backdrop, I would  
11 like to make a few recommendations. And several have already  
12 been made, so I'm just going to provide a highlight.

13 But certainly, you know, some of the proposed  
14 changes to things like the accredited investor rules -- and  
15 obviously we want to be part of that debate, and continue to  
16 be so -- but that, you know, negatively, I think you have  
17 heard some of the statistics -- you know, our projection is  
18 that it could ultimately impact as many as 50 percent of  
19 qualified investors for products like this, which again,  
20 ultimately impacts that downstream flow of cash to small  
21 businesses.

22 Also, proposed changes to things like the financial  
23 advisor community, things like the Investment Adviser Act  
24 that was discussed earlier, Section 913 of the Dodd-Frank  
25 Bill, and the bad actor legislation, again, also will have

1 tremendous impacts -- some rightly so, and others, again,  
2 that we would like to participate, and our members would, in  
3 the open debate around this -- around getting it right. But  
4 again, it will have significant impact on the number of  
5 advisers, and their ability to provide these products to  
6 clients in this environment.

7           And the third is really the product sponsors, the  
8 product providers who face several what I would call process  
9 inefficiencies that add cost, and elongate their delivery  
10 system, which impacts, again, the capital markets. You know,  
11 I would just suggest that there are some actual regulatory  
12 opportunities that are available.

13           You know, several of these redundancies actually  
14 involve federal and state regulation in our industry. Now,  
15 since there is no federal system -- an example of which is  
16 since there is no federal preemption of -- or guidelines for  
17 review of our offerings, again, there is an inconsistency in  
18 state overview and approval time lines, obviously taking now  
19 an estimated 9 to 12 months for products to ultimately be  
20 approved in some situations.

21           You know, there are also -- and again, those  
22 impact -- the significance of that is the impact it takes to  
23 actually just get product to market and delay, again, the  
24 ability to have sufficient flows.

25           There are also regulatory opportunities we feel

1 that could help promulgate a more effective  
2 technology-centric order entry system in this industry,  
3 similar to what you see in mutual funds and the annuity  
4 industry. There is currently a no-action letter that is  
5 pending on document retention that will impact our industry.  
6 And this industry will need, in our opinion, some form of  
7 federal exemption on what signatures in order for paperwork  
8 to be in good order and, again, expedite the delivery system.

9           Now, successful implementation of an electronic  
10 order entry system we feel will create those efficiencies for  
11 this industry, reduce costs, provide the added ability for  
12 oversight in audits, similar to what you see in other  
13 industries.

14           Now, all these issues either directly or indirectly  
15 impact capital formation through this equity markets  
16 continuum I described. As I said earlier, our association is  
17 committed to sound and appropriate regulation.

18           In fact, we actually feel we need to shoulder some  
19 of that burden as well, in the form of self-regulation, an  
20 example of which is we recently just adopted and published a  
21 supplemental performance measure practice guideline. We  
22 think it was important. It was something that we have been  
23 encouraged to do, and it's something that we feel is going to  
24 be very important as we go forward in monitoring and  
25 providing self-regulation to our own industry.

1                   So, I trust you sense our desire for a  
2   collaborative and mutually agreeable principles to enhance  
3   the effectiveness of our industry. I will defer, obviously,  
4   to some more experience in this area on the specifics of the  
5   regulation and how it should be addressed. But I do know  
6   that if we do create the most effective and yet  
7   consumer-oriented equity market system that we can, that  
8   capital markets will be impacted in a more positive manner,  
9   both today and in years to come. So thank you.

10                  MR. LAPORTE: Thank you very much, Kevin. Our next  
11   speaker is Jim Jaffe, who is the President and CEO of the  
12   National Association of Seed and Venture Funds. Jim?

13                  MR. JAFFE: Good morning, and thank you for  
14   inviting me. Our association represents 170 national and  
15   international organizations with 750 individuals engaged in  
16   seed and early-stage innovation capital creation.

17                  We're an organization of innovation capital  
18   leaders, private, public, and non-profit organizations  
19   committed to building their local and regional and state  
20   economies by investing in local entrepreneurs. And our focus  
21   is on advancing innovation capital.

22                  We began in 1993, and have been around for 17  
23   years. Our members recognize the importance of small  
24   business capital formation in the United States. And we  
25   represent the seed and early-stage capital investments. The

1 investment amounts range from roughly \$100,000 to \$2.5  
2 million. And the funding that -- of these investments is  
3 provided by individual angels, angel groups, early-stage  
4 venture capital organizations, government-financed state and  
5 regional economic development agencies, and federal  
6 government programs such as SBIR, SSTR, and so on, and  
7 incubators and accelerators.

8           We are involved in a number of new initiatives that  
9 I would like to share with this forum, and specifically talk  
10 about some activities with the Department of Agriculture, and  
11 the Agricultural Research Service. This is the principal  
12 intramural research agency of USDA. The annual research  
13 budget for the Agricultural Research Service is over  
14 \$1,200,000,000.

15           They conduct research by 2,500 scientists in 21  
16 national programs, in 100 locations throughout the U.S. And  
17 under the Stevenson Wydler Act of 1980, and the Federal  
18 Technology Transfer Act of 1986, ARS is responsible for  
19 determining how best to commercialize technologies that are  
20 developed by these scientists.

21           In realizing that this early-stage investment  
22 continuum was dealing with a shortage of start-up funds, our  
23 organization, our national organization, along with eight  
24 regional technology-based economic development organizations,  
25 formed the Agriculture Technology Innovation Partnership,

1 ATIP. And its purpose is to strengthen the opportunities for  
2 private sector investments in agricultural technology. And  
3 this is done through licensing and establishing cooperative  
4 research agreements.

5 Membership in this ATIP program is formalized with  
6 partnership agreements organized by the Office of Tech.  
7 Transfer at the USDA/NARS. There are nine economic  
8 development agencies along with ourselves that are involved  
9 in this: Wisconsin Security Research, Mississippi Technology  
10 Alliance, Maryland TechCo, Georgia Research Alliance,  
11 California Association of Local Economic Development, Kansas  
12 BioScience, and the Center for Innovation in Arlington.

13 What ATIP provides is a network for ARS with each  
14 member serving as a conduit to a great number of state and  
15 local agencies. The goal of this is to develop a seed fund  
16 for the partners to deploy with a one-on-one -- one-to-one  
17 matching arrangement. And one of the real challenges that  
18 state and regional economic development agencies have --  
19 those are the organizations that, in fact, operate just like  
20 seed funds, excepting they receive money from public  
21 sources -- one of the real challenges is attracting new  
22 investors. And we believe a fund with a one-to-one match  
23 could be very effective.

24 In addition, NAS works with an innovative  
25 coalition, which is an informal group of international

1 organizations that are involved with promoting, advocating,  
2 and communicating the benefits of innovation. This is a  
3 collaborative group that supports each part of the continuum  
4 for commercializing university research to create companies  
5 that create jobs, along with all other research aspects, as  
6 well. And the goal is to garner a better understanding of  
7 each other's mission, and to work collaboratively in this.

8           One of my associations, Marianne Hudson from the  
9 Angel Capital Association, they're a member of our group, and  
10 it includes the National Business Incubator Association,  
11 Brett Palmer's group, who is over here, Association  
12 University Research Park, Association of University Tech  
13 Managers, the State Science Technology Institute, the  
14 National Small Business Investment Companies, Community  
15 Development Venture Capital Association, Association of  
16 University Research Parks, and the Tech Councils of North  
17 America. And we think that this informal coalition can speak  
18 with a voice that will make sure that people can understand  
19 the common need that there is for innovation capital.

20           In addition, however, to the lack of early-stage  
21 funding, I want to talk about some other issues. The first  
22 is the angel tax credit. The National Academies have  
23 cautioned that without high-quality, knowledge-intensive  
24 jobs, and the innovative enterprises that lead to discovery  
25 and new technology, our economy will suffer and our people

1 will face a lower standard of living.

2           Our trading partners around the globe recognize the  
3 long-term value of R&D, and have moved aggressively to  
4 implement generous and permanent tax policies that attract  
5 these investments. We recommend -- our members recommend --  
6 the thoughtful application of lessons learned in modeling the  
7 angel investment tax credit legislation.

8           Currently there are 21 states who have enacted  
9 legislation to enable angel investors to take advantage of an  
10 innovative method for providing capital for early-stage  
11 companies. NASVF believes that the tax credit for investing  
12 in qualified early-stage companies is crucial to enhancing  
13 the local and regional entrepreneurial business environment.

14           Two examples from Wisconsin and Minnesota. In  
15 Wisconsin, Act 255 provides a tax incentive for investors in  
16 early-stage companies. This has created a healthy angel  
17 community which helped sustain that region's innovation  
18 early-stage companies.

19           Minnesota's angel tax credit provides incentives to  
20 investors or investment funds that finance start-ups and  
21 emerging companies focused on high-tech or new proprietary  
22 technology. This tax credit gives a 25 percent individual  
23 income tax credit for qualified investors, is refundable --  
24 and non-Minnesota residents, including residents of foreign  
25 countries, are, in fact, eligible for the credit -- allows a

1 maximum credit of \$125,000 a year per individual, and a  
2 maximum of \$250,000 for those married or filing jointly.

3 We believe that every effort should be made to take  
4 advantage of lessons learned in order to build an effective  
5 tax policy that helps sustain local and regional economic  
6 improvement on a national basis.

7 We also urge a competitive legislative initiative  
8 regarding angel investor tax credits with specific attention  
9 to the areas of immediate behavioral rewards. We think that  
10 incentives must reward changed behavior. And to benefit our  
11 current economy, that behavior should change. An incentive  
12 to invest in early-stage companies must be one that  
13 encourages immediate action. To do that, the incentive has  
14 to have an expiration date, and be of a high-enough value to  
15 warrant action.

16 We recommend a five-year term on the credit, with a  
17 3-year carry forward/carry back provision, a 25 percent to 30  
18 percent credit for the total investment would elicit action,  
19 and the investment could be held for 3 years, or the tax  
20 credit be recaptured.

21 Alternatively, a 10 percent credit awarded every  
22 year for the first 3 years of investment would assure  
23 patience in exiting and multiple years of capital investment.

24 Care should be taken to define the types of  
25 ventures that would be eligible for the investor. We

1 recommend qualifying these as per exclusion the Section 1201(e)3 in  
2 the IRS code.

3           Legislation should also define how the investment  
4 funds might be used if they are to qualify for a tax credit.  
5 We recommend exclusive investments to repurchase or redeem  
6 shares invested by family members, and capping investments at  
7 \$2 million per taxable year, with a maximum any one venture of  
8 \$1 million.

9           In closing, supporting and encouraging angel  
10 investments will allow local business to create high-skill,  
11 high-wage jobs, resulting in a positive economic impact in  
12 local and state and regional economic growth. We support  
13 proper legislation that rewards immediate incentives in  
14 qualified early-stage ventures. The ATIP partnership program  
15 I mentioned and the innovative coalition are two of the many  
16 ways that are innovative and that we feel are engaged to move  
17 the needle forward, and will hopefully produce new and  
18 additional innovation capital for America.

19           In closing, we strongly support the national angel  
20 tax credit legislation, as it is extremely important to  
21 America's growth portfolio. Thank you very much for the  
22 opportunity to appear before you today.

23           MR. LAPORTE: Thanks, Jim. Our next speaker is  
24 Brett Palmer, who is the president of the National  
25 Association of Small Business Investment Companies. Brett?

1                   MR. PALMER: Thank you very much. You have my  
2 written statement, so I am not going to read it to you, but I  
3 would like to hit some of the highlights. But before doing  
4 so, I would like to thank you for holding this event, and for  
5 continuing this event year after year.

6                   Since this event today is designed to deal with  
7 the Dodd-Frank implementation and some of the other  
8 ramifications of it, it's worth mentioning -- and we talked  
9 about some legislative history before -- that as Dodd-Frank  
10 was being put together, it was being put together in a time  
11 of outrage about what was happening in the financial markets.  
12 As that public outrage was being directed into legislation,  
13 there really wasn't a lot of discussion about small business.  
14 It was not at the forefront of any of this. This was talking  
15 about, you know, financial titans that had stumbled, that --  
16 bailouts and the rest, and how to prevent that systemic risk.

17                   And so, many of the people at this table were an  
18 afterthought to that, because we weren't on fire. We weren't  
19 the ones who were the source of the trouble, we weren't the  
20 ones who were melting down. We certainly were feeling some  
21 of the pain of it, but we weren't the driving forces behind  
22 it.

23                   And so, I really do appreciate the SEC taking the  
24 time to listen to us, because we know we're not the biggest  
25 guys in the room always, but we do think we carry some

1 important messages.

2           As you heard before, there is a continuum of  
3 private equity investing. And that continuum isn't a clear  
4 continuum. It doesn't have clear, defining marks between the  
5 different sections. But it's important that they're all  
6 here. You have angel, you have seed, you have venture, you  
7 have change and control transition funds, and they're all  
8 important.

9           The key for us, both for NASBIC and our new  
10 expanded effort with the Small Business Investor Alliance, is  
11 that it's the small business investing continuum. If any  
12 elements of that continuum get sick, is troubled or choked  
13 off by market dysfunction or regulation or tax policies or  
14 what have you, eventually it will be trickled up or down to  
15 the other ends of that spectrum.

16           None of the small business investment continuum  
17 were part of the systemic risks that cause a financial  
18 meltdown. None of them could be, frankly. And none of them  
19 are going to be going forward.

20           Frankly, the funds and the financial players in the  
21 small business continuum did a much better job of protecting  
22 and growing small businesses in the financial meltdown than a  
23 lot of the bigger players. It's nothing -- that we have  
24 anything against the bigger players, but they were just in  
25 trouble and they don't really invest in small business.

1           Small business investing does require risk. The  
2 nature of capitalism is you have to embrace risk. We thrive  
3 on risk. These are risk-takers here. This isn't gambling  
4 risk, this is thoughtful business risk, and the people who  
5 are investing in small businesses know how to manage the  
6 business risk. They don't know how to manage the regulatory  
7 risk.

8           And as this is a new and expansive role for federal  
9 regulators into much of the private equity space, it's a  
10 little terrifying for a lot of the smaller funds and the  
11 small business players. And so we appreciate your listening  
12 to us, and making sure that communication is going out to  
13 those players.

14           Small business investing -- and particularly SBIC's  
15 lower middle market funds, you know, later-stage growth,  
16 venture capital funds, generally are set up as limited  
17 partnerships with a 10-year life span. They are dealing with  
18 institutional investors in many cases. In some cases they  
19 are dealing with individuals and their accredited investors,  
20 and that's healthy.

21           It's -- these are funds that are very different in  
22 structure, financial structure, from the very large funds.  
23 Because of their size, they can't live off of fees. They  
24 really have -- they can get by on fees, but the real profits  
25 are driven by profit sharing. There is an alignment of

1 interest that is a healthy and constructive thing, and you  
2 see that in the interest debate as far as the impact of  
3 venture and small business investing, and it's something that  
4 should be continued.

5 But as these funds are not a systemic risk, are  
6 providing critical capital to small businesses domestically,  
7 we are literally looking at the SEC registration as a  
8 significant burden and a significant threat.

9 As I mentioned before, the small business side of  
10 the equation was not really part of the congressional agenda  
11 until a number of people at this table started jumping up and  
12 down and hyperventilating and saying, "Hey, guys, this is  
13 going to be the impact."

14 You know, to that end, small business investment  
15 companies were exempted. That is constructive. That is  
16 good. The language on there is a little convoluted, because  
17 there was concern throughout the entire bill that any  
18 exemptions or any reductions could be gamed and -- by large  
19 players, and get them out from underneath the ability of  
20 regulators to pay attention to what's going on.

21 But, as such, it's important to mention that there  
22 is that correction for the BDC. I know the SEC was concerned  
23 that the SBIC exemption would be a back door for large  
24 players to just walk away from a registration that was not  
25 the intent, and it's not what happened.

1           But as you're looking at the SEC registration rules  
2 and such, I would encourage you to exclude the SBIC portion  
3 of the capital from the triggering event for SEC  
4 registration, because in many cases SBICs - say you have a  
5 \$150 million SBIC, they may have another side entity, another  
6 fund, that has, you know, \$50 million or \$60 million. That  
7 \$50 million or \$60 million fund would not otherwise be forced  
8 to register, but they could if you have an SBIC associated  
9 with it. We don't think that those two should be additive,  
10 we think they should be excluded.

11           We also think that the SEC registration, you know,  
12 trigger points, if there is some flexibility in raising that,  
13 or -- would be helpful. As the legislative history goes, I  
14 would encourage you to review it, because the focus on the  
15 \$150 million standard and triggering point was, again, to  
16 avoid gaming. But the impression, too, from the folks on the  
17 Hill from guidance given to them by folks in the Executive  
18 Branch was that registration was only going to cost about  
19 \$10,000.

20           Now, that may be the case for the paperwork side of  
21 it, somehow. But for a small fund, I promise you it is a  
22 whole lot more than that, and is a very onerous task for  
23 funds that are in the couple of hundred million dollar range.  
24 I mean a common fund that's a small business investment fund  
25 may have \$1.2 million in annual budget, and they're talking

1 about \$100,000 to \$200,000 in compliance costs, and the rest  
2 with it for legal fees and accounting fees and all the  
3 reporting fees with it. That is a meaningful cost, and  
4 should be taken into account.

5           So, if possible, if there is a way to raise that,  
6 that would be great. If not, certainly phasing it in and  
7 making that later in the implementation phase would be  
8 beneficial, because with the rush to -- the significant move  
9 in the entire industry to have to get registered, the costs  
10 for the people that provide those services have gone up  
11 significantly, and -- because the market hasn't absorbed  
12 that.

13           As this rolls along, if registration cannot be  
14 raised to a more reasonable level, certainly having them  
15 later will lower the price for their compliance because there  
16 will be systems in place, there will be softwares in place,  
17 there will be other things that will be targeted at smaller  
18 funds and funds in these niches.

19           I would also mention in that same vein that if  
20 there is a way to have a "registration lite," or some type of  
21 less burdensome or onerous or expensive compliance system for  
22 funds that are investing exclusively in small businesses,  
23 that would be a reasonable outcome. You know, there is a  
24 venture exemption for -- in the Dodd-Frank bill that's a good  
25 exemption, we support that exemption.

1                   There is a reason why it's not defined. They  
2 couldn't figure out how to define it. They -- as you know,  
3 sometimes when Congress can't figure things out they punt it  
4 to the regulators and say, "You figure it out and you get the  
5 lovely job of dealing with us again."

6                   But that description, you know, really was targeted  
7 at small business investing, more broadly, where there is not  
8 a clear pre-profit/post-profit, you know, this type of  
9 investment, that type of investment. The key thing that they  
10 were trying to get at is they wanted to make sure capital was  
11 not cut off to small businesses. And I think that's  
12 certainly a goal that the SEC can feel comfortable embracing.

13                   And so, as you are looking at those definitions,  
14 making sure that they are flexible enough and clear enough  
15 that small business investors can not have excessive costs  
16 associated with registration.

17                   Now, there are a number of other issues that are  
18 out there. I will spare you those. They're in my written  
19 testimony. But I would mention that it's important to  
20 recognize the difference between the ability of small funds  
21 and large funds to deal with regulatory compliance, to deal  
22 with market efficiencies, the ability to invest in small  
23 businesses.

24                   It is impossible, or nearly impossible, for a very  
25 large institution, a financial entity, to invest in small

1 businesses because they have to deploy capital in such large  
2 chunks that small businesses can't swallow them, they can't  
3 digest them.

4           And so there is a different model -- you know, it's  
5 a sliding scale, and it will be up to you eventually, how you  
6 deal with these sliding scales and these breaking points --  
7 but please keep in mind throughout all of your regulatory  
8 processes, not just for SEC registration, but down the line,  
9 please drill down to that small business investing, and sort  
10 of how that model works in the real world, because too often  
11 it's very easy to look at these aggregate numbers of private  
12 equity and investing and say, "Here is the problem, here is  
13 the issue," and that may be the case in aggregate. And that  
14 works for the systemic side. But really, when you drill down  
15 to the 1,600, you know, funds that are below 300 or 400  
16 million, it's a really big difference.

17           So, I appreciate your time, and I look forward to  
18 working with you in the future.

19           MR. LAPORTE: Thanks, Brett. We are doing pretty  
20 good on time, but we need to make sure that everybody stays  
21 to their allotted time, so that we can finish by the time the  
22 chairman gets here at 12:15.

23           Our next speaker is Mark Heesen, who is the  
24 president of the National Venture Capital Association. Mark?

25           MR. HEESEN: Thank you very much. You know,

1 sometimes titles are actually important in semantics. And I  
2 think it's interesting, when you look at today's event, it's  
3 the SEC's Office of Small Business Policy that is putting on  
4 the small business capital formation forum. And I would  
5 posit to you that no one on this panel actually invests in  
6 companies that they want to stay small. All of us want to  
7 invest in companies that actually become emerging growth  
8 companies that become companies that actually want, can, and  
9 will go public on a U.S. exchange.

10           And I think that's actually very important, from a  
11 press angle and from the way the Securities and Exchange  
12 Commission puts itself out, because it's not about small  
13 business, it's about getting our companies that we care so  
14 much about that are tiny today, but have a mind set that they  
15 will not be tiny in the future.

16           And that's very different than a small business  
17 that doesn't need capital formation, because a small business  
18 basically is -- a small business is a mom and pop operation.  
19 The companies that we invest in are companies that need seed  
20 and angel and venture and mezzanine, and all these other  
21 types of different financing. And it's a very different  
22 bird. And it's one that is in trouble today.

23           And I think that when you look at our entrepreneurs  
24 today, after 20 years of working in this business, it is a  
25 real concern when today you have entrepreneurs who literally

1 say, "I don't want to go public." And we never saw that  
2 before. But today there are many company CEOs who say, "I  
3 would much rather sit here and grow this company to a point  
4 that it gets acquired, instead of going public. And why  
5 don't I want my company going public? Because I don't want  
6 to deal with Sarbanes-Oxley." And that's not the only  
7 reason, but it is an important one.

8           And in that regard I reaffirm BIO's comments on  
9 404(b). They don't want to go public because of lack of  
10 analyst coverage, because of the Spitzer settlement and other  
11 things that has really tamped down the ability for smaller  
12 emerging growth companies that go public to actually get out  
13 and become the blockbusters that they think they can become.  
14 They don't want to become public because of liability issues.  
15 They don't want to become public because of board composition  
16 requirements and compensation requirements that go with going  
17 public, with all the accounting requirements that go with  
18 going public.

19           This is a true concern for the U.S. economy because  
20 what we have found is that the vast amount of job creation  
21 occurs after a company goes public. And so, if you are going  
22 to have so many companies get acquired, which is happening  
23 today, we are simply not going to see the job creation engine  
24 that we have seen in the past.

25           When you look at venture-backed companies, 10 years

1 ago, you know, at least 50 percent of our companies that were  
2 successful went public. Today we are seeing less than 10  
3 percent of our companies going public. What we are seeing  
4 instead are companies going the acquisitions route. Now,  
5 some of that is for business reasons, but an awful lot of it  
6 is because CEOs, entrepreneurs, see it as an easier route, a  
7 less bureaucratic route. And then they can go off and create  
8 another company -- which is great. But once again, it's that  
9 need for -- at the end of the day, for companies to go public  
10 on U.S. exchanges in the United States.

11           When you look at the 59 companies that have gone  
12 public this year on the venture capital side of things,  
13 that's much higher than we have seen in the last two years.  
14 We only had 18 in the last two years, combined.

15           So people look at 59 and say, "Oh, well, that's  
16 great." But then you start to delve down at those, and you  
17 see that a lot of these companies are not U.S.-based, these  
18 are companies that are coming from China, India, elsewhere,  
19 and going on to U.S. exchanges that were venture-backed.  
20 That's a concern.

21           When you see the lure of M&A transactions, that's  
22 going to continue very likely over the next year. And that  
23 is going to hit our bottom line as investors and as a nation  
24 as a whole if we don't look at it from a whole new  
25 perspective.

1           You know, drilling down, as the folks said earlier,  
2 tomorrow the SEC is going to put forward its definition for  
3 venture capital for registration purposes. And a lot has  
4 already been talked about that, so I won't get into the  
5 specifics there. But I think what is very important to note  
6 is that you have not heard of venture capital investors. And  
7 those are predominantly colleges and endowments, corporate  
8 pension funds, state pension funds out there screaming for  
9 the venture capital industry to be regulated.

10           These are highly, highly educated, sophisticated  
11 investors who know the venture capital process, and have  
12 looked under every nook and cranny before they invest in a  
13 venture capital firm. And so, I urge you to make sure that  
14 you take the views of not just the venture capital community,  
15 but the investors in venture capital into consideration who  
16 are not saying that they want or need this regulation. In  
17 fact, the ones that I have spoken to say, "We want you out  
18 there finding the next Yahoo, eBay, not sitting in your  
19 office working on registration documents."

20           So, that sounds simplistic. But the reality is  
21 that even your "large venture capital firms" have less than  
22 two dozen employees. So these registration -- these  
23 paperwork requirements actually do impact the time management  
24 issues of venture capital firms. Most venture capital firms  
25 have easily less than 10 people.

1           So, once again, when you're faced to deal with  
2     accounting, legal, federal regulatory issues, that is going  
3     to take time away from what we are supposed to be doing, and  
4     that is out there finding those companies that are not small  
5     businesses, they're emerging growth companies, and that are  
6     hopefully going to become the next large employers here in  
7     the United States. Thank you.

8           MR. LAPORTE: Thanks, Mark. Our next speaker is  
9     Debbie Froling, who is a partner at Arent Fox law firm in  
10    their Washington office, and she is speaking on behalf of the  
11    Real Estate Investment Securities Association. Debbie?

12          MS. FROLING: Thank you, Gerry. I appreciate the  
13    opportunity to be here on behalf of the Real Estate  
14    Investment Securities Association. And thanks to Gerry and  
15    Meredith and the staff here at the SEC for putting on this  
16    important event, and allowing us to participate and provide  
17    our views.

18          The advantage of being at the end of the alphabet  
19    is that a lot of what I had to say has already been said, and  
20    the disadvantage is that it's already been said.

21          But I would like to -- we did submit a written  
22    statement, so there is some more detailed information about  
23    our positions on various issues. I would like to highlight  
24    some of those in my written remarks and agree and disagree  
25    with some of the comments that have been made today.

1                   One of the big issues that the Real Estate  
2   Investment Securities Association has found is the fiduciary  
3   standards contained in section 913. We know that the report  
4   to Congress is due in January. But one of the things that  
5   hasn't been addressed here is kind of the impact on the  
6   day-to-day business of a large segment of REISA's membership,  
7   which is the independent broker-dealer community.

8                   We feel that if a fiduciary standard, as it is  
9   currently included as an investment advisor fiduciary  
10  standard, a lot of the day-to-day business that's currently  
11  done by our broker-dealer members in the Reg. D 506 private  
12  placement market will be curtailed for reasons that they  
13  would not be able to recommend a client to purchase an  
14  illiquid security that is a private placement.

15                  It also could increase the cost of doing business,  
16  because the E&O insurance for a fiduciary standard would be  
17  significantly increased in insurance premiums. And, as a  
18  result of all of that, capital formation for these kinds of  
19  syndications and private placements and real estate-related  
20  securities would be substantially harmed.

21                  I did note that in the bad actors provisions Alan  
22  Berkeley's comments regarding how you define a bad actor is  
23  going to be extraordinarily important for our members  
24  because, you know, minor technical violations of a Form D  
25  filing throughout the 50 states who have different

1 regulations regarding what is a fraudulent or deceptive  
2 practice, or how they could require you to settle some minor  
3 violation, could in fact then impact that issuer's ability to  
4 use Reg. D for a long period of time.

5 In the look-back of 10 years, you know, somebody  
6 who had settled something two years ago on a minor technical  
7 violation could be swept up in a disqualification from using  
8 Reg. D, which is a huge part of how they raise capital.

9 I agree with the angel investors, that the  
10 accredited investor deduct for a mortgage under water is  
11 problematic, again, for a large number of REISA investors who  
12 have always included their primary residence in their  
13 calculation. But if they have to exclude it to then get  
14 another deduct for a mortgage liability that is non-recourse  
15 under state law, it does not seem fair to us.

16 One other issue under the accredited investor  
17 standard, I know NASA has submitted a comment letter  
18 regarding investments owned standard. REISA is opposed to  
19 doing anything to change the accredited investor standard.  
20 They would agree that if you had it as an additional standard  
21 as opposed to you have a net worth, you have your annual  
22 income, or an investment owned standard, that would be  
23 something that they could, in fact, appreciate. But having  
24 an investment owned standard instead of a net worth standard  
25 would be problematic for a large number of investors in REISA

1 members' products.

2           The investment advisement registration issue is  
3 something that is a concern to REISA members. They -- a lot  
4 of our members are sponsors and advisors to the non-trade  
5 REIT products. And depending upon how the investment advisor  
6 registration requirements come about, they don't typically  
7 fit within any of the current exclusions. They are not  
8 private funds, they are registered products, they're usually  
9 registering \$1 billion. They have proceeds that they have  
10 raised of \$500 million, \$600 million. And they typically  
11 only have one or two funds. So they used to fit under the  
12 less than 15 clients.

13           But now, if what they do is part of their advice to  
14 their non-traded REIT client, includes advice regarding  
15 securities, it's unclear to us yet whether or not that will  
16 ensnare them into the requirement to register as an  
17 investment advisor. And obviously, that would be problematic  
18 for many of them, because of the different rules and  
19 requirements regarding investment advisor registration.

20           And I think that's the conclusion of what I have to  
21 say. Again, I appreciate the opportunity to be here. And on  
22 behalf of REISA, thank you very much.

23           MR. LAPORTE: Thanks, Debbie. Our final speaker  
24 from a private organization is Steve Shapiro, who is the  
25 Co-Chair of the Society of Corporate Secretaries and

1 Governance Professionals, Small and Mid-cap Companies  
2 Committee. Steve is also the General Counsel of Cole Taylor  
3 Bank in Chicago, Illinois. Steve?

4 MR. SHAPIRO: Thank you very much. Thanks to  
5 members of the staff. Thanks to my fellow panelists for  
6 their insights. And thanks to everybody participating here  
7 and on the web who has managed to hang in there to this  
8 point.

9 I am honored to be testifying here, on behalf of  
10 the Society. We have over 3,100 members, which include  
11 corporate secretaries, assistant secretaries, corporate  
12 securities lawyers, both in-house counsel and outside  
13 counsel, many of whom are alumni of the SEC and other  
14 regulatory agencies. Some also serve as general counsels or  
15 deputy general counsels or compliance officers. Our members  
16 work for companies of every size, and in every state, and in  
17 every industry. More than half are from small and mid-cap  
18 companies.

19 We believe the society is uniquely positioned to  
20 provide insight into the practical implications of small  
21 business capital formation, the Dodd-Frank Act, and the  
22 implementing rules, and the potential unintended consequences  
23 of them because: one, our members serve the boards of  
24 directors of their companies, including their compensation  
25 and risk committees; two, we are familiar with executive

1 compensation practices and risk management policies and  
2 disclosure policies at our companies; and three, we are  
3 involved in the development of the public disclosures,  
4 generally, and specifically with compensation practices and  
5 risk.

6           In my role as General Counsel and Corporate  
7 Secretary of Cole Taylor Bank, I believe I have a unique role  
8 here today, as probably the only one here who actually has  
9 the day-to-day responsibility for complying with these regs.  
10 And I want to make clear that we are committed to full  
11 compliance with those regulations. But I also want to make  
12 it clear that I have been in-house in a couple of  
13 organizations in the last 12 years which pre-dates  
14 Sarbanes-Oxley, and that I have noticed three things.

15           One is that the cost to them is high -- compliance  
16 is high. The cost of complying with them continues to  
17 increase. And third, the cost of compliance falls  
18 disproportionately on smaller reporting companies. I believe  
19 that Commissioner Paredes made this point in his opening  
20 remarks, and I am glad to hear that.

21           And I want to emphasize -- and I think this is a  
22 very critical point -- that compliance with these  
23 regulations -- and if you take them seriously, as we do --  
24 does not only require the resources and time of the staffs  
25 that are designated to comply with them at any of our

1 companies, such as general counsels, compliance officers, and  
2 controllers and their financial staffs, but it also requires  
3 the time of senior executives, from the chief executive  
4 officers. And I believe it requires a disproportionate  
5 amount of their time when their time could also be spent on  
6 other projects like managing other risks.

7           We need to figure out what these rules mean -- and  
8 sometimes there is some effort required in doing that --  
9 muster our internal resources and staffs to get buy-in on  
10 every level, and to make sure we include everything,  
11 sometimes with very far-flung staffs all across the country,  
12 and then sometimes circle back to get buy-in at different  
13 levels of the organization. And as we learn more, get some  
14 push-back on compliance and then figure out how to apply them  
15 in response to that push-back.

16           And so, I think it's very important to understand  
17 that these resources are limited. If we don't have the  
18 resources in-house, as Greg Yadley pointed out, we need to  
19 employ and spend money on these resources, which is money  
20 that, again, small reporting companies have in more limited  
21 quantities. I think there is a critical mass of securities  
22 compliance. And I think that's one of the main reasons that  
23 these regulations and compliance falls more  
24 disproportionately on smaller reporting companies.

25           I would also make one final point in this regard.

1 All of these regulations are cumulative, so that at each  
2 stage that there is more compliance required, regulations and  
3 compliance does not decrease. There is nothing that replaces  
4 it and requires more and more resources to be devoted to it.  
5 And I think it's important to keep that in mind.

6 In that regard, I refer to our letter that we  
7 submitted, which contained two sets of recommendations. The  
8 first set were recommendations that had been made to this  
9 business forum today and in prior years that we feel need to  
10 be adopted. And as people on the panel pointed out, I think  
11 the time is now because of the continued weakness of our  
12 economy and the need for jobs creation. And since those have  
13 been put forth in the forum in past years and other people  
14 have spoken to them, I will not speak to them because there  
15 is quite a lot of background from other lawyers, business  
16 executives, government officials, and trade associations.

17 I did want to spend the remaining period of my time  
18 on two proposals that have not appeared in previous forums,  
19 because they are the result of the rule-making under  
20 Dodd-Frank. The first has to do -- and this is also in my  
21 letter -- with compliance with the conflict minerals. And  
22 just to take a step on that, I want to point out that these  
23 new disclosure requirements are not limited to companies  
24 using materials in the conflict zone, and that it's not  
25 exactly clear under Section 1502 what steps an issuer must

1 take to determine the country of origin.

2           Again, in terms of the cost that it takes to comply  
3 with, it will take time for companies to figure that out.  
4 And it will also take out-of-pocket costs, because there  
5 needs to be a report and that report must include an  
6 independent private sector audit of the report that the  
7 issuers must submit to the SEC.

8           So, again, I want to point out that that's  
9 cumulative, and the cost of that may fall more  
10 disproportionately on smaller companies. And so I think it's  
11 something for the SEC to consider, that there be some scaled  
12 regulation to small reporting companies.

13           The second point is that I think the SEC needs to  
14 exempt smaller reporting companies from the requirements of  
15 Section 14(a) of the Exchange Act, notwithstanding the  
16 instruction to the new Rule 14a-21. The reason for this is  
17 that smaller companies, we believe, would nevertheless be  
18 compelled to include CD&A disclosure, even though it's  
19 technically not required, to avoid an unfavorable stockholder  
20 vote.

21           And one of the reasons for that is that smaller  
22 reporting companies lack the resources to review the reports  
23 or proxy advisory firms that are purchased from institutional  
24 stockholders. And so, to avoid an unfavorable vote, I think  
25 more smaller companies may decide to provide CD&A disclosure,

1 which is technically not required, and that may be contrary  
2 to what the SEC intended.

3           Again, thank you very much for our participation.  
4 The Society is honored to be here. I look forward to the  
5 discussions this afternoon.

6           MR. LAPORTE: Thanks, Steve. Thank you to all our  
7 panelists for your remarks. Do any of my fellow people from  
8 the SEC have any questions? Do any of the panelists have  
9 questions of other panelists?

10           MR. PALMER: I'm not sure it's a question, but it's  
11 a comment. I think Mark's comments on the desire for small  
12 businesses to grow is largely true, but not universally true.  
13 A lot of the businesses that -- a lot of them are small  
14 chains of local dry cleaners, and they have five or six  
15 chains and they're growing. They're not going to go public,  
16 but they're going to be good businesses, they're going to be  
17 solid businesses.

18           There is a lot of manufacturing investing that we  
19 do that probably isn't ever going to go public, but we do  
20 hope it grows. If it can go public, fantastic. I mean  
21 that's the end-all goal, but that doesn't have to be a  
22 requirement for our investments to work. And those are still  
23 important investments, and still supporting good businesses.  
24 So that's just a small comment from my side.

25           MR. LAPORTE: Anybody else? Do we have any

1 questions from the audience?

2 MR. HIRSCHMANN: I would simply ask this. Is there  
3 a process to consider, evaluate, and implement some of the  
4 recommendations that come out of these forums? And how can  
5 we work constructively to move from excellent discussion to  
6 action on some of the things that have been recommended?

7 MS. CROSS: That's an excellent question, and we  
8 were actually talking about that yesterday as we were getting  
9 ready for today's forum, because we recognize that there are  
10 a lot of recommendations that are kind of hanging out there  
11 that would be good for us to move forward on. And I think  
12 that we had -- we came in during the financial crisis, the  
13 current -- you know, the current Commission came in sort of  
14 in the height of the financial crisis.

15 We have been working our way through the  
16 rule-making to restore investor confidence, we are doing  
17 Dodd-Frank, so we are in this mode of trying to keep the  
18 trains running as we do those things. But we recognize that  
19 it's critically important that we take up some of these  
20 recommendations.

21 I think that -- and so we are in the process of  
22 sort of doing triage, looking at them, which ones are the  
23 most doable, which ones wouldn't require additional  
24 legislation, which ones don't raise serious investor  
25 protection concerns that would make them more doable?

1           So, we are currently working on that internally.  
2     We are going to engage in outreach, so you will hear more  
3     from us. I don't want you to feel like these just go into a  
4     black hole. We are looking at them and trying to figure out  
5     what makes sense to do.

6           That leads to the question that we had for the  
7     panel here, if we had time at the end was, if there is one  
8     thing that each one of you wants, what would you like us to  
9     move forward with? I think that would be -- is it move the  
10    \$75 million smaller reporting level higher? Is it a 12(g)  
11    reporting -- there are a whole lot of recommendations that  
12    are kind of all over the place. What would you really like  
13    done?

14           MR. SHAPIRO: The top of our list is increasing the  
15    \$75 million threshold to \$250 million threshold. And I point  
16    out that, in the securities industries, I think that they  
17    view a smaller cap company as a billion and less.

18           MR. HEESEN: We would agree with that, that 404(b)  
19    is very critical. We can work with some of the other things,  
20    but that is very, very important.

21           MR. PALMER: The registration costs, and what that  
22    means for small business funds from the -- across the  
23    spectrum, regardless of flavor, raising that up and making  
24    that minimally expensive to comply with would be very  
25    significant to small funds.

1 MS. LIPNIK: We definitely would want the \$75  
2 million increase. But the big one that I think would be  
3 helpful in the long run is the change to Rule 12b-2, because  
4 we know eventually, if there is a transition to IFRS, that's  
5 another issue that small biotech companies have come to us --  
6 besides SOX compliance, they're concerned with how we're  
7 going to comply with IFRS. They always have those  
8 administrative concerns.

9 Definitely I agree with Mark, that it's increasing  
10 the \$75 million exemption. But I think in the grand scheme  
11 of things it's the change to Rule 12b-2.

12 MR. HIRSCHMANN: I would look at it as the \$75  
13 million exemption would benefit everybody at this table,  
14 whereas the -- some of the individual ones would benefit some  
15 more than others. But if you wanted to do one thing that  
16 would have the broadest impact, that clearly is the  
17 recommendation.

18 MS. HUDSON: I guess I would agree with that, too.  
19 And in terms of the definitions for angel investing, leaving  
20 them essentially as they are now. It doesn't require a lot  
21 of change, except for the rule-making you need to do with  
22 Dodd-Frank.

23 MS. CROSS: There is a lot of talk about raising  
24 the Reg. A threshold, the \$5 million, making that higher. And  
25 I am curious if people -- that's not been a widely used

1 exemption. Is that because of the \$5 million, or is that  
2 because of something else?

3 MS. FROLING: I would say on behalf of REISA that  
4 one of the reasons we don't use Reg. A is because of the  
5 non-federal preemption. And so Reg. D is where we typically  
6 do most of our transactions.

7 MR. MILES: My name is Theodore Miles. I am the  
8 Associate Commissioner for Securities for the District of  
9 Columbia. And my question is -- someone mentioned the  
10 problem of extending the fiduciary duty to broker-dealers in,  
11 I think, the real estate context. And I just wondered what  
12 were some of the particular difficulties that might emerge  
13 from that.

14 MS. FROLING: I guess that would be me. The issue  
15 is that currently if you are an investment advisor you have a  
16 fiduciary standard to recommend securities to the best  
17 interest of your client. And in the broker-dealer context,  
18 you are typically in a -- more in a sales mode.

19 And the question is, we could deal with the  
20 fiduciary standard that could be dealt with with a  
21 disclosure. But having a fiduciary standard to a client who  
22 has come in to you to execute a securities transaction you're  
23 interested in is a difficult one to make. And REISA members  
24 believe that that would significantly hinder their ability to  
25 sell Reg. D real estate investments.

1                   MR. HEESEN: To answer on the Reg. A -- to go back  
2 on that, I know that there was a legislative proposal last  
3 year to raise that to \$30 million. And my understanding is  
4 that there are folks who are very interested in reintroducing  
5 that in the new Congress. And we would be supportive of  
6 that.

7                   MS. CROSS: And you think people would use it?

8                   MR. HEESEN: That's a very good question. When you  
9 have so few companies already going public, it may give them  
10 that opportunity to look at a different avenue.

11                  MS. CROSS: Because it doesn't give them an ongoing  
12 reporting obligation, I suppose. But you do still have a  
13 State Blue Sky Law. So it's an interesting question for us.  
14 I'm not uncomfortable with Reg. A, because the staff gets to  
15 look at it. So this isn't something the staff is having a  
16 problem with. We're just a little bit concerned that it will  
17 be pretty much effort to do, and then will anyone use it.

18                  MR. HIRSCHMANN: I think, if the threshold was  
19 higher, then maybe some of the exchanges would consider  
20 trying to find ways to make it attractive for people to use  
21 that. At least that's what they have approached us about.

22                  MR. MAKENS: I would like to comment on Reg. A.  
23 The principal difficulty that you run into with Reg. A today  
24 relates to the state's requirement for audited financials.  
25 Reg. A is viable, it's fairly easy to work through. Getting

1 through the states is generally not that difficult, because  
2 you now have the coordinated state review process. So the  
3 state obstacles that were there, if you look back 5, 10 years  
4 ago, don't exist today, other than that you do have the  
5 review process still to go through.

6 But I did a Reg. A a few years ago, and it's not  
7 like going to the dentist. But the problem is that you will  
8 be forced into audited financials. And if you are going to  
9 do something to make it more effective, I would think that to  
10 decide where there was a threshold where you could use  
11 reviewed financials rather than audited financials would  
12 probably be a beneficial partial step in the process.

13 At \$30 million you should be able to use audited  
14 financials. But at \$5 million, it's much more problematic.  
15 So my recommendation would be that if you consider expanding  
16 Reg. A, consider also determining a threshold, and then  
17 working with the states to see if you can get them to accept  
18 reviewed financials.

19 MS. CROSS: Chairman Shapiro is here, and I would  
20 like to go ahead and get her up here, if that's okay. I  
21 appreciate the comments from the group, and I will introduce  
22 the Chairman.

23 I hope everyone enjoyed this morning's panel. It  
24 was a terrific presentation from everyone, and I really  
25 appreciate all of the effort that went into your remarks.

1 And we really do look forward to coming up with ways to  
2 reduce burdens on small business, and your recommendations  
3 are very helpful for that.

4 I now have the honor of introducing our Chairman,  
5 Mary Shapiro. Chairman Shapiro rejoined the SEC in January  
6 2009, having previously served as an SEC Commissioner in the  
7 late 1980s and early 1990s. And I was lucky enough to work  
8 with her back then, and I love working with her now.

9 She left the SEC to become Chairman of the  
10 Commodity Futures Trading Commission in 1994, and left the  
11 CFTC in 1996 to join NASD, the predecessor to the Financial  
12 Industry Regulatory Authority, or FINRA, where she rose to  
13 become the CEO.

14 Chairman Shapiro has been leading the Commission in  
15 a time of great change and renewed focus on our mission of  
16 protecting investors. Under her guidance, we are all hard at  
17 work on an agenda designed to restore investor confidence in  
18 our markets, which should ensure that our capital markets  
19 remain an important funding alternative for issuers large and  
20 small.

21 It is now my pleasure to turn it over to Mary  
22 Shapiro.

23 CHAIRMAN SHAPIRO: Thank you very much, Meredith.  
24 Good afternoon. I want to thank everyone for participating  
25 in this year's SEC Forum on Small Business Capital Formation.

1 I know that you have had a very productive morning, and I  
2 look forward to hearing about the constructive discussions  
3 that I know you will be engaging in this afternoon.

4 As the daughter of a small business person, I am  
5 really familiar with the unique challenges small businesses  
6 face. And at the SEC, we do appreciate how much small  
7 business is a truly driving force in our economy. Reliable  
8 data suggests that small businesses have created 60 to 80  
9 percent of net new American jobs over the last 10 years.

10 And it's not just the number of jobs that are  
11 created that are important, it's the kind of jobs. At a time  
12 when improving our global trade position is a top priority,  
13 small businesses produce almost a third of America's exports.  
14 And at a time when expanding those exports - while increasing  
15 domestic market share - often means producing at technology's  
16 cutting edge, small business employees earn patents at 13  
17 times the rate of those in larger firms.

18 Making sure small business can attract the  
19 investments they need to grow and thrive is absolutely vital  
20 to our economic recovery. And so, it is only natural that we  
21 would want you to be a part of the ongoing dialogue about how  
22 best to harmonize our obligation to protect investors, the  
23 markets, and our economy from another financial crisis, with  
24 our important responsibility to facilitate access that  
25 growing companies have to America's investment capital.

1           While we won't make any final decisions here today,  
2 this event is important to the decisions that the Commission,  
3 as we move forward in implementing the Dodd-Frank Act, will  
4 eventually have to make. And it is part of a process  
5 designed to ensure that those decisions are informed by  
6 detailed and intelligent discussion - from a variety of market  
7 participants, including especially smaller companies.

8           When Dodd-Frank was signed into law, we were  
9 determined that the SEC would seek out input from the widest  
10 range of market participants. And it's that determination to  
11 hear all voices that really helped to shape the agenda of  
12 this year's small business forum.

13           We started the day with a panel devoted to sections  
14 of Dodd-Frank that will have particular impact on small  
15 business. After that, we heard from a number of  
16 organizations with suggestions about how to maintain  
17 important investor protections while improving small business  
18 capital formation.

19           This afternoon's breakout groups will carry on from  
20 there, continuing the exchange of ideas and the formulation  
21 of recommendations in areas such as private placements,  
22 securities regulation of smaller public companies, and the  
23 regulation of M&A brokers and placement agents.

24           The thoughtful contributions of this morning's  
25 panelists and the recommendations that result from this

1 afternoon's breakout groups are giving the SEC direct access  
2 to a unique and very, very important perspective. Your input  
3 will be especially meaningful, as we seek ways to assure that  
4 the new accredited investor and bad actor disqualification  
5 rules - required for private placements by Dodd-Frank - are  
6 workable in practice, and do not impose undue regulatory  
7 burdens on small business capital formation.

8           We will need your help, as we look for ways to help  
9 private companies access capital more cost effectively.

10           And, we will need your ideas as well, as we consider  
11 how to continue scaling disclosure and other rules for smaller  
12 public companies to reflect the benefits and costs to those  
13 companies - and, eventually - to their shareholders. Rarely has  
14 there been a more important time for us to hear your views -  
15 as we work to implement major reform while keeping America's  
16 small business engine running smoothly.

17           But as beneficial as it is for Gerry and Meredith  
18 and other senior SEC officials to hear directly from you  
19 about your needs and concerns, this is just one avenue of  
20 communication. The SEC has structured the Dodd-Frank  
21 rule-making process to create broad opportunity for public  
22 comment, with maximum transparency.

23           We have a dedicated area on the SEC's websites on  
24 which anyone with views on Dodd-Frank implementation can post  
25 comments, even before rules are formally proposed and the

1 official comment period begins. And I encourage all of you  
2 familiar with the interests of small business to take  
3 advantage of that channel of communicating with us.

4 We are also making an effort to meet face-to-face  
5 with as many stakeholders as possible, and hope that you or  
6 other representatives of the small business community will  
7 sit down to meet with us on initiatives of particular  
8 interest.

9 And of course, you will be able to monitor the  
10 discussion and continue to contribute to it as we move  
11 forward. All public comments we receive will be available on  
12 our website. Memos describing face-to-face meetings,  
13 including participants, issues, and handout materials, will  
14 be posted there, as well. And we will also be posting  
15 relevant portions of the transcript from this morning's forum  
16 on our website, so they will become a matter of the written public  
17 record, as well.

18 We absolutely know that our decisions will be  
19 better decisions if they are made with your input.

20 Before closing, I would like to acknowledge the  
21 state regulators and congressional and federal agency staff  
22 who are here today or are listening online. We look forward  
23 to continuing to work with you on the many issues facing  
24 small business in this challenging economic environment.

25 We appreciate all of your support here today, and

1 we look forward to benefitting from your views and expertise,  
2 and appreciate your willingness to share the perspective of  
3 small businesses from across the country.

4 Thank you all very much, and I wish for you a very  
5 productive afternoon.

6 (Applause.)

7 (Whereupon, at 12:20 p.m., the meeting was  
8 concluded.)

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