32nd ANNUAL

SECURITIES AND EXCHANGE COMMISSION

GOVERNMENT-BUSINESS FORUM ON

SMALL BUSINESS CAPITAL FORMATION

RECORD OF PROCEEDINGS

Thursday, November 21, 2013

9:00 a.m.

SEC Headquarters

Washington, D.C.

CONTENTS

CONTENTS (Continued)

Moderators:

Keith F. Higgins, Director
SEC Division of Corporation Finance

David M. Lynn, Partner
Morrison & Foerster, LLP
Washington, D.C.

SEC Commissioner Kara M. Stein

Panelists:

Kim Wales, Founder and CEO
Wales Capital
New York, New York

Douglas S. Ellenoff, Partner
Ellenoff, Grossman & Schole, LLP
New York, New York

Annemarie Tierney, Executive Vice President, Legal Affairs and General Counsel
SecondMarket
New York, New York

John D. Hogoboom, Partner
Lowenstein, Sandler PC
Roseland, New Jersey

P R O C E E D I N G S
Call to Order

MS. OSHEROFF: Good morning. I think it's probably about time to get started if you can take your seats please. My name is Mauri Osheroff. I'm the Associate Director in the Division of Corporation Finance with responsibility for, among other things, the Small Business program in the division. I'm here to call to order the 32nd Annual SEC Government-Business Forum on Small Business Capital Formation. This event is being conducted under the mandate of Section 503 of the Omnibus Small Business Capital Formation Act of 1980. We welcome all of you who are here in person as well as those of you watching the webcast.

Before we begin, on behalf of each person from the SEC who will speak on today's program, I want to make it clear that the views that they express here are their own and don't necessarily represent the views of any other person from the SEC or the views of the agency itself.

I'm going to turn this over to Keith Higgins for a few opening remarks. Keith has been the Director of the Division of Corporation Finance since July. Before that, he practiced law for 30 years at Ropes & Gray in Boston where he advised public companies on a variety of securities law matters, so he's an expert on many of the topics that the forum is considering today not to mention the additional expertise he gained since joining the Commission.

Many of you know Keith, but even those of you who don't will know him a lot better by the end of the morning since we prevailed on him to be a co-moderator for both of this morning's panels.

Keith?

MR. HIGGINS: Thank you, Mauri.

Good morning. I'd like to welcome everyone here today and thank you for taking the time from your busy schedules to share with us your insights and experiences, which are very important to the work that we do. This is -- I'm sure will be an exciting event addressing topics that are extremely current and very important to the division, to the Commission and, if I can be a little grandiose here, very important to our economy and the markets. I know we'll have a very interesting day ahead of us.

I want to especially thank all of the private sector participants who are joining us today. You're really our eyes and ears in the small business community, letting us know the effect our rules are having on small business capital formation. Your insights are critical to our rulemaking deliberations and for our recommendations to the Commission. We're always eager to hear and listen to the comments and thoughts, and recommendations that you have.

I'd like to welcome also the representatives of state and federal agencies and Congressional offices who are joining us today. Their insights are very important to our process, and we're all working to-- Congress is regulating; other agencies are regulating. We're all in this together to help small business capital formation.

I'd like to welcome guests that are here today whether you're joining us here in the auditorium or whether by webcast. We want to make sure -- we've tried to make it so that we can hear everybody's views and so that people can participate all across the country. We welcome and look forward to hearing your comments today.

We've worked hard to make this year's forum as inclusive and accessible to everyone as possible. We've made an extra effort to ensure that businesses owned by women, veterans, and minorities were invited to participate in today's discussions. And to maximize participation, as Mauri said, we've made it possible to view this morning's proceedings on the SEC website, which will-- the webcast will be archived, and people can participate this afternoon in the breakout groups by conference call, so everybody's views ought to be heard. Whether you're in Washington or elsewhere in the country, we want to hear your voice so we can help fulfill our mission.

I had next hoped to be introducing the Chair of the SEC, Mary Jo White, but unfortunately she's not able to be with us here today and sends her regrets that she won't be here this morning. She does plan to watch the archive of the webcast and very much appreciates the input that participants today will be providing.

Before we start, I'd also like just to take a moment to acknowledge the hard work that's been done by Mauri Osheroff, who, as she mentioned, is the Associate Director for Regulatory Policy, and by others in the Office of Small Business Policy in the Division of Corporation Finance, the office that Mauri oversees. As many of you know, that office is the SEC's main point of contact with smaller companies. In addition to organizing events such as today's forum, it also serves and coordinates the SEC Advisory Committee on Small and Emerging Companies, which the Commission recently renewed for a two-year term and plays a key role in Commission rulemakings under the Jobs Act affecting small businesses, and does a great job day to day in reaching out to and working with smaller companies.

Mauri, would you like to introduce the other members of the Office of Small Business Policy who have worked so hard putting the forum together? Yeah, you want to do it from there or come up -- either way.

MS. OSHEROFF: Before we start the first panel, I do want to recognize the staff of the Office of Small Business Policy. First there's Tony Barone. And if Tony -- if people are in the room, I hope they'll stand up. But I realize they may be behind the scenes taking care of things. Tony has been the primary organizer of the forum for many years, and without his hard work it would have been much harder to put on the forum.

The other members of the office are doing a lot of work today, and you'll see them around all day. And in addition, they've been putting in countless hours working on some of the small business initiatives we'll be discussing today.

Please stand up if you're around, Zachary Fallon, Johanna Losert, Shehzad Niazi, Karen Wiedemann, and our intern this fall, Will Mastrianna. Thanks to all of you.

I don't know if our former Chief, Gerry Laporte, made it. He did register for the conference. And I thought, if I were retired, with all due respect to the excitement of the forum, I don't know if this is where I would be. But in any event, if he either is present or watching, I hope he will feel that we didn't let the event go downhill in his absence. We haven't yet named a new office chief to replace Gerry, but we're working hard on it. We hope it won't take too much longer.

I'd like to direct your attention to program materials. Some of the slides being used by the panelists are in the folders, and other sets of slides are in the handouts at the registration tables. In fact, those of you who got here really early may want to check the registration tables again because a few additional handouts were put out.

Also in the program material are the biographies of the panelists. If the introductions of the panelists are briefer than you like, and you want to know more about these fine people, you can always refer to the biographies for more detail.

We've allowed some time at the end of each panel for the panelists to answer questions from the audience. The Small Business Policy staff will be circulating to pick up the green cards that you find in your folders, although the questions don't necessarily have to be on green cards. And we'll also be checking emails from those who are watching the webcast who should send their questions to smallbusiness@sec.gov.

This afternoon many of you will be participating in the breakout groups. These groups are designed to formulate recommendations in the area of small business policy for the Commission to consider. The panel may give you some ideas for recommendations, and your own thoughts and experiences, of course, will be very valuable. Now, I will turn it back over to Keith.

Panel Discussion: Evolving Practices in the new world of Regulation D offerings.

MR. HIGGINS: Thanks, Mauri. Now, we'll move directly to our first panel of the day, which is “Evolving Practices in the New World of Regulation D.”

I think it's without too much hyperbole that I can say that Title II of the Jobs Act, which directed the Commission to eliminate the ban on general solicitation in Rule 506 offerings, was one of the most significant changes to the securities laws probably since 1933. As far back as I suspect anyone in this room can remember, it's been an article of faith that in private placements under 4(a)(2) of the Securities Act of 1933, you simply couldn't do general solicitation.

We'll be discussing today some of the implications for issuers, advisors, and investors that have resulted from the elimination of this decades-old ban on general solicitation and the imposition of new bad actor rules under Rule 506(d)

I'd like to thank Greg Yadley for agreeing to moderate the panel with me. Greg is a partner and chair of the Corporate Practice Group in the Tampa, Florida office of Shumaker, Loop & Kendrick. He represents clients in financing transactions, mergers, acquisitions, contract negotiations, disputes, strategic planning, and general corporate matters, just a jack of all trades.

I've known Greg for years. Greg has been a face of small business and a face of many in the ABA and other places where he represents small businesses. So let me turn it over to Greg to introduce our other panelists.

MR. YADLEY: Thank you, Keith. And let me add my word of welcome to those of you who are in the room and participating by internet.

This is an important -- this is the 32nd conference that the SEC has sponsored, and your participation is more than welcome; it's important. For example, last year there were 32 -- same number -- of recommendations that came out of the discussion groups in the afternoon. While the SEC did not take action on all of them, the ones that achieved the most votes from participants requesting that the Commission study and act on measures were, in fact, adopted. If you look at last year's recommendations on the elimination of the prohibition on general solicitation, nearly every point that was requested to be included in the rules were, in fact, so included.

Crowdfunding was more of a mixed message, but most of the views expressed last year did make their way into the proposals. Other of the forum recommendations from 2012 are under study. So thanks everyone for participating.

In addition to Keith, we have a wonderful panel of people with great expertise who are going to talk to us today. Christopher Mirabile is Co-Managing Director of LaunchPad Venture Group, and he's on the Board of the Angel Capital Association. Christopher is based in Boston, and prior to being a full-time angel investor, he was a public company CFO. He was a corporate and securities lawyer, and he was a management consultant for a major firm.

We also have with us John Chory from Latham & Watkins, also in Boston. In addition to being a lawyer, he has an MBA degree and is a former member of the Advisory Board of the MIT Enterprise Forum.

Next, Troy Foster from the West Coast. Thanks for coming all the way from Silicon Valley, Wilson Sonsini Goodrich & Rosati firm. Troy primarily works in the life sciences and clean energy area, representing emerging growth companies, venture capital firms, public companies, and investment banks.

And finally, Rick Fleming, who is the Deputy General Counsel of the North American Securities Administrators Association. Prior to that, he was General Counsel for the Office of the Kansas Securities Commissioner. In addition to doing disciplinary and enforcement work which we expect of a state regulator, he also had a hand as the author in a number of statutes and regulations, including the nation's first crowdfunding law to permit Kansas companies to raise capital through crowdfunding.

So, I think we're going to kick it off with maybe, Keith, a few more comments on the rules to -- the amendments to 506 and that area, and then we'll move to the panelists. Thank you.

MR. HIGGINS: Thanks, Greg. Let me just set the table by -- I'm sure most people in the room and in the -- and probably listening in the audience are familiar with what the Commission has done in the 506 area, but I think it's helpful to set the table and remind where we've been.

This summer the Commission implemented Title II's elimination of the ban on general solicitation, and these rules became effective in September of this year. Under the new 506(c) exemption, issuers can use general solicitation to offer and sell securities under 506, provided they sell only to accredited investors and that they've taken reasonable steps to verify the accredited investor status of each of those purchasers.

Issuers can satisfy their verification obligation in one of two ways. They can use a flexible principles-based approach in which they would look to the particular facts and circumstances of the offering, the amount of information already known about the purchaser, the method used to solicit, the size of the offering, the size of the -- the amounts that each individual investor has to raise. And they, using those facts and circumstances, determine the steps that would be reasonable to verify the accredited investor status.

Alternatively -- and this was in response to comments, if purchaser is a natural person, the Commission has provided for non-exclusive methods of verification that would be conclusively presumed to be reasonable. These methods are designed to verify a person's income or net worth or can be certified by a broker-dealer, a lawyer, a CPA, or investment advisor. And finally, there's a grandfather provision that allows existing accredited investors in offerings to self-certify on future offerings.

As I mentioned, 506(c) became effective in

September, September 23rd of this year, and we've already seen significant use of the exemption by issuers based on the Form D filings that we have. And, of course, everybody knows not everybody files Form Ds, but there have been 306 new offerings conducted under 506(c) from September 23rd to November 15th and resulting in approximately $2.2 billion in total amount sold. I will say that 506(b) offerings still are the vast majority that are being conducted.

At the same time the Commission adopted the rules under 506(c), it adopted the bad actor rules that were mandated by the Dodd-Frank Act. The rules disqualify from security offering -- felons and other bad actors that are not able to rely on Rule 506. And this is 506 across the board, not just for general solicitation deals -- covers issuers, other persons such as directors, partners, compensated solicitors, and applies to certain disqualifying events, criminal convictions, court injunctions, final orders, cease and desist orders and the like.

At the same time the Commission proposed changes to Reg. D and to Form D designed to enhance the Commission's ability to understand and evaluate the market practices in the 506 offerings and to address concerns that may raise when issuers engage in general solicitation.

These amendments include a proposal to require advance filings of Form D no later than 15 calendar days before engaging in a general solicitation, requiring issuers to file a closing Form D within 30 days after the termination of a 506 offering, disqualifying issuers from using 506 in future offerings if they fail to comply with the Form D filing requirement, subject to certain grace periods, and expanding the information that would be required under Form D, including use of proceeds, control persons, verification methods used, and type of general solicitations engaged in.

Other proposed changes involved legending requirements, interpretations under Rule 156, and the requirement to -- on a temporary basis for a two-year period to submit general solicitation materials to the Commission when they're first used.

The comment period closed earlier this month. We received -- as you can imagine -- a significant amount of comment letters on the proposal, over 450 letters so far. Many commenters expressed strong views about the advanced Form D filings, the disqualification provisions for failures to make Form D filings, and the submission of written general solicitation materials. We're going over the comments right now, and the division will formulate a recommendation to the Commission in due course.

So that sort of sets the table on what we've done, what the new world of Reg D is -- at least from a regulatory standpoint looks like. And I'm delighted that we have a panel of true practitioners, folks that are living this day to day, as well as a securities regulator with Rick, who has a vantage point from the states to help us understand better what the implications are for fundraising. So with that I think we're going to turn it over to Christopher.

MR. MIRABILE: I may need a switch to the slide deck if I could get it. But while we're waiting for that, I'll just make a couple of comments. I was -- this is a terrific panel, and I was sort of elected to go first simply because I have a little bit of data and perspective on the market.

And I also, I think, have an interesting perspective on these issues, just having been a full-time angel and on the ACA board and dealing with angels from all across the country and the globe. But having a background as a recovered corporate and securities lawyer who worked with the Commission doing IPOs in the early part of my career and then spending a long period of time as the general counsel and ultimately the CFO of a company that was listed on two exchanges.

And so I'm trying to bring a broad perspective and an open mind to this and separate the usual sorts of people who are adverse to change and everyone throws up their hands when anything gets changed, says everything's unworkable. And you want to sort of discount that a little bit and just tell people to calm down and give it time to settle in.

But at the same time, I think there are some very specific issues where things don't quite map to how deals are actually getting done. And I'm going to try to highlight a couple of those just to set the stage.

So what I'd like to do first is just buzz very quickly through a few slides just around the market to set a little bit of a perspective on what's going on.

The Angel Capital Association is the largest trade group for angels. It's about 10,000 accredited investors all over the place, including Canada and Europe and Australia and New Zealand. Angels are funding nearly all of the early stage deals, not money-wise, but deal-wise. The vast majority -- if you look at VC deals or -- you know, in the neighborhood of 2,000 angel deals are in the neighborhood of 45,000 at the seed stage.

So if you're in the United States and you're creating a business that's expected to grow quickly and consume risk capital equity as its fuel, there is an extremely high probability you'll end up working with angels.

And I think everyone here appreciates that startups are a tremendous source of jobs. Net-net job creation is obviously an important issue here for the Commission and for all of us. And I would just point out that this is not a fad. This is 35 years of data on that slide. Startups have been an incredibly important engine for economic growth in our country for 3 1/2 decades and probably longer if I had a longer horizontal axis.

And as I said before, angels are funding 90 percent -- they're the capital in 90 percent of start-up financings and investing and amount which is approximately equivalent to what VCs are doing. They're just doing it in every main street in America, 67,000 deals a year, as opposed to something on the order of 3,700 or 3,800 deals a year for VCs. And a lot of household brand have started as angel-backed companies. So it's clearly an important source of capital.

Who are these angels? These angels are not money managers. These are not brokered deals. These are educated, successful people who are investing their own time and their own money. And the time element of it actually is in some ways more important than the money element to help these startups in their communities get off the ground.

I should also point out that the practice of investing in angel groups is a very professional practice. This is an experienced, value-added group of investors with a median years of investing at nine years, a median number of investments of over 10 investments. They're taking board seats. They're sitting on advisory boards. They're giving advice for all stages of company growth and formation.

I should also point out -- and, again, I apologize. I want to go through this quickly and get to the recommendations. I should also point out that these are not penny ante financings. These are fairly significant deals with an average size approaching a million dollars. And in today's world, with the changes in technology, a company can accomplish a significant amount in -- with a million dollars.

So with that, by way of background, I just wanted to lay out for the panel to chew on a few things that, from my perch, are kind of a -- causing us some concern, three sort of critical issues from the angel and startup perspective.

The first is that at this point the way the community works the general solicitation deals are almost unavoidable given the kinds of activities that startups undertake. And so I think the Angel Capital Association would love to just get a little clarification around the principle-based approach. And I'll talk to that in a moment.

The proposed Reg D rules present a few problems for the community. There's a little bit of heartburn there. And I think probably some of those 450 letters came from that community. I know I was a signatory to one of them.

And finally, looking a little bit forward -- and there's going to be some time on the next panel on this. One of the potential changes afoot is a proposal to look at the accredited investor threshold, to potentially raise that threshold in 2014. And I wanted to make a couple of comments on that because I feel that, in the context of this job creation and capital formation issue, that would be very detrimental.

So on general solicitation -- I think Keith did a terrific job outlining it, so I just want to observe that a lot of the things that startups have always done and are routinely doing now are suddenly coming into focus as "oh my gosh. Is this going to be a problem?" The kinds of things I'm talking about are the demo days and the pitches and the business plan competitions, the

Twitter feeds and the kinds of social media activities. These are all things that are suddenly causing everyone to wake up with sweats, going, "Wait a minute. Is this all general solicitation, and am I now living in this 506(c) world?"

These activities are sort of the lifeblood for startups, and it's made them problematic now. Companies literally do not know -- John and I were talking about this before the panel. They literally don't know whether to check B or C, and there are investors who are refusing to do C deals probably in part because of that everybody's afraid of change issue. I'll be the first to stipulate that there is some fear of change in the mix.

But there are some really fundamental questions around what do we do with these pre-seed friends and family rounds now that there's no exception for unaccredited investors; what -- how far back do we have to look in the company's history; and how much do we have to regulate their behavior.

The key issue from an investor perspective is accidentally getting money stranded in a company that's going after a market window -- market opportunity that's not going to be open forever and they are suddenly unable to raise additional capital because they had a foot fault, and now that money is essentially dying on the vine because the company is going to have trouble raising more with any kind of reasonable time frame or cost of capital -- go back and do a (4)(2) deal or something.

The early hand-wringing in the angel community was around the safe harbors, and I think it was a total overreaction. A lot of angels had tremendous antibodies when they saw this list of things because angels as a group are pretty averse to publicity. They are concerned about identity theft, data piracy, fraud, those kinds of things. And this notion of getting a lot of third parties involved and your social security number and your tax returns. And angels are -- tend to be a do-it-yourself crowd, so they're not really wanting to be paying somebody to validate them.

So there was a lot of concern about that, and I think that's settled down to some extent. And the Angel Capital Association is really quite focused on the principle-based approach, and they have written a white paper. And I would love to come out of today's conversation with a sense that this white paper's reasonable and on target.

And they're basically saying, "Look, if you're willing to sign a written certification like you always have, saying you're accredited, and you can demonstrate that you're a member of a professional angel group where there's been some peer verification; there's been a background check; you've been doing deals; and the group is maintaining professional standards, that a company ought to be able to rely on that as a reasonable basis for believing that you, as a known commodity, are an investor.

MR. HIGGINS: Hey, Christopher, what kind of peer -- you mentioned in your criteria some sort of peer review or peer assessment. What happens in the angel group?

MR. MIRABILE: What I'm really referring to there Keith is groups are -- they're invitation only, and they almost universally require a referral. And so members of groups are introduced by existing members, and there is -- at least in some of the larger groups there's a fair amount of competition to get in. And so a track record of investing and references from entrepreneurs you've worked with become fairly important. So the point is it's not a person walking in off the street, going to do themselves harm. It's more of a community with its own standards, sort of self-regulating community.

Keeping the pace up here -- so we believe the principle-based verification method is workable. However, we have -- this is the guidance we gave as we were referring to as the established angel group.

We do need some clarifications from the SEC, the first being that we'd like affirmation that the ACA's white paper on established angel groups is reasonable and the companies can rely on it and that their counsel can confidently recommend the approach to them.

The community is definitely very fuzzy on what general solicitation means. And my perspective is that a lot of sort of the case law and understanding around that developed prior to the advent of social media and a lot of these kinds of things. And so there is a little bit of fuzziness that has crept into the general solicitation. It's no longer just a tombstone and a newspaper. It's a lot of different kinds of behaviors.

And then the third is trying to understand as a practical matter how you do a 506(c) when there have been some friends and family, unaccredited people who are on the cap table as a result of the earliest pre-seed financing.

Quickly changing channels, on the proposed rules, ACA has some significant heartburn with these rules, as I said. The concerns are around the harshness of the penalties for noncompliance. I think everybody understand the importance of compliance, but the penalties may be sawing the baby in half.

The advanced Form D is proving to be a little bit hard to get your head around given the -- how dynamic and how fast-moving a lot of these fundraisings -- some of them can be -- the entire fundraising can be two or three weeks long. I think there's a desire to have some of the Form D be allowed to be treated as confidential, which is probably not a controversial request but would be an important one.

There is some concern in this 140-character Twitter world that we live in that the legends are longer than the length of a tweet. And it's not -- that's not entirely a humorous point. But maybe we could look at narrowing where the legends are appropriate and where they aren't. So where information about the product or the company is being discussed maybe a legend isn't necessary. But where the terms of the offering are being discussed, I think a legend would be very appropriate. So maybe we can distinguish a little bit around the legends.

This notion of submitting all of your materials in advance, even given that it's temporary and that it represents a good faith effort on the SEC's part to learn -- I think the concern is that that's going to be a bit of a burden and it's going to raise competitive issues for companies and maybe there's another way to get that learning into the Commission that is less of a burden for companies.

And then, you know, finally, is there something we can do to carve out and get a little clarity around the demo days and the pitch days and those kinds of events so that today's start-up world is kind of reflected in the Commission's thinking on general solicitation and we can kind of get that reconciled a little bit.

And then finally, as I mentioned, I just want to quickly make a point on the accredited investor definition. This is the threshold that uses financial means as a proxy for financial sophistication. It's been set at a million dollars and $200,000 in income for approximately 30 years. A couple of years ago they took the value of your house out of the calculation.

There are some proposals now -- the SEC is supposed to look at it next year. And the concern is that raising that amount even a little bit would pull approximately 60 percent of today's angels out of the mix. These are not ultra, ultra rich people. These are people who are in their 50s and 60s, have had some success in their careers, and they're plowing some of their savings back into our economy. And raising that threshold could have a very, very significant and detrimental effect on the formation of capital and the creation of jobs.

And this is not just my data. This is data that the SEC has from the GAO report and was also pointed out in the Dodd-Frank discussions.

So I went through that as quick as I could. I hope it wasn't too much and too fast. I'd love to get the rest of the panel involved. Thank you.

MR. HIGGINS: Yeah. We'd - I'd love to hear on the general solicitation point -- we've heard a lot of people saying, "Gee, can you give us some guidance?" What kind of guidance would be helpful, John, Troy, Rick? Rick, maybe you're not looking for guidance. I don't know.

MR. FLEMING: I'm not looking for guidance, but I do have a thought about this whole issue --

MR. HIGGINS: Yeah.

MR. FLEMING: -- Because I think the angels do make a -- they express a valid concern. And so the question is how do you address that concern. And to me, it would be preferable to address that not by, I guess, watering down 506(c) and the requirements in 506(c) but rather by focusing on the toggle between 506(b) and 506(c), namely the definition of general solicitation. To me that seems -- that approach seems to be more compatible with investor protection.

And the reason I say that is just based on my experience. You know, 15 years as a state regulator I just -- you know, I have investor protection in my DNA, I guess by now. But in all those years I would hear, you know, a couple of times a year about angel events that were happening. And it just never really raised any kind of alarm to me.

And in thinking about why that is, I think it's fundamentally because these are events that are investor-driven. It's the investors that are getting together and inviting issuers in. And it's the investors that decide who comes, who makes the pitches, who gets to actually attend the event. Sometimes there are universities that sponsor them or government -- you know, economic development agency or that type of thing. But it's really not the issuer or issuers that are getting together to organize these events and saying, "Let's go out and find a bunch of investors."

So to me it seems like -- you know, to basically say that these events are a general solicitation by the issuer -- you know, that might be something that we want to look at as a potential solution.

MR. HIGGINS: You know, on that point I'd just point out -- and without endorsing this -- but almost 20 years ago the division issued a letter to Michigan Growth Capital Symposium on this very point. I mean they were describing a classic demo day, and they actually said -- I mean the division -- in their view the purpose of 502(c) -- that the symposium involves no general solicitation or general advertising.

Now I'm not endorsing -- I think we ought to take a look at that right now. But it has -- it lays out some principles on when these types of events shouldn't be considered general solicitations that I think would be worth everybody taking a look at.

MR. YADLEY: Yeah, I think that's true. And although I'm no longer a member of the staff, probably on behalf of the staff representatives here, remember that Keith, Mauri, and others are speaking for themselves individually, not on behalf of the Commission or the staff.

Universities -- that's a great reference Keith. And for the reason that Rick said, many universities have incubators or, through their business schools or engineering schools have programs where they act as really start-up supported endeavors, often by students. And most of these are not direct pitches for money, certainly not contemporaneous. They're more an explanation of a business plan. So I think that's true.

The other thread running through what is general solicitation is a couple of other words that aren't defined but widely disseminated and, you know, how much social media is used in context. So I think those are fertile fields for further discussion to sort of decide what's here. And not to get too deep into the proposals, but that would certainly be a distinction to be made there in terms of what materials the SEC might want to see during the temporary period.

MR. HIGGINS: Troy, if you have a client that wants to go to a demo day, any particular advice that you give to him or her when they --

MR. FOSTER: Well, in the absence of, you know, sort of additional guidance at this point, I think our view is you really need to think about these the same way you think about, you know, sort of being in the pre-filing quiet period, okay? So you'd want to -- you know, you can sort of talk about the company generally, but you want to try to refrain from doing anything that would -- that could be viewed as an illegal offer. And so in that context you wouldn't want to be talking about financials. You wouldn't want to be talking about your round.

You would want to -- you know, you could talk to people about the company and invite them to contact you to get more information. But really, you know, limit it until you kind of get the parameters of, you know, what a rule is and try to just avoid a general solicitation in that context.

MR. MIRABILE: So I think that's great advice. I bet John gives similar -- I'm guessing -- advice. The problem is -- and I don't want to split hairs here. But at least some headlines -- is it convertible debt or is it a price round; when is it going to close; roughly how much you're raising -- I mean these are just fundamental elements of a pitch discussion. There's, you know, who's the team and what's the product, but on some level you're there because there's an opportunity to invest.

MR. FOSTER: Sure.

MR. MIRABILE: And even if there's basic headlines, there's got to be some discussion of what's going on or it's -- why not just go back to the lab and keep working.

MR. FOSTER: No, no. And that is exactly the client's response --

MR. MIRABILE: Yeah, I bet.

MR. FOSTER: -- you know, in these discussions, right, is, you know, for it to be effective we need to be able to at least lay out the parameters of what the offering is. But, you know, the truth is, if you really want to stay -- and our client base can get a little aggressive around these things. So, you know, we offer advice, but we're not in a position of mandating necessarily what they do. So you provide the advice that is the conservative advice, but, you know, they have to make a risk assessment of, you know, where they're spending their time and what they want to get out of the event.

MR. CHORY: I might also add that Keith seemed pretty flexible on it.

MR. HIGGINS: That's John's view. It doesn't represent the view of anybody else in the room, I think. No. I mean we'd love to hear ways -- you know, the -- in the public -- when the securities offering forum was done back in the middle of the last decade, it dealt with similar communications issues of what's not an offer and the regular release -- you know, business information.

Now it also has the safe harbor for any communication more than 30 days before the filing of a registration statement that doesn't specifically mention an offering isn't considered to be an offer. That may be a bridge too far in the general solicitation. But I think those are the things that people need to be thinking creatively about and offering us some insights on what might work because I don't think -- I think it's pretty clear that the Commission doesn't want to shut down demo days and doesn't -- recognizes the importance of investors being able to communicate with --

MR. MIRABILE: So can you get Troy on board with less conservative advice?

MR. YADLEY: Well, sort of at the other end --

MR. MIRABILE: It's lonely there with no companies.

MR. YADLEY: Yeah. At the other end of the spectrum where you're not widely disseminating via social media but you're simply -- you have friends and family rounds, so you have couple of dozen, 50 investors, all people you know, and now you're raising money again, and they know other people, individual basis, being introduced to the issuer. I think lawyers traditionally -- you know, friends of friends of friends was something that we could perhaps acknowledge was going on but wasn't something that we could sanction, certainly something that would be a block to issuing an opinion.

MR. MIRABILE: I just -- Keith, I guess I would just make the point that to me there may be a fraud issue in the situation where there's an unscrupulous broker who has -- makes compensation for driving a transaction. I completely am sympathetic with that. But the vast majority of those deals in those charts I put up are individuals investing their own money where there's no middle man. The event is a free event. They pass the hat for the cookies and coffee. The companies come. It might be the only meal they eat that day.

And it's a conversation around the opportunity and the team. And there's no -- there's no broker. There's no opportunity for fraud. In fact, the investors get so many of these kinds of invitations that they're just trying to find out which of these events is going to have the best signal to noise ratio and be the best use of their time.

So for me in the direct investment context, it feels like the companies ought to have a little bit of latitude when they're invited to come to a -- win the right to come to a demo or a pitch day. They ought to be able to say with comfort and the backing of their counsel, "Hey, you know, this is a million-dollar convertible debt deal or a price round, and we're closing in December.”

MR. HIGGINS: One thing -- observation I'd like to offer is, you know, I've only been in this job for almost five months now, so -- having spent 30 years in private practice. And my practice, you know, involved generally representing companies that wanted to do the right thing, you know, didn't always want to do everything the SEC expected or, you know, wanted them to do. But they basically wanted to do the right thing and stay on the right side of the law.

One of the things I've learned since coming to the Commission is that doesn't -- that's not the entire universe out there. There is actually a lot of people out there that don't want to do the right thing and are out -- there's a lot of fraudsters out.

And we just need to keep in mind that any advice we give generally has to apply across all -- you know, the entire spectrum. And what might be perfectly sensible advice to an angel group may be very -- may have problematic aspects to it when you've got somebody bent on affinity fraud or something that's --

MR. MIRABILE: Sure.

MR. HIGGINS: So I think we just need to keep that in mind as we do it.

MR. MIRABILE: Sure. I --

MR. HIGGINS: Should we move on? John?

MR. YADLEY: Yeah. I was going to say that is a perfect segue to maybe John. For those clients that are interested in doing it right and are coming to see a lawyer -- maybe you could comment on how you're discussing the new rules with your clients and does 506(b) now make more sense for some of them. And what do you tell them about 506(c)?

MR. CHORY: So, great. Thank you. So my practice, just so you understand my perspective, is I almost exclusively represent entrepreneurs and the companies that they built. So I don't spend a lot of time or any time really representing investors, angels, venture capitalists. I just truly focus on the companies. Some of these are two or three people just getting started. Many of them are. And others are large companies with over a billion in revenue and thousands of employees.

But one thing that they all have in common at some point in their life -- and for some of them it's almost throughout their life -- is their -- the need to raise money. They're constantly looking to raise money. At least when they're interacting with me, that's one of the topics that they want to discuss -- is raising money, how to do it.

And when we give advice to our clients, the advice -- the lens that we look through is, by taking this next step, by doing this next transaction -- is that somehow going to hamper your ability to grow into a billion-dollar company?

So another thing that my clients have in common is they all want to be a big company. They all want to become Akamai or Zipcar or something like that. So -- I look at the lens -- I'm okay with change, right. I'm happy with change. But all I care about is does this next step help or hurt them grow to be a large company. That's all I care about. And I care about complying with the law as well.

MR. MIRABILE: That went without saying.

MR. CHORY: Yeah. So, you know, they raise -- they raise money all sorts of ways. Sometimes it's self-funding. Sometimes they borrow money. But most of the time it's - they're selling their stock. They're selling their securities. So we're having conversations about these general solicitation rules, and there are -- there are pros and cons to them, and I usually go through the pros and cons, again, with the lens of what's the best thing for this company to do to continue to move forward and become a very large, successful company.

So the pros are -- I'll start with the pros as I go through it. But occasionally we see a news -- you know, we're working with our clients. They're out their raising money, and we see -- some of them are out there trying to get buzz and trying to get press. And we see an article in a journal, a business journal or something, and it features the entrepreneurs and their company and the products and how cool they are. And then at the end it says something like, "Oh, and they're in the middle of raising $5 million in their Series B round."

And that -- you know, we get a sickening feeling in our stomach. But in the new general solicitation rules, if it's one of those financings, that would be okay. So that's -- that is a pro. You're out there. You're talking about it. You're free to talk about it. You're free to leverage all your social media. And people spend a lot of time with their Facebook pages and getting all the people to like them, and they start communicating with them. They have all their Twitter followers.

So a general solicitation allows you to take advantage of that, allows you to find a lot more investors a lot more quickly, right? It's obvious. But a lot of these financings prior to general solicitation take – a fast one is three months. Typical is six to nine months. And that's six to nine months when you're not building the product; you're not creating jobs; you're not moving your technology forward. You're out there going to meeting after meeting and arranging the meetings, going to the meetings, and then sort of managing that process. So general solicitation could really shorten that cycle.

The other things is -- is you could potentially get higher valuation on the financing. You could potentially get much better terms. So if you have a broad general solicitation and you find a bunch of accredited investors and they're each putting in 50,000 or 40,000 or 100,000, they may not be as invested in spending the time and energy negotiating the terms, right?

If you -- if the company has that certain buzz about it and that certain sort of feel and they're ready to put the money in, they may just take what's being offered. So potentially you can get better terms, and the terms are very key in structuring these offerings. In fact, as a corporate lawyer I spent probably most of the time on worrying about what the terms are and how those terms are going to influence the future growth of the company, the ability of the company to continue to grow, continue to raise more money.

But I think that we will see some companies raise money faster on better terms and higher valuations than they would without general solicitation. So in some cases that's a good thing. Some cases it's not a good thing. And I'm sure there are going to be many others that we'll see and we'll learn about as this thing -- as it develops, but time will tell.

So on the negatives -- so I -- my list for the negatives was a little bit longer. Again, it really is I have a very narrow perspective. But when they come to -- when they come to me and they say, "Let's talk about raising money" -- "what do you need it for? How much do you want? How much do you think you need? How long is that going to last? How are you going to use it?"

And I -- one thing I tell them all is you need to really manage the process. You have to control the process. You can't let the investors control it. You can't let the angels control it. You can't let your friends control it or your advisors. You as the entrepreneur have to control the process. You have to carefully manage the process. And I worry with a general solicitation you'll lose a little bit of that ability to control the process.

I frequently tell them that overexposure is a bad thing. So if I'm an angel investor or -- and I'm a top tier VC and I hear about this company on day one and then six weeks later I hear again from another source that they're looking to raise money and then I hear again and then I read about it in the paper, I think there's a stigma there. I think as an investor I'm going to say, "Wow, what's wrong with this company? Why is it having such a hard time raising money? How many people are out there flogging this thing?" So I think you need to be very careful as a company raising money because if you're overexposed, I think that takes a little bit of bloom off the rose or something like that. And I think you have to carefully manage that process. And you do lose the ability, in my view, if a lot of people are talking about you.

So if you're going to do a general solicitation, make it quick. You do not want to be hanging around for a very long time.

And I think there are some -- and I've heard some of the VCs say this -- that they're -- you know, they don't want to be involved in a company that has a bunch of sort of unknown investors that were sort of collected from the blogosphere or the Twittersphere because there's -- there are ups an downs. You know, you really need to know who your investor is.

Due diligence for investors -- it's a two-way street. The VCs and the angels are doing a lot of due diligence on the company. And I tell my clients, "You should really do a lot of due diligence on the people that you're about to take money from." I think it's a little harder to do that due diligence in a general solicitation, but why is that important? Because it's not always -- you know, incorporate the company and 13 months later you're public. That rarely happens. And there's ups and downs, and it's really good to have investors that are going to -- that you know, that sort of understand what the mission is, and you can rely on them.

And when you're an early stage company and you have a great product and GE really wants to use that product and GE wants to invest in that product and take you on as a service provider, one of the things -- and they'll do it. They'll take a chance with a startup.

But one of the things they always look at is who are your investors. And if your investors are two or three of the top tier VCs, they're more willing to take a chance on that new technology. They're more willing to -- because they think that a year from now or two years from now you'll still be there. You'll still be supporting this product. You'll still be improving it. And in the end it will be a good thing for GE or any other -- any other large company.

I suspect that they would have a different view if there was a handful of people who put a little bit of money in and that weren't really committed, actively involved, sitting at the board meetings and actively involved with the business.

And another thing, stealth is important. I used to be an intelligence officer, so I believe in secrets. So stealth is very, very important in some cases for some companies. So it creates a little bit of a mystery. And you just lose that with any type of a general solicitation.

So I think -- you know, a couple of the other things. There's a lot of work in verifying who the accredited investors are. I'd hate to have to, you know, file something -- a lot of people are going to all of a sudden find themselves in a general solicitation, and then they're going to say, "I think we're in general solicitation." And I'll -- I don't want to have to say, "Did you file that Form D 15 days ago." So that, I think, could be a problem.

MR. HIGGINS: Hey, John, what about the problem where, if you do a general solicitation and you have to sell all to accredited investors and you've got some friends and family, some, you know, folks that you want to include in the financing? Do the entrepreneurs think about that, or is that a point that you raise with them?

MR. CHORY: Well, we often tell them they can't take money from accredited investors period. We're very --

MR. HIGGINS: From non-accredited investors?

MR. CHORY: Right, from non-accredited investors. We're very strict about that. But, you know, occasionally when their first name is Uncle or Aunt, we -

- you kind of have to look the other way. But we wouldn't be able to do it in a general solicitation if they're not accredited.

You know, and as an entrepreneur, when you're doing a friends and family round and you decide you're going to be in general solicitation, you may not want to ask your college roommate's dad to turn over the W-2s or the -- so you may avoid investors that you might otherwise had -- would have been able to go to because, I think as Chris pointed out, it's a lot easier to get an accredited investor to say, "Yes, I'm accredited, and I'll fill out a self-certification." But you're going to lose some of those people.

But -- so I -- not a very broad perspective. Again, like I told you, it's just a perspective of clients trying to raise money, how they should think about this, and is it going to hurt them or help them going forward.

MR. HIGGINS: Do you have any clients that are generally soliciting on purpose?

MR. CHORY: I'm glad you added on purpose. No, I don't think so. No. No.

MR. YADLEY: Maybe this is a good time to move to Troy to continue this discussion but with more of a focus on revised documents that -- or documentation that you may be advising clients to create new due diligence practices now that we have the bad actor disqualifications and things like that.

MR. FOSTER: Sure. So, you know, my perspective will end up being, I think, pretty similar to John's. Thank you. I'm at Wilson Sonsini, which is based in Palo Alto. And you can tell because I'm the only one not wearing a tie. So that is our West Coast focus there.

You know, I've got a set of slides, which I will blow through pretty quickly. I'll skip the infomercial about the firm and about me, and I'll just go to the key points that, you know, I'd like to hit on here.

You know, the -- I'm going to focus pretty narrowly on the general solicitation and bad actor rulemaking and how those impact our sort of, you know, day-to-day documentation and diligence practices. The one other thing that I'll hit on is just where I think the trading platforms, the -- I know Annemarie's here from SecondMarket. But the SecondMarkets and the SharesPost -- where I think they can play a role in helping out to, you know, make the transition go a little bit smoother here.

So, again, in 506(c) the safe harbors around the reasonable steps to verify -- you know, here the issues that I wanted to hit on -- we've updated our purchaser reps and the investor suitability questionnaire that we deliver in the transactions. That's not going to be, I think sufficient in order to get over the hump. So the safe harbor verification methods are useful. I think the challenge that, you know, has been identified is that folks are going to be reluctant to turn over tax returns and sort of things like that.

And so for our clients to find a middle ground that's not a check the box but is something a little bit less than the current safe harbors will end up being pretty useful.

I think where the rubber meets the road for us is the issuance of legal opinions because what you'll find is, if you are advising a client, you can say -- saying what's reasonable -- you know, you've got a little bit of flexibility there. But if you're going to put your firm's name on the line around a compliance issue, you're going to need to fall into a recognized safe harbor. And that, I think, is going to be one of the key pivot points on this going forward.

You know, as a practical matter, we would, I think, like to see some more liberal safe harbors for sort of smaller transactions. And I think that would end up being a useful thing for, I think, maybe the angel community as well because you see a lot of the deals in Chris' presentation were of sort of a smaller category. So sub million-dollar deals -- allowing those to do general solicitation and get a little bit more flexibility there would be a helpful thing.

And the other thing that we are actually in the process of formulating are a verification sheet for trading platforms and for the trading platforms to be able to be the recipient of the verification information and then provide that through a certification to the issuers. And the thinking there is that, you know, the college roommate's dad would maybe be reluctant to turn over that information to an entrepreneur, but to have a trading platform to be a recognized sort of third party to hold that information and keep it safe and just provide a simple certification to the issuer would be a tactic that would potentially make the certification process easier.

A couple more sort of just diligence and documentation points -- you know, we're -- the practice here is evolving, and the request for safe harbor documentation -- we are receiving those and holding them. I think that the backup certifications for management in the backup certificate to the legal opinion is a place where we're seeing some amount of negotiation. And really what it comes down to is who's going to ultimately take the risk of being wrong.

And where the investor counsel, I think, has really been pushing us in the few deals that we've seen come through -- they've wanted to see the firm not rely on a simple backup certificate to the company, that the company has sort of performed the verification, and they're looking to the firm to provide some more independent sort of verification around the investors and their certification. And that's another place where I think the -- having the trading platforms participate could be useful.

I'm going to skip now to the bad actor provisions.

MR. MIRABILE: Can we -- can I just stop quickly before you jump there on the -- that commotion was me having a heart attack when I heard that one of the leading, if not the leading firms in Silicon Valley, is going to require -- is going to advise their clients to require safe harbors from their investors. That just strikes me as putting you in a position to put your clients in a bad spot because the investors aren't going to want to do it, and you're going to need it for the opinion quite reasonably --

MR. FOSTER: Right.

MR. MIRABILE: -- I think given the situation we're in. And that puts our startups in a really tough spot because with the -- I mean 38 million passwords at Adobe? I mean the identity theft risks out there right now -- there's no way accredited investors are going to be Xeroxing their tax returns and sending them all around. It's just not going to happen.

MR. FOSTER: Yeah. No, completely agree, and that's where, again, just for -- just in terms of a clearing house or a sort of a third party that is, you know, a regulated third party -- because the trading platforms are regulated -- to have them be the sort of holders of the information for purposes of being able to certify independently and to have them be responsible for protecting against identity theft and those issues.

MR. MIRABILE: Investors are just not going to do (c) deals if they have to pay third parties to hold their confidential information. It's just going to be a -- it's going to be the end of the (c) deals. It's going to -- everyone's going to have to do (b).

MR. FOSTER: Yeah, the economic issues is -- I mean it's not necessarily -- you know, I'll let Annemarie sort of speak to what the trading platforms would -- whether they would charge for that. But there's an argument that -- you know, that that's not a cost that the investor ought to bear and that that could be something that the companies pay for.

MR. HIGGINS: Of course, the company's getting the money from the investors, so it's a little --

MR. FOSTER: Yeah.

MR. HIGGINS: But just one --

MR. FOSTER: We have --

MR. HIGGINS: One question I have is do angels not have brokerage accounts because when they open a brokerage account, there's anti-money laundering requirements. Brokers need to know their customer. They need to get this information. Now maybe they don't have brokerage accounts, but my guess is that there's -- there are things that are done.

MR. MIRABILE: There are --

MR. HIGGINS: And on the PII information, nothing precludes an investor from taking a tax return, striking out -- you know, blacking out the social security number. I don't think anybody believes that --

MR. MIRABILE: In today's electronic world though that's really hard to suppress. And I mean I have seen signature pages collected by -- drafted and circulated by law firms on deals where every investor is expected to put their social security right on the signature page, which is crazy. And then they get sent around everywhere.

MR. FOSTER: So we don't do that.

MR. MIRABILE: I'm sure you don't. I'm sure you don't. Yeah.

MR. FOSTER: I just want it for the record.

MR. MIRABILE: Not a great practice if any of you are practicing lawyers.

MR. FOSTER: So on the bad actor provision, I mean I -- you know, these are significant. We did a little survey and noted about 2,500 bad actors in SEC-related matters just in the four years from 2007 to 2011. You know, as a diligence matter, the bad actor issues -- you really need to vet that in advance of the financing. But in practice that's tough.

We don't -- you know, we don't often get clients approaching us saying they want to do a 506 deal. More often what we get is, you know, "we're going to -- we need to close by the end of the week to make payroll or -- or in fact, these guys have wired the money. We need you to paper it." And, you know, in that context the -- you know, it's -- this is sort of a brand new world, right, for us, because this is not -- these are not issues that we, as lawyers have had to -- at least in our practice have had to focus on before.

And, you know, it goes back -- really when you're talking about the -- applying to company management, you've really got to look back into the hiring, appointment of directors, and the investors that the company is soliciting.

So, you know, our -- the inquiry that we have is whether there are procedures that a company could undertake. And, you know, they have to be cost-effective procedures for the early stage clients in order for it to work to be able to satisfy the reasonable standard of care to avoid dealing with bad actors. And, you know, some of the suggestions that we make on that front are potentially providing an exemption where a company has sort of gone through a background check with an entity that hasn't yielded bad actor results. And, again, you know, to tie this into the platforms a little bit, to maybe allow for a company to rely on a platform to be able to, you know, have a vetting process and to give that person the stamp of approval.

And I think that dovetails a little bit with the proposal in Chris' presentation about having the -- you know, having the angel groups be able to sort of perform that service as well.

And then I know that there's been sort of a maybe recent negative experience with government-run web sites, but there is a suggestion that you might, you know, keep a database of bad actors that have come through the SEC process for ease of companies being able to sort of search and identify those folks and eliminate them early in the process.

Okay. So just a few more things that we are doing in practice. We are -- there are now, in addition to the ISQs, a sort of a, you know, ancillary bad actor questionnaire -- although I'm sure we don't call it that -- that goes out to financing participants to be able to try to, you know, vet these issues early in the process. There are representations and warranties that go into the transaction documents now and the stock purchase agreement dealing with the -- you know, trying to elicit disclosure around bad actors so that you can, you know, try to vet that before closing, if possible.

You know, notice obligations you put into documents in the covenant section. If someone becomes a bad actor, you know, it's challenging, right, because you're relying on self-reporting for someone who's obviously demonstrated that compliance is not their highest priority. And so that's not necessarily -- you know, but I think it is a reasonable step to take. And then, you know, there are transfer restrictions to bad actors. And those, I think, are -- you know, I'll run through those first because I think those are pretty non-controversial and easy to implement.

There are some more controversial provisions, which, you know, are under consideration. You know, the notion of removing rights from an investor to the extent they become a bad actor or that you find out, you know, that they're a bad actor so that they, you know, would be unable to exercise rights of first offer to accumulate additional stock and things like that.

And, you know, there's also -- one of the key things we do in our practice is provide for vesting of shares that are in the hands of management, you know, kind of over time. It's a part of the -- part of the sort of Silicon Valley standard set of rights that we put in place. There's a thought that you could potentially put that onto investor shares as well as it relates to bad actor type activities. That's going to be incredibly difficult to implement and would not -- you know, it's just hard to see how that would work in practice.

So I think I'll then skip to just -- my last slide will be on the secondary markets. You know, the current rulemaking has been focused, rightfully so, on enhancing the clarity around primary issuances. We'd encourage the Commission to think about developing, you know, rules to help the private secondary markets, which, you know, sort of serve as an on ramp to the public markets. And the thoughts -- one suggestion there is around the Rule 144 amendments to make secondary trades easier and to help facilitate that.

You know, I think, again, the trading markets, in my view, have a role going forward. They can sort of help, I think a lot of the -- help bridge the gap on a lot of the topics that we've been talking about. And so, you know, providing a little bit of guidance to get people comfortable around using those platforms more generally would be helpful.

MR. YADLEY: Great. Thanks, Troy.

Rick, maybe you can talk about some of the enforcement concerns of the states and reaction to the proposals to amend Form D, and I know that NASAA also has a proposed multi-state review process for Reg A+ offerings when they come. And if you could maybe touch on that as well, that would be interesting.

MR. FLEMING: Sure. I'll -- and I'll try to be quick because I know we've had a lot of questions turned in, and I want to have some time for discussion.

You know, as far as our regulatory concerns, obviously fraud is always a concern. Private offerings are always at the top of the list of sources of complaints that are made to state regulators. They're always at the top of the list of our enforcement actions. And, you know, I think it's fairly apparent that, when you allow issuers to go out and solicit strangers via general solicitation, that's just going to get worse, not better.

So that is an issue. But our concerns really are much broader than just fraud. I think there are a couple of things about private offerings that we could probably all agree on. One is that they're very risky. Even VC deals -- the majority of VC deals lose money. So, of course, the trick is to pick enough big winners to balance out a bunch of small losers. But that only works if you have pretty deep pockets. And so I think, you know, we have some concern about the accredited investor definition and it being 30 years old, that type of thing.

But the second thing -- the second kind of fact, I guess, at least as far as we can gather from what's been discussed earlier is I think most of the better deals are going to be done through 506(b), which means that it'll be sort of the leftovers that go through 506(c) and -- which will make that marketplace even more risky.

And so I think it was important. One of the most important things in Title II was that Congress required verification of accredited investor status. And so that's something that we -- you know, from our perspective we don't want to see that watered down. I know it may be difficult to comply with, but there are things that we even advocated for, such as allowing third party verification and things like that.

But I think the point that I want to make is that there is a reason for that. There are legitimate investor protection concerns, and so while we're aware of some of the complications that that creates, just, you know, we try to keep that in balance.

As far as the proposed rules, the one thing that we are really -- have really emphasized that would be helpful to us is to have an advanced filing of Form D. And I know that's caused a lot of consternation. And we're not necessarily asking for it to be 15 days in advance, but to us it seems that, if an issuer is getting ready to go out and do an advertising program, that it's not too difficult to file a Form D before you go out and do that.

And, you know, if you -- let me give you a little background about why that's important for state regulators. One of the things that we do is that we go out and do investor education seminars. You know, we go to the senior citizen centers and the various community groups around our states. And the thing that we always tell people is to call our office to check out an investment before you decide to invest. And so we get these calls, you know. Grandma will call up and say, "Hey, this nice young man from Boca Raton has just called and has this great investment opportunity. What can you tell me about it?"

Well, in the old days under old 506 it was pretty easy. We'd get on our computer, look it up, unregistered offering. And so we'd ask, you know, Grandma, "Did you have any kind of pre-existing relationship with this person? Is he calling from a brokerage firm that you're a customer of, something like that?" "No." "Well, okay. It looks pretty likely that that's an unregistered illegal offering, so you might want to really think twice about whether to invest in that or at least ask a lot more questions before you invest."

Okay. So now fast-forward to the new 506(c) regime. And now when we get those calls, we look it up. It's unregistered, but the next step of the analysis is to determine whether it might qualify for an exemption. And we can't determine that if we don't have some sort of requirement to file a Form D or whatever because now there's no ban on general solicitation. That was always our key thing that we could look to to decide pretty easily is this somebody that's at least making an attempt to comply with 506, or is this somebody that's not apparently concerned about it at all?

So to -- since we no longer have general solicitation, to us it would be very useful to have a Form D filing requirement in advance of general advertising so that when we get those calls, we could look it up. We don't have to call the issuer and ask a bunch of questions about their offering to get a sense of whether they're trying to comply with the law.

MR. MIRABILE: So can I make two comments? Rick's comments were excellent. I think those are very legitimate issues. But in one case I want to highlight a distinction you made, and in another case I want to prescribe a different remedy to a problem I agree is real.

MR. FLEMING: Okay.

MR. MIRABILE: The first distinction is just that the person in the nursing home, who undoubtedly is a regulatory problem and a risk and a public policy issue, is a middle man, a paid broker who gets transactional benefit from pushing a transaction. And I think the perspective on a lot of the people in the early stage investing community is they're sort of being swept up in a regulatory net that doesn't really apply to their kinds of activity.

So trying to figure out how to make a distinction -- it's unlikely that any of John's clients are going to go to the nursing home. They're going to go -- or Troy's. They're going to go to the pitch day instead --

MR. FLEMING: Right.

MR. MIRABILE: -- because those are direct issuers. So that's one distinction I just want to throw out there.

MR. FLEMING: Well I would say that -- though that our enforcement cases are not necessarily focused on the broker-dealer or the intermediary. They're often against the issuer itself.

MR. MIRABILE: An unscrupulous --

MR. FLEMING: Yeah.

MR. MIRABILE: -- selling silver mine stock or something. But in any event there's that distinction. And then on this issue of the accredited investor, you know, the solution you proposed is -- I would argue is the wrong solution. The problem was legitimate. But it's -- bringing the standards up and precluding more people from activity is not the right remedy in my view. The right remedy, if you're concerned about that, was hinted at in your own comments, which is "these are unbelievably risky and diversification is very important." So to the extent you want to look at that issue, lower the cap or put a cap on how much a person can invest. Don't push the standard out.

So to the extent someone has a more modest income level or wealth level, put a limit on the size of a check they can write to any one issuer. Don't disqualify 60 percent of the people forming capital in our economy.

MR. FLEMING: Yeah. I think concentration limits like that are kind of baked into some of the security -- the state-level blue sky laws. So that's an interesting idea. And I think that, you know, as we go through the analysis of a new accredited investor definition, I think that's a -- you know, something to give some consideration to is whether we could build in some concentration limits and maybe swerve over into some sophistication element of this definition as opposed to just asset-based.

MR. MIRABILE: Yeah. I mean -- yeah --

MR. YADLEY: Rick, another thing -- and I think you are looking at issuers, who now that they can generally solicit, might blast email all kinds of people. And why not because you can figure out if they're accredited.

I mean part of the education message should be "if you receive by email or in the mail what's clearly a mass mailing, you should ask for" and then talk about the disclosure requirements and that sort of thing. It seems to me that there will be some, but not most of the issuers, who are simply using the internet to find investors -- they're not going to have a bunch of people lined up and then sell to them all on the same day. It's going to be a rolling sale.

So the 15-day advance period -- that's only 15 days, and it seems that the states would be able to carry out their regulatory functions if the filing were, as it is today, 15 days after the first sale, or at worst, at the time of the first sale. So -- because on the other side, for an issuer having to make this advance filing, there's the publicity aspect that John talked about. There's just the decision-making that goes into are you going to use general solicitation or not and then the foot fault that's been mentioned by a number of speakers, that if you inadvertently use general solicitation, you're 15 days too late at that point.

MR. FLEMING: Yeah. And I think for our purposes the filing wouldn't necessarily have to be done 15 days before the advertising as long as it was, you know, just before or simultaneous, it would satisfy our concern.

I better wrap this up because I know we have questions. And I want to talk just briefly about Regulation A+. I know that's beyond the topic for today, but that's the next thing on the hit parade -- it seems like -- under the Jobs Act. So I wanted to give you a little bit of information about what's going on with the states.

Of course, under Regulation A+ you'll be able to do $50 million deals. But unless they're sold to qualified purchasers as defined by the SEC or are listed on an exchange, they will be subject to state review.

So what we're working on is a multi-state coordinated review process to make the filing process simple. Basically you indicate what states that you want to qualify the offering in. It gets distributed to those states. We pick one or two lead examiners from amongst the states to do -- to really handle the review of the application. There would be a lead disclosure examiner picked from one of the disclosure states and a lead merit examiner if you file in a merit state.

Okay. So at most, from the front side the issuer would be dealing with one or two state-level examiners. Now on the back end, you know, that -- those examiners would be communicating with the other states where you filed your application. But everything would be funneled through those lead states so that you're working with just one or two examiners and not getting a bunch of different comment letters from different states that are -- you know, duplicative or perhaps even contradictory.

So we're -- you know, as far as the process, we're trying to make it simple and efficient. But in addition to that, we're also taking a look at the substantive requirements that we apply to those types of offerings. And some of our longstanding policies as far as, you know, the conditions that you had to meet to get registered -- we're scaling some of those back. And we could really use your input as far as looking at those requirements, what may not work in the context of a Reg A offering. And so we would solicit your input about that.

Our proposal is out for public comment through the end of this month, but I think we'd probably allow you a little -- a little wiggle room beyond that. So if this is something that's of any interest to you, please look up our proposal on the NASAA website. That's NASAA.org, or you can just email me, and I'd be happy to send you a copy of it.

MR. YADLEY: Thank you very much. We do have some questions. Let me throw one out for the two lawyers relating to principles-based. There's still some lack of clarity about exactly what principles-based means in this context. And is there a middle ground on accredited certification in a 506(c) offering that your firm might consider utilizing in a principles-based method?

MR. FOSTER: Yeah, sure. So I think the answer -- I'll just answer the last question. I think there is -- again, I think the issue is, you know, when you're -- whether you're requested to issue a legal opinion or not. So if you're -- if you are just advising on the transaction, the principle-based approach makes sense. And you can really -- at least in our case and I'm sure in John's as well -- you look over the -- your firm's body of work around these types of deals, and you can really develop a sense of, you know, is the investor known to you. And in a lot of cases in Silicon Valley they'll be people that we've transacted with before, and that's an easy sort of box to check.

If you're being requested to give a legal opinion though, you're really going to want to have something to anchor that opinion. And in that context the principles-based approach, I think, is going to be a little bit less useful, at least in my view.

MR. YADLEY: What about if an investor is using a professional organization to file a tax return? Could that

-- you know, not a CPA but some of these companies that help file. If that organization certified, would that be something that you might consider under a principles-based approach?

MR. FOSTER: Yeah, definitely. I think that would be -- again, I think that would end up being a pretty helpful thing to build into the safe harbor because, again, I think here -- and Chris can comment on this. But I think there's a -- there will be a reluctance to provide the intimate -- what people consider to be intimate personal information to the, you know, entrepreneurs of a company they're investing in. I think that there will be less reluctance to provide that to an entity who is, you know, sort of -- that doesn't have that relationship with them but is instead simply a service provider.

And so to -- you know, from our perspective, outside of the context of a legal opinion, I think that from a principles-based approach that would actually work today. And if there were some guidance out there, you know, even in the form of a no-action letter, that that would provide, you know, the ability to rely on that for a legal opinion, that that would actually smooth the process quite a bid.

MR. MIRABILE: I'd make one observation that's nuanced, but it's just a -- gives a little insight. Most of the people managing money for a fee think that these early stage deals that Rick referred to are a bad idea and they don't certainly generate any fees even if they are a good idea. And so going to your money manager and saying, "Hey, can I have some more of my funds back to take them elsewhere? And, oh, by the way would you give me a letter as well," is going to result in a grudging fee-based yes -- would be my guess.

MR. YADLEY: Canada, for instance, has an education criteria built into its investor sophistication or accreditation standard. Do you all think that this is something, as the Commission looks the definition of accredited investors, could be utilized, for example, an advanced business degree, a chartered financial analyst certification, being a lawyer?

MR. MIRABILE: I do. The ACA has given detailed thoughts on this. And it's our view that, while using just income as a yardstick for sophistication, a proxy for sophistication, has worked okay for 30 years, we could probably do better. And looking at other criteria or indicia of sophistication would be workable and reasonable and cost-effective and might actually end up with a better rule personally. So I -- and I believe the entire Angel Capital Association would back that enthusiastically.

MR. CHORY: I wouldn't be opposed to it, but I wouldn't want it to just be a bolt onto whatever the rules are. If you could show a smaller net worth but sophistication and still be accredited, that would -- that makes sense to me.

MR. MIRABILE: I think that's a very important point.

MR. YADLEY: There is a question for Rick. You said the majority of complaints and enforcements of the states are private-offering related. Do you know what percentage that is roughly? I mean is it 50 percent?

MR. FLEMING: It's not the majority of the complaints, but it's the highest on the list of various sources of complaints. So I don't know the particular percentage. It's, I'd say, in the neighborhood of 15 or 20 percent if I had to hazard a guess. The number of enforcement actions in the last two years has been 350 roughly involving 506 offerings. Now some of those are against broker dealers for failure to do the due diligence or, you know, lack of suitability. Many of those would be offering frauds.

MR. YADLEY: Great. Thanks. There was a question about Troy's discussion of trading platforms. And the question was, "Why would they even be involved," and I think in some cases they would be. In others you're simply saying these are groups that are establishing themselves and collecting information. But maybe you'd like to elaborate on that.

MR. FOSTER: Yeah, that's right. So there's a spectrum of these platforms and what they do. And sometimes they -- like there's a company called AngelList that does get involved in primary offerings. And then in some cases they -- the SecondMarkets and SharesPost of the world deal mostly with secondary trading. But the reason that I bring them up is that they are already -- they already have a pre-existing relationship with a lot of investors. So SharesPost in particular is a membership organization. And so they've already -- you know, for purposes of being able to verify accreditation, for example, they've already got a lot of the information from the various investors and would, I think, be able to provide that service to the investor community.

MR. YADLEY: Great. Well, I thank all the panelists. I think, Keith and Mauri, is that we out there living with the new rules understand the SEC's desire to understand the impact of the rules and how people are using the exemptions. But we also want to keep in mind that our fundamental interest here is to promote safe capital formation for smaller companies.

And we don't want to run counter to that goal by having too much regulation that's not scaled appropriately or applicable for certain segments such as the angel segment or the universities and so on.

And maybe, Keith, you'd like to close out the panel.

MR. HIGGINS: Really only say thanks for taking the time today. It was a lively discussion. We learned some things, and obviously we got our work cut out for us. The market -- it's still early, still developing, but hopefully, working together, we'll figure out ways to eliminate some of the friction in the system. Thanks. (Applause.)

MS. OSHEROFF: We'll be taking a 20-minute break. And so the next panel will begin as scheduled at 11:05.

Panel Discussion: Crystal ball: Now that you raised the money, what's next for the company and the markets?

MR. HIGGINS: Why don't we go ahead and get started if we can take our seats and we'll get the second panel under way.

Before we start with the next panel though, I'd like to -- it's my pleasure to welcome Commissioner Kara Stein, who is joining us. Commissioner Stein joined the Commission this past summer as a Commissioner -- she's even more recent than I am -- after serving as Legal

Counsel and Senior Policy Advisor to Senator Jack Reed and the Staff Director of the Senate Banking Committee's Subcommittee on Securities, Insurance, and Investment. So she has a distinguished career on Capitol Hill. But in addition to that, she's also served tours of duty in the private sector and in academia. And we're delighted to have you here this morning, and we look forward to having you participate if you wish.

COMMISSIONER STEIN: Thank you.

MR. HIGGINS: Anyway, our next panel is quite exciting. We're happy to bring a group of distinguished practitioners again together to talk about the new world that's been created by the Jobs Act.

You know, the regulatory landscape, as we talked about on the last panel, has changed already for private companies. And with our rulemaking proposals both that are out now and soon to be underway, there'll be even more change. We have obviously the new exemption for Section 5 -- from Section 5 for crowdfunding offerings. And we had that proposal out in the last month. We also, under the Jobs Act Title IV, have been directed to create a new exemption similar to Regulation A for offerings of up to $50 million over a 12-month period.

Significantly, the Jobs Act increased the 12(g) threshold for Exchange Act reporting from 500 holders to 2,000 holders of record of which no more than 500 can be non-accredited investors. And that's setting aside savings and loan companies.

The result of all these changes is that the old paradigm of the smaller company conducting private offerings and then conducting a registered offering if it wants to ultimately raise capital and become public and then becoming a reporting company is really going to evolve into something perhaps entirely new. Companies can now generally solicit the public to purchase securities and raise an unlimited amount under 506(c) and potentially when Reg A+ comes in raise up to $50 million every year. Very soon companies, you know, will have Reg A+. They'll have the crowdfunding exemptions, again, without subjecting themselves to our regime of Exchange Act reporting.

So today we'll be discussing the emergence of this world and the implications, the opportunities and challenges it creates for smaller companies and for investors. What will the new world look like from the perspective both of issuers and investors? What -- will issuers have the same incentives to conduct registered offerings given the new alternatives they have available to them to raise capital? What level of liquidities will investors come to expect when they purchase securities? Will there be trading markets for these securities, and, if so, what will they look like? How will they be different than the markets people have come to know and expect?

For companies to successfully raise funds from the public through one of these new exemptions, what are the issues that they're going to have to be considering in doing these deals? They'll now have a large number of shareholders. But without the current Exchange Act reporting system what will the obligations of those companies be to their shareholders, including what disclosures will they be making to their new owners? What type of shareholders and governance rights would investors expect or even demand from companies in this new world?

So these are all very interesting questions, cutting edge questions. They are questions that the group here and you all in the audience and throughout the world on the webcast will be helping us think about ways that things will be different.

I'm delighted to be joined today by Dave Lynn as co-moderator of the panel. Dave is a partner at Morrison and Foerster here in Washington where he advises clients in the corporate and securities sphere. Prior to joining Morrison, David was Chief Counsel in the Division of Corporation Finance at the SEC.

And I'm glad you're here with us today. So Dave, why don't you introduce the panelists, and we'll get the discussion started.

MR. LYNN: Great. Thank you very much, Keith. I'm very pleased to be here, and I'm very pleased to have a chance to interact with this great panel, which really will delve into many of the issues that Keith described.

I'm pleased very much to be joined by Kim Wales, who is the founder and CEO of Wales Capital, which is an advisory and consulting service really focused on companies utilizing research and analytics and product development, as well as a founder of CrowdBureau, which is a technology company that's focused on research and ratings and investor relations efforts in the private placement market.

Prior to enactment of the Jobs Act, Kim had been an international banking consultant and had also served as CEO of a fund administrator. And she's been very involved in the crowdfunding efforts, as she will discuss in the course of her presentation.

Douglass Ellenoff is joining us today. And he's a member of Ellenoff Grossman & Schole since its founding back in 1992. He's a corporate and securities lawyer. Many of you probably have talked to or been familiar with. He represents issuers in lots of business transactions and corporate financings and public companies in connection with offerings of all type, including the pipes market, registered directs, reverse mergers, crowdfunding as well. And he represents broker-dealers and venture capital investors and others in connection with fundraising activities.

Not a week goes by that I'm not on a panel with Annemarie Tierney. And this week we're doing two together. So Annmarie Tierney is General Counsel and Corporate Secretary of SecondMarket. And she has responsibility for the firm's legal and broker-dealer compliance functions. Prior to that she was General Counsel and Corporate Cecretary of NYFIX, which was a NASDAQ-listed public company, as well as Assistant General Counsel for NYSE Euronext. She worked at Skadden Arps and was also a staffer at the Division of Corporation Finance's Office of International Corporate Finance.

And I'm pleased to also introduce Jack Hogoboom, who I had the pleasure of knowing for some time. And he is a partner at Lowenstein Sandler. He founded the group's -- that firm's Specialty Finance

Group. He is the Vice-Chair of the Life Sciences practice there, does M&A, public and private securities offerings, private equity investments, general corporate securities law. And he regularly represents issuers of all shapes and sizes, underwriters and investors in public and private securities offerings.

With that I guess I would like to set the stage on some of the topics that we're going to address here. You know, and I think one of the key things to think about in the context of what the post-Jobs Act landscape looks like -- I'd like to use a word that unfortunately I didn't coin but Professors Don Langevoort and Robert Thompson at Georgetown wrote about, and they call it “publicness,” the “publicness of our offerings and disclosure and capital markets after the Jobs Act.”

You know, I think what they're getting at there is how the line has either moved or become more fuzzy about what is really a public offering and a public disclosure regime as compared to a private offering and a lack of a public disclosure regime, which we have all become accustomed to under the federal securities laws.

And when you think about it, it was really sort of a legislative accident that you had the '33 Act happen first and the '34 Act happen the next year. One very much focused on SEC regulatory authority over public offerings and clearly representing or contemplating that private offerings, offerings that were not public, would be exempt -- and then, you know, periodic reporting regime that was really designed for listed companies, you know, sort of the largest companies.

And that model -- you know, obviously it was in place for about three decades until 1964. After many, many attempts, there was an effort to say, "We really need to look at essentially the over-the-counter market and those companies that by virtue merely of their size of their assets and the number of record holders should be treated like the listed companies and be subject to the periodic reporting regime. And then, shockingly enough, about 50 years went by before we ever revisited those decisions again. And only in the last, you know, decade or so has the topic been coming up again and again is this the right line between when I become a public company having 500 shareholders as it was prior to the Jobs Act and $10 million in assets.

So today now when we look at what the world will look like as all of the proposals that Keith mentioned come into place, it's really sort of a much-enhanced spectrum of financing. And the slide that's up now just kind of tries to represent that graphically. And what I did here was, I think the length of the boxes, basically the -- equal to the amount of hassle it takes to conduct the offering.

MR. HIGGINS: Is it drawn to scale?

MR. LYNN: And as you can see, if we had looked at this box pre-Jobs Act, it would be missing about four or five of these elements. So just having those additional elements is very helpful because it gives companies sort of a longer life cycle, a much more attractive, you know, capital access than they might have had otherwise.

But what comes with it, I think, which is most striking -- and we're going to explore in this panel -- is how we've now blurred the lines between which of these hassles are public offerings and which of these hassles are private offerings and then how much hassle must be put upon the issuer after the offering in terms of communicating with their investors and keeping people up to date as they go forward.

And I think probably what we'll spend the most time talking about is things like the exemption under Title II that's being worked on as well as the exemption under Title IV with respect to Regulation A+ where there you're talking about issuers that will do essentially public offerings that are exempt from registration with prescribed disclosures as the Commission will ultimately determine and then update that information over time through a -- essentially a periodic reporting system that's outside of the Exchange Act and not subject to all of the other requirements.

And so I think, you know, when we look at this -- when we step back and look at this, we see that, you know, there's really going to be a graded approach going forward here, a very much scaled approach depending on the type of offering and the type of issuer in terms of how much disclosure people can expect and will want going forward.

A couple of the other things, I think, just to keep in mind as we talk about these topics is, you know, not only is this a change in the regulatory environment that we're talking about here in terms of what is public and what is publicness and what should we expect in terms of information on an ongoing basis. But it's obviously a huge technological shift in the way in which people share and think about and access information. And so Kim's going to talk about how that's really changed the way that we're looking at things, particularly investments in companies going forward.

You know, I think the other aspect of it is really what -- what is the right balance. And as we talk about crowdfunding, what is the right balance in terms of these sort of quasi-public offerings -- if that's really a correct term -- in terms of how much information the investors should have up front short of a registered offering and then how much information they'll need going forward. And we're going to talk about that. And Doug's going to talk about that in the context of, you know, the crowdfunding proposals.

And then ultimately, you know, as companies have access to these exemptions and can raise capital, you know, how will they deal with their investors going forward, and what sort of considerations do they have in terms of the liquidity that those investors will have going forward. And we'll talk about, you know, how that has changed and rapidly changing as we go forward.

And then Jack will really focus on the topic of, once the company has finally accessed the public markets, the traditional public markets, what considerations do they then have that may tend to make things harder on them once they've gotten to the finish line as it were in terms of actually doing registered offerings and becoming a full-blown '34 Act reporting public company. So with that I will turn it over to Kim.

MS. WALES: Good morning investors, startups who are seeking funding, successful CEOs, who have already obtained capital, and good morning all of you who are helping these companies to achieve their visions through capital formation and job creation.

I'd like to start with a little story. In 2012 a small company made the games industry sit up when it raised $8.6 million Kickstarter to make and launch an Android-based console. Does anyone know what company that is?

(No response.)

MS. WALES: Ouya. Since raising $8.6 million, Ouya has raised another $15 million of funding from VCs. Some might ask how. By collecting information that showed an increase in demand in the product but also while they were servicing their 12,000 developers that registered on their site in order to make games for the console.

What might appear to be an overnight success could have only been achieved by the company disclosing specific company information in an executive summary, harnessing their social capital, and by creating an online campaign. Ouya's open source platform creates a new world of opportunity for established and startup game creators. This equals job creation and capital formation, which could have only been accomplished through crowdfunding.

Thank you to the Commission for inviting me here today. Let me tell you a little bit about what I am doing and why. Prior to the enactment of the Jobs Act, I spent 17 years as a consultant to banks. Some were on Wall Street. After the enactment of the Jobs Act, I started CrowdBureau and Wales Capital because I love working on really hard problems, and I also love learning. But more importantly, I believe that once the Jobs Act succeeds it will change society for the better and our global capital markets.

My company CrowdBureau is the Morningstar for the private placement industry in the style of Yelp. Wales Capital advises companies on the exemptions and on how to implement the Jobs Act. For almost two years as a CFIRA board member, I have worked alongside many of you, advocating, lobbying, and writing many of the letters which were cited 57 times in the proposed final rules from the SEC. I am a CF50 board member and also the formal chair of the CFPA.

The world has changed in four categories, creating a greater need for the Jobs Act, women, Gen Y, the global internet, and mobile devices. Did you know that 51 percent of the world's population is made up of women? As of July 2013, only 4.2 percent women hold CEO roles at Fortune 500 companies. That's 22 women out of 500 companies. Did you know that individuals between the ages of 18 and 37 make up the largest population category the U.S. has ever seen? 86 million strong, it is seven percent larger than the Baby Boom generation, and Generation Y makes up 27 percent of the U.S. population.

The global internet population grew 6.59 percent from 2010 to 2011 and now represents a whopping 2.1 billion people. Mobile devices -- only 40 percent of the population use mobile devices. The first two examples of how the world has changed with respect to women and Gen Y represents a substantial percentage of the financially disenfranchised. In the aftermath of the biggest recession in our lifetime, the financial markets must change.

The integration of the internet with social capital fuels the demand and the supply for crowdfund investing. As the paradigm for capital formation through crowdfunding evolves, I believe there is an emergence of a new asset class and an evolution of intelligence embedded in three principles that we are creating at CrowdBureau through crowd instinct. These principles are social computing, collective intelligence, and deliberative democracy. Here is how.

The data we collect from companies needs to be transformed into relevant information for the entire ecosystem, namely investors, clients, entrepreneurs, and regulators in a digestible manner. Did you know that every day we create 2.5 quintillion bits of data -- so much that 90 percent of the world's data today has been created in the last two years alone?

The first principle for capital formation through crowdfunding is social computing and social media information. It is brought to life with the billions of mobile devices which are rapidly becoming the world's primary interface to the internet as well as the primary source of communication.

In one study done in China, 90 percent of the users who participated said that their mobile devices were in arm's reach 100 percent of the time. And most importantly, knowledge workers today have 24-hour access to something else, each other. In a world where value is rapidly shifting from things to knowledge, knowledge workers are the new means of production. And that follows that the social network is the new production line. This is important.

In a social enterprise intrinsic value is derived from cultural experience. Value is not established by how much knowledge you amass but rather by how much information you understand and how you share it with others. Your ability to actively manage risk, make decisions, and deliver value depends on your capacity to quickly collect the data, translate it into information that will keep your business competitive in this changing landscape. How are you collecting and sharing information?

It is important to understand the differences between data and information. Data is raw, unorganized facts that need to be processed. Data can be useless unless it is organized. When data is processed, organized, structured, and presented in a given context to make it useful, it is called information. How can you be a winner of information, and what tools do you need to be a winner?

The second principle of capital formation through crowdfunding is the collective intelligence, the wisdom of the crowd, which helps our financial markets make financial decisions since the crowdfunding landscape is vastly changing. It is influencing how investment firms like Carlyle, KKR, and Blackstone are seeking new asset classes, a new class of investor, and a new way to be competitive in the market. These mega funders, as successful as they are, like to learn from their colleagues and clients as to the value and crowd wisdom of a company.

Crowdfunding brings together many individual voices to form a community to support the growth of a company. The Royal Bank of Canada estimates $45 trillion of capital sits in the pockets of high net worth individuals. Carlyle estimates that 10 trillion of that sits in the households of 5 million U.S. households. Without public solicitation, Title II, 506(c), or web-based crowdfunding portals which will be governed under Title III, there is no way to reach beyond a small percentage of investors.

Now let's look at the non-accredited investor, which fit into the crowd investing. Americans have accumulated $3.5 trillion in their 401(k) plans, retirement plans. Assets in 401 type retirement plans will grow about six percent a year to $5.03 trillion by 2016. In November of 2012, KKR started two funds for individuals, one an open-ended fund with $2,500 minimum investments with daily withdrawals. And the second is an unlisted closed fund with 25,000 minimum investment with quarterly withdrawal.

Why is this important when we are collecting data and translating it into information? Many of us are sitting here thinking that crowdfund investing is only for small companies like barber shops, nail salons, Laundromats, working in local funding portals in their local communities. Well, that's true, and that was the intent of the Jobs Act. And it will be the reality for some of you, but now to big business.

Capital formation will continue to be driven by large corporations until small emerging companies are given an equal playing field. That includes creating a secondary market that supports small emerging businesses, provide incentives to the disenfranchised population and reduce unnecessary expenses like audited financial statements to small businesses. These changes will drive market confidence and create liquidity.

Crowdfunding adopts elements of both consensus decision making and majority rule. This proves the third principle of capital formation through crowdfunding. It is central to innovation, productivity, growth and decision making, deliberative democracy. Crowdfund investing makes it possible for you as individuals and the public at large to decide who gets funded and who the winners can be. As the paradigm for capital formation continues to evolve and a new asset class is developed, crowd -- three principles imbedded in the evolutions of intelligence, crowd instinct, will shift the funding landscape.

I believe that it will be equally important to disclose company information to investors, clients, regulators, after a crowdfunding raise in order to complete the potential full life cycle of onboarding emerging companies to the IPO rep. Making informed decisions through digestible information will be necessary to foster market confidence and liquidity that we all need. Thank you.

MR. LYNN: Doug, maybe we could dove into the crowdfunding a little bit more in terms of how --

MR. ELLENOFF: Okay. I'm going to work slightly off my slides, but I'm going to also just speak -- Kim and I have worked a lot together, so I think that we can be pretty fluid. The first thing that I do want to do is express appreciation for being here today and the SEC inviting me. But more importantly for the collaboration that we within the crowdfunding industry have experienced over the last 18 months with Trading and Markets and Corporation Finance, the SEC has been exemplary throughout this process in being available, accessible and interactive with us.

I believe what we have today in the proposed rules which came out is a reasonable balance between investor protection and capital formation. Are there things that I'm sure the SEC would like to change and that we would like to change? Yes. I think everybody on this panel will want to see comments from commercial people, so that we can get to an even better result than we already have. But having lived this for the last 18 months and worked extremely closely with the SEC, it's a heartfelt thank you for getting the proposed rules out. And we really appreciate the effort that went into it.

MR. HIGGINS: And just to say the comment period extends through February 3rd I believe, and we're -- comments are coming in and we're looking forward to getting more.

MR. ELLENOFF: As well as that goes to a body of comment letters that came out previously as well that people can look at online. My remarks are online in the slide presentation, but I'm going to go through what I have here quickly because I do want to get to a lot of things. I was asked to speak about the post financing crowdfunding world as I envision it, so I don't even have to comment on the proposed rules today which is a good thing.

But what the proposed rules do envision as well as Title III itself is that crowdfunding opportunities are a private placement, and they are an exempt security. And the companies remain private afterwards, even though as David is pointing out whether or not the terms publicness or publification of companies -- I'm not sure where it will net out there.

But all that happens after a company has raised money in a Title III campaign is they have a responsibility annually to file reports with the SEC. And if you had to do audits under the original rules because you raised more than $500,000, you'll have that continuing obligation. You will post to Edgar, you don't have to print it out and mail it to people. And so that is really the extent of your actual statutory responsibility as it relates to providing information after you've raised money.

Title III fundings unlike Title II, have to be done through a SEC crowdfunding portal which is SEC monitored as well as FINRA regulated. And through that relationship that the issuer is going to have with the funding platform, you will see even though it's not required, the publicness actually emerge. You will see versions of current and periodic reporting. You will see the entrepreneur, the CEO having ongoing communications whether it's through a Google hangout or other technological ways of speaking to their investors.

One of the things that we speak about a lot is the use of proceeds and how you monitor the use of proceeds in the post financing world of a crowdfunding opportunity. And that's an area of great sensitivity. And I think you will see this industry conduct itself in ways that are an improvement to that which I see every day in my ordinary exempt world.

You will see technology solutions where the investor can really see what's going on, monitor other people in the audience that I'm working with that have technology solutions that are tied to major service providers, whether or not it's credit card companies or payroll processing, to make sure that money is spent in accordance with the terms of the original offering. And I think that's a terrific development within the exempt world.

It probably could be used even in our public offering and public company world, but what I'm trying to convey is that I think the folks in the crowdfunding industry are trying to do the exempt market world better than what's been done. They're not just trying to see what the -- benchmark themselves off the minimalist elements of the Title III standards.

The next thing I would point out is that the securities that are ultimately sold in a Title III primary offering are not resalable again in that same environment. Crowdfunding portals are not exchanges, they're not ATSs. While they will be regulated as brokers by FINRA, they are not broker-dealers and you may not buy and sell securities in that environment. That is not so say, however, that the issuers and the investors don't have expectations of liquidity.

While I think the vast majority of Title III campaigns you'll see done as debt rather than equity which may come as a surprise to most people because they will be self-liquidating securities, I think there will be a lot of companies in the Title III world that are community based, won't have a liquidity event other than through self-liquidating securities. But, you know, also the reality is you will have plenty of issuers in a Title III world that will be sold, and that's one liquidity event even if they don't have debt securities.

There will be plenty that will also go out of business, and we don't shy from that conversation. It is a reality of all small business that a certain percentage of them will fail, although I would say that the failure rate in Title III is less likely in my judgment than Title II, because I think Title II campaigns are built for a venture model where there is a heightened amount of risk taking as opposed to community based crowdfunding.

I believe that crowdfunding is friends and family finance done online. Might there be a certain amount of virality, potentially. But I don't think it's going to permeate the industry, I think it's a way for people who do friends and family finance to do it online in a more standardized way than it's ever been done before.

And the numbers for friends and family financing dwarfed both venture as well as Angel investing.

For those companies that don't get sold or go out of business there will be some that ultimately find a pathway towards going public. I think it's much more likely in a Title II world, as was mentioned earlier on the earlier panel, that some of those companies that are not A-list deals that won't go public -- keep in mind there are only about 250 companies in this country that go public a year.

Many of them will find a new way of getting onto the markets, whether or not it's onto the OTC markets or going to other alternative trading platform environments like Gate Technology, what Shares Post and SecondMarket used to do. And Annemarie is going to point out that they no longer want the ATS business, but I do believe you will find that some issuers ultimately -- and even in the proposed rules by the SEC there's an acknowledgement in certain of the materials that there will be a certain amount of these companies that go public and do trade on the OTC marketplace.

And hopefully we see that it is the baby steps that they will take in order to up list to exchanges over time. So that -- and the last thing I'll point out is the other thing that the SEC proposed rules acknowledged is that the crowd rule not -- when they transfer their shares, trade to the '34 Act reporting requirements, even though it may go over the threshold numbers. And so it means that an issuer won't have to file their Qs and Ks on the secondary market trading. Thank you.

MR. HIGGINS: Doug, thanks. I'm advised that Commissioner Stein is only with us until noontime and then she has to leave. But in the few minutes that we have before that I know that the life cycle of financing in the companies and the sort of menu of things that the Jobs Act has brought about is of keen interest to you. Are there questions you have or comments that you want to make on that?

COMMISSIONER STEIN: No. I'm only here to listen today. I'm going to keep some of my staff here to keep listening. And I have been -- Keith and I have been talking about this. One of the things I think all of us want from people who are crowdfunding is ability to grow and prosper and to go to the next level of capital raising. And that's why I wanted to come to this particular panel is we sort of think about a continuum of capital raising which people are sort of talking about.

If you start out with a minimal amount of capital you need to grow but then you go to the next step and you need more, are we doing a good job of providing a pallet of options? And ultimately, you know, to go back to the 250 companies a year who might go public, is there a pathway eventually for some of these firms to do that? So I think that's something we all need to be focused on, and how to preserve ownership rights as people transition from one type of capital to the other.

We were talking at one point about a crowdfunded company that eventually might be very attractive to venture capital, so venture capital comes in very sophisticated. What happens to the ownership rights, you know, that people got initially as a crowdfunded company? So that's one of the things I'm particularly interested in is that we actively think through and try to have an ability for people, not just the firms but the investors, to grow with the company.

MR. HIGGINS: That is a good question, Doug. And some of the skeptics on crowdfunding have said, "Yeah, the successful companies who will become attractive to the venture industry will have trouble if they -- you know, if they've raised money from 250 of their closest friends on crowdfunding. But what do you think the -- how are we going to address that?

MR. ELLENOFF: I think the concern is a legitimate one, I hear it all the time. You know when Rick was up here earlier, he mentioned that he thought the better deals first would go to the VCs. And the VCs, you know, are in business for a reason. They're good at what they do, they have a lot of money. But there are a lot of deals that they don't do because of the amount of money that they have, so they can't do smaller deals.

I think the statistics show that they also don't want to go out of the Silicon Valley area or Massachusetts or New York. And there are a lot of talented people in this country as Kim pointed out in her slides, that don't have access to money. And you get into the Angel conversation, and the Angels are wonderful at what they do, but they don't capture everything as well. So I think there are a lot of deals that are not profiled for either Angels or VCs that will raise money in Title II.

And AngelList which was mentioned earlier as well which is an extraordinary story, they have 3,500 companies that are generally soliciting as we speak. That's powerful, so I don't know what people want to believe the conclusion from that number is. But there is value in what they're doing, and there's certainly a market need.

That brings us to Title III. So I think Title III they would be largely community based deals that would never go public or raise money from VCs. Again, back to my point on friends and family. That's why I think they need debt securities so they can be self-liquidating. These are stable community based businesses that need money, because local banks aren't lending to them. But as it relates to the investor rights, we struggle with that. We've heard lots of issues. I think a good deal will get taken out.

I'm in a deal right now where the venture guys want to take me out, so I certainly get that. I think the two structures that I've heard, the one that I'm most taken by is that the crowd goes into a series preferred stock so they don't get diluted. And it's an emasculated preferred stock where they don't have some of the voting rights and other things, but they have all the economic rights which is really what they want.

They don't want to vote, they don't necessarily want to be on the board. And I think if they're in that position, then maybe that's less offensive to institutional investors.

MR. HOGOBOOM: Keith, can I make a comment about this? I mentioned during the break I thought one of the things that John Chory didn't cover in his remarks was the concept that when the company that's been through this crowdfunding looks to go public, you've got people there who you can't control.

And you know because of your practice in the private sector that the idea of now going to several hundred people to get them to sign lockups, especially when they're not party to an investor rights agreement that requires them to provide it, and the inability to -- or the difficulties of maintaining the confidential nature of the IPO process when you have that many people, lots of whom are unsophisticated, makes it highly unlikely in my view that the idea of a continuum is ever going to come to pass in the way that you're considering if you're thinking about it from crowdfunding to Reg A+ to ultimately some kind of a public offering event.

MR. HIGGINS: But I think it will be up to creative lawyers like yourself, like Doug, to be able to figure out structures that will give crowdfunding investors the economics of what they're looking for but maybe also provide a pathway, so they wouldn't be an impediment to --

MR. HOGOBOOM: But you know that the difficulty is going to be questions about valuation and all the rest of it. I mean the point was made in the first panel that in some of these general solicitation deals -- I assume it will be the same for crowdfunding, that the valuation will be much more favorable to the company than would be the case in a more traditional private placement.

The venture capital guys are going to come into that process if you really want to play out the continuum concept. They are going to have a completely different set of valuation metrics that they're looking at. They are going to insist on control, they are going to insist on those people passively going along for the ride. And at the end of the day, the only way that they are going to tolerate those people that came in through the crowd-funding is if they can be neutralized.

MR. ELLENOFF: But like every negative there's also a positive. Now one of the things that our underwriters struggle with is getting to the 300 and 400 shareholder account numbers, so they can be on an exchange. Solved. So I'm not saying it solves all your problems, but there are -- there's good and bad. And the other thing you have and it's very misunderstood by the more established financial community, is you have a crowd of people who really believe in your product and services. And don't underestimate that the example that Kim gave on the -- botched the saying of the name Ouya --

MS. WALES: Ouya.

MR. ELLENOFF: -- Ouya was very powerful. In fact they not only did raise the money, but they changed their product in the process to accommodate for what the crowd wanted. So there are commercial issues that need to be resolved. There's many more positives than negatives in my judgment.

MR. HOGOBOOM: I don't want to get into a debate about Ouya, but the one thing you have to understand there -- because I'm a big fan of Kickstarter -- is that they raised that money because people bought the product. So it's kind of like reverse venture capital. They went out and demonstrated that there was a robust market for their product, and that's why they raised money from venture capitalist. That $8,000,000 they raised was not crowdfunding, it was not a general solicitation. Those were product sales.

MR. ELLENOFF: The last point I'll make is on Kickstarter, because that's a good example. The Pebble watch which went on and did a pre-order campaign and raised $10,000,000, no sooner did they do that than all of the established sources of capital they had gone to previously for financing who would not give them money until the crowd validated the product, then financed their future round. So I'm not saying that it solves all the problems, Jack. I just think it's not to be as underestimated as I believe that it has been.

MR. LYNN: One question I have is do you think that -- going back to the topic of this ongoing reporting and disclosure that comes with crowdfunding exemption, is that going to be a gating issue for a company that has the SEC's proposed disqualification too? If you don't keep up your reporting and -- would that be something that would make people shy away from doing equity or that kind of funding just because they would sign up for something very costly -- potentially costly going forward?

MS. WALES: Well, I think in terms of crowd-funding completely it's around the expenses to the issuers. And so anything that we can do to minimize that expense will actually, you know, provide incentives to more issuers coming on board for crowdfunding. I think that investors will be more supportive of that, because they have an idea as to where that money is being used. And so anything that's going to alleviate that pain point for small companies is what we need to really consider with the new final proposed rules.

Going back to something that Doug was saying, one of the things we didn't talk about is how a crowd-funded raise -- I think in the proposed rules today we talk about doing a parallel. We called it integration, but now we're looking at parallel deals.

So if you see a crowd-funded round and it looks like it's being pretty successful only because you can raise $1,000,000 per annum per issue, it's very possible that you can do a 506(c) offering which then again, puts you in that next level of a qualified investor. And so it also pushes that threshold up a lot, and we think that that's where we're going to see a lot of opportunity as well.

MR. ELLENOFF: Just because I think it's important to know while the SEC was extremely accommodating in the proposed rule as it relates to that particular side by side financing issue, people should note that the quid pro quo for that privilege is to severely curtail the marketing campaign that you do in your 506(c) offering in order to not violate those rules. And it has to be more in line with what the advertising is allowed in a Title III campaign.

MR. LYNN: Yeah. I'll ask one question. Does anyone see the concept of groupings, not grouping of non-accredited investors kind of similar to an Angel group concept, as a way to manage the process for effecting a better second round financing?

MR. ELLENOFF: I mean that's what I was intimating as it related to the series preferred stock is that they all go in that way as well. I think it responds to some of Jack's issues as it relates to that they would have the economics but they wouldn't have the say or a vote.

MR. LYNN: Yeah. So Annemarie, I think the next topic really is once you have a security, what do you do with it, and what are the avenues available to get liquidity and to, you know, participate once you've already been an investment from an issuer?

MS. TIERNEY: So I think what I'll do is sort of give a historical overview of how I think the market has developed over the past, you know, five or six years. SecondMarket is a registered broker-dealer, we are an ATS. We got involved in the private company stocks, secondary trading space in 2006, 2007 when former Facebook employees started coming to us. We were making markets in various liquid securities, and they reached out to us and said, "Can you help make a market in Facebook stock?" And strangely enough it was very easy to find buyers who wanted to buy pre-IPO Facebook stock.

So we had a very, very nice business through 2009, 2010 and 2011, where people were coming to our platform in droves. They were going through an accreditation process, and we were exposing them to other companies that they potentially might want to invest in. The problem was for lesser known companies, it was very difficult for us to identify buy side interest.

And so once Facebook went public, the two I think main issues that companies -- shareholders face when they're trying to get liquidity for their shares, are first of all most private companies have rights of first refusal over the shares. So in order for me to sell shares in SecondMarket I would actually have to send a letter, Jack wants to buy my shares. We'd have to send a letter to SecondMarket saying Jack wants to buy my shares at, you know, how many dollars a share.

And then the company could choose to buy that stock back from me at that price or assign the right to a third party. And that process is a 30 to 60-day process just to get that approval done. So it's a big impediment to secondary transfers. The other problem is, you know, if you are not a shareholder that's owned common stock for 12 months or you're an affiliate, you cannot rely on 144. And so then you're sort of in a 4 (1 1/2) market which is the owner is not a statutory exemption.

And different law firms were writing opinions but required sort of different elements to be met. So there was really a disconnect across especially West Coast and East Coast about how 4 (1 1/2) was applied. I actually had Marty Dunn tell me 4 (1 1/2) didn't actually exist, which I laughed at him and then he changed his mind. But I --

MR. ELLENOFF: Because you laughed at him?

MS. TIERNEY: No, because when I joined

SecondMarket they were saying oh well, all our sales went out 4 (1 1/2) and that made me a public company, and we were very nervous. So we actually went out and we hired MoFo, Wilson Sonsini and Skadden and -- to do an analysis of 4 (1 1/2) in the context of an employee accessing options and selling the underlying common. And they all came back with a specific fact pattern, and we got comfortable with that.

But not every law firm wrote an opinion on that -- on that analysis, and so that created some conflict. So that -- so the two big problems were the right of first refusal or -- right and then what exemption was the seller relying upon at the federal and the state level. And every single company that was accepting transfer requests required an opinion of counsel always at the federal level and then a growing level at the state level.

So as the market developed, we identified one specific type of company as really requiring the benefits of liquidity and that was community banks, private community banks. And these are bank holding companies that were formed to take advantage of the trust preferred tax efficiency that was later taken away in Dodd-Frank. But they were companies that had no business being public. They have, you know, a growing number of shareholders. Many of them are getting close to 500, so they were looking to us to help them minimize the shareholder base. But we couldn't actually reach out to our own membership. We had about 40 or 50,000 accredited investors on our platform at that point in time.

We couldn't actually reach out and solicit those investors as a registered broker-dealer because the primary exemption that secondary sales rely on at the state level is unsolicited transactions through a broker-dealer where the bid is unsolicited. And there's almost no guidance around what that meant. And we actually reached out to the State of California and said, you know, in a scenario where someone comes onto our platform, goes through accreditation, tells us they want to buy a private company stock, says they're interested in California, can we tell them about a bank that we have for sale?

And the answer was, "We're not comfortable with that analysis." So I don't know what unsolicited is other than someone trips onto your platform, finds a company and tells you they want to buy. So we ended up after 18 months realizing that we could not make efficient markets in these private company stocks if the company was not really, really well known.

And then the well-known private companies had no interest in secondary trading, because even though the shareholder cap is 2,000 they don't want individuals owning their shares, sort of the same issues with crowdfunding companies. They don't want a lot of individuals that they have to manage. They don't have an investor relations team as a general matter, they don't want to be, you know, requesting -- have investors requesting information that they're not willing to give out.

So even though the number was 2,000 they were still not happy with liquidity happening sort of in an easy way around their shares. So we ultimately shifted our business model and where we're seeing secondary liquidity happening almost exclusively at least through SecondMarket is in the context of private tender offers. So third-party tender offers or company buy backs where the company has complete control over the transaction, they get to decide the price, they get to decide who participates and they control if that's the transaction.

And in that context we're basically acting as, you know, posturing paying agent where the entire transaction is done on a platform electronically from sign-up. We have everyone's shareholdings available to them on a profile page, they can see exactly what they can participate with. All the documents are signed electronically, and then we do the closings. So that's really where we're seeing the secondary trading market occurring. Now that not is not efficient for every private company.

And I know that NASDAQ acquired the SharesPost platform for their secondary trading, but they hadn't launched the market yet. So I'm not really sure how they are building that. I'd be really interested to see if they're able to solve the right of first refusal problem and the state law problem. So I thought what I would do is we actually spent about four months doing an analysis of the 50 states and the four major exemptions that are available for secondary trading. And we presented this to NASAA and I'll talk about NASAA's efforts in this space in a second with Rick Fleming's blessing.

So the four major exemptions for secondary trading -- the first is called the manual exemption. This requires the company be providing public information, financial statements and other types of information to a regulator. So most banks can satisfy the manual exemption if they apply for it. There's a cost involved. But if you're not a bank filing with the OTC or the FDIC, you're not going to qualify for the manual exemption. So no private companies generally rely on this exemption.

And this will give you -- what we did was broke down, you know, in a geographical context, so you can sort of see the disconnect across the 50 states on each of the four major exemptions, which we think is part of the confusion and part of the problem. The second exemption which is really pretty prevalently used is isolated non-issuer transactions. And this basically says that if you're a seller, you can sell in a private secondary transaction over the course of a year in isolated number of transactions.

Now not every state applies this the same way, as you can see. Some states actually enumerate how many transactions satisfy the rule. Some states are five, some states are 25, some states are unlimited. So then, if you're trying to create an efficient market across the 50 states, that's something very, very difficult to track and a seller themselves is not going to actually know these rules. So that creates a lot of confusion.

The third is offers and sales to institutional investors. This is generally easier, except the fact that the -- that definition of institution varies across the 50 states. So again you have to do a pretty good analysis about what the -- how the word institutional investor is defined if you're going to try to create a market.

And the fourth one which I talked about was the unsolicited transaction through a broker-dealer. And here what's interesting is most state have adopted some form of this exemption, but some states limit its availability to affiliates, so they can't rely on this exemption. So if you're an affiliate, it's really difficult for you to get liquidity and almost impossible to understand what hoops to jump through.

So we started talking to NASAA about all this in the context of community banks a little bit more than a year ago and have been very pleased to see, you know, their thoughtfulness and their focus on this issue. So we actually proposed a model exemption to NASAA that I believe has gone out to a number of states for their own comment and commentary. And my understanding is the reaction has been generally positive, but the question will be if this exemption is adopted across all 50 states, will we end up in the same place with the other exemptions where different courts and different states analyze or interpret it different ways, impose different obligations.

The other part of this exemption is that it requires two years of audit financial statements be provided which, you know, most startups will not have. So really you're looking at mid-level, mid-term private companies will probably be able to satisfy this. So I don't know how long it's going to take for the states to actually work through this, how many states will actually adopt this exemption.

And the question becomes well, what happens in the meantime? So now we have a situation where companies can stay private a significantly longer time, thanks to the increase to the 2,000 shareholder number which excludes employees. We have a situation where people who can't rely on 144 have to look to 4 (1 1/2).

You can generally solicit under 506(c), you can generally solicit under the crowdfunding rules. I'm talking off my next slide -- 4 (1 1/2) does not allow for general solicitations, so you have this weird disconnect. And you're going to have this big bottleneck of shareholders who came in through 506(c) offerings and came in through crowdfunding offerings when those rules are finalized and effective but are not able to find liquidity in an efficient manner. So, you know, my strong opinion -- and I know some people in this room agree with me and some do not. If you do not, come up to me afterwards, and I'll convince you, like I did to Marty.

But I honestly think it's definitely time for the SEC to step up and codify 4 (1 1/2) in an updated manner. So right now, you know, the basic tenets of 4 (1 1/2), again, subject to different analysis depending on the firm and the coast, are that the buyer is accredited, there is no general solicitation which, again, I think has to be revisited, that the shares are legended, as restricted, that all the buyers are -- I said that all the buyers are accredited, that there's not a distribution involved, and that the securities -- did I say securities are legended, and the buyer steps into the shoes of the seller with respect to all the restrictions.

So I think if you codified something that looks like 144 but it's available to employees who hold stock options and can't afford to convert those options without being able to sell the underlying common immediately or takes into consideration the needs for affiliates to sell, that you'll have an exemption that is actually workable and really, really necessary.

We actually approached the staff a couple of years ago to try to get some guidance, some no-action letter guidance. And Tom Kim sort of laughed and said, "Please, we're dealing with the Jobs Act, come back when we're done." So Tom's gone, so here I am. But so I really think it's an important point in time, and I honestly think the market needs this very, very deliberate specific guidance. Otherwise, I don't know how markets are going -- like SecondMarket I don't know how we would get back in the business of creating efficient liquidity without, you know, the continued questions around the federal and state exemptions.

One thing that's thing that's been helpful to us is that when we actually created liquidity we worked with companies. Companies engaged us to do that, so we were able to get disclosure documents, financial statements and risk factors and other things, just sort of solve for information disparity of potential insider trading. But if you're just trying to create a bulletin board market or something that looks like a bulletin board for secondary shares for private companies, I don't really know how that works.

MR. HIGGINS: Annemarie, let me ask you a question on the 4 (1 1/2). Is the problem that you're trying to solve principally related to option exercises by employees?

MS. TIERNEY: It's -- I think it's twofold. Right now there's no clear availability because I'm sorry, the one piece of the 4 (1 1/2) analysis that I forgot to mention which is the most important part, is there's a concept of a hold period.

MR. HIGGINS: Right.

MS. TIERNEY: And there used to be a concept of like six months being, you know, acceptable. That's definitely dropped something like 60 days to 30 days, depending on the law firm issuing the opinion. But if you think about an employee getting options, it's usually at the point of employment, and there's a vesting schedule over those options. So the first vesting usually occurs at one year where they get maybe 25 percent vest and then the rest vests over, you know, generally another three-year period. So they've held that stock for a long time. They may not be interested in buying, but there's no clear guidance in the market from a securities law point of view that they can actually exercise and sell that underlying stock.

MR. HIGGINS: Right. Of course as a securities lawyer you know that they held the option but their investment decision is when they exercise the option, and that's when they pay over their money.

MS. TIERNEY: Just the exact comment, yeah.

MR. HIGGINS: And so we would be really undoing quite a lot of law if we were to go that way, because if it's not options, if they've held their securities -- there's a one-year holding period now for non-affiliates.

MS. TIERNEY: Correct.

MR. HIGGINS: Affiliates, I realize that's a different kettle of fish but for non-affiliates, and that would be most employees, there's a one-year holding period. I do get where the option -- because the holding period does not start until the exercise.

MS. TIERNEY: But what you have to keep in mind is that normal employees do not have cash on hand to exercise options and pay the underlying taxes.

MR. HIGGINS: Right.

MS. TIERNEY: And when an employee leaves a private company there's a period at which those options expire, and it's sometimes 60 to 90 days. So for rank and file employees and, you know, we're talking hundreds of thousands of employees across America who work for private companies, that value disappears at 60 to 90 days. So if they cannot afford to do that exercise it expires.

So it's a real problem and, you know, really like Chris' first slide that shows job growth at -- in the startup space is very, very significant. And you join a startup because you hope that that stock is going to be worth a lot of money someday. You don't generally get a large base salary, you get a larger equity component. And if you can't actually find liquidity for that stock when you need to buy a house or a car or pay for private school, that compensation becomes less valuable to employees.

And what we're seeing in the secondary space was a company would say okay, we'll let you run an auction for our stock. We'll let existing employees sell 20 percent of vested equity. And they will allow the excess in the common immediate sale under the opinion letters that I have been seeing from pretty reputable law firms. So it's a real problem.

MR. LYNN: Now, Jack, we'll move on to the topic of what if I've already gone public and I'm a public company? And everything about the Jobs Act is really focused on the private market and going public. And what happens once they're public?

MR. HOGOBOOM: Well, first of all I'd like to also thank the staff for inviting me back despite my sometimes incendiary comments of past appearances. And I promise if I get invited back again I'll do slides. But this is the first year I think everybody has done slides. So before I launch into my tirade I just wanted to make a couple of points.

If you're looking for predictions about what's going to happen as a result of the Jobs Act, I think that one of the easiest predictions to make is that it's going to depend in part on what the SEC wants to have happen. I'm still not sure in my own mind whether the SEC's view is that the Jobs Act was a mistake that was foisted on them by a Congress that was uninformed and, therefore, the goal of the SEC is to do what they're obligated to do but keep the maximum focus on protecting investors, or whether the staff and the Commission have now embraced the concepts of the Jobs Act and are fully committed to this concept of the democratization of capitalization.

One of the things I think that's absolutely clear is that you're not going to have anything unless you figure out some way to facilitate secondary trading. I'm not necessarily of the same mind as Annemarie is. Arguably employees exercising options is a special case. The SEC has dealt with employee securities issues in separate ways in other contexts.

And so arguably you could take care of that problem if you wanted to, but the AIM market in London should be the greatest example of what happens when there's no secondary liquidity. Ten years or so ago everybody was -- the AIM was the vogue. Everybody wanted to go to London to do their financings. It was supposed to be streamlined, lots of smart investors, et cetera, et cetera. And as soon as the professional investors realized that they couldn't resell what they bought, that market dried up and died.

As far as things like Reg A+ go, I think that it will only be successful if there is robust secondary trading in shares or securities that are issued pursuant to that exemption. Nobody in this market after the things that we have all seen in the last five years, is going to be willing to hold illiquid securities for an unlimited period of time.

With respect to crowdfunding, people may be less sophisticated about what it means to be holding illiquid securities, but I would assume that people will try crowdfunding. And when they realize that they're not able to resell what they bought, they're going to realize that they're stuck pending some kind of liquidity event like Doug indicated. And they're going to say well, that's it for me. If I can't exit the investment, then what's the point?

So for me one of the litmus tests that I think about when I think about how the staff is feeling about the Jobs Act is whether they're willing to do something to facilitate secondary trading in all these securities, because one way to kill the provisions is basically to not change anything in terms of the trading markets. Because as I said, I don't think anybody is ever going to invest if they can't sell what they buy.

On the other hand if you guys are really embracing the Jobs Act, then the thing you have to do is you have to do something to facilitate some kind of secondary trading or else these concepts will never get off the ground. Having said that, it hadn't really struck me until I sat here and listened to everybody else, but there's a real sort of dynamic tension between some of these provisions in the Jobs Act and what happens to companies when they actually go public.

I think that the concept that we're going to take these provisions from the Jobs Act and somehow package them as a continuum of life for a company to go from organization through IPO is pollyanna and probably never going to happen, because as everybody who has been on these panels today has pointed out, the best companies, the ones that are ultimately going to go public, are not going to have to avail themselves of these types of financing techniques.

And they're going to want to go the more traditional -- the more certain way, because you may hate venture capitalist but they bring more to the table than just money. They prefer -- companies prefer professional investors, professional investors prefer other professional investors. The last IPO I worked on the company was trying to augment the proceeds that it was going to be able to raise in the offering, wanted to involve a bank that was retail focused who could bring in a substantial amount of retail money.

And the lead accounts -- the lead banks and the IPO and the lead investors who had basically indicated interest for the offering said no way, we don't want to deal with individual investors as part of this transaction. And to Doug's point the involvement of individual investors in that IPO process was limited only to the extent that it was necessary to satisfy NASDAQ that we had 300 round lot holders and, therefore, we met the requirements to list on NASDAQ.

So there's this incredible dynamic tension between these democratization concepts that are going to make it easier for lots of people to invest in private companies. And the ultimate goal of growth and some type of an exit strategy of going public, as I've mentioned at other points today, the more people you have that are potentially impacted by the IPO process, the more difficult it's going to be to herd all those people, to keep your deal confidential, to avoid gun jumping issues, to avoid conditioning the market, et cetera, et cetera.

And I think that the companies that realistically think that they have an opportunity to ultimately become public are going to be highly focused on doing whatever they can to restrict their shareholder base, not expand it. Having said all that, I'm somewhat frustrated by the fact that I've been coming to these conferences now for probably 10 years or so. And the focus always seems to be on everything other than what I think it ought to be on which is the easy things that the staff could do to make life easier for the smaller companies that are already out there and public.

You know the Jobs Act is great and there have been some aspects of the -- of what I guess we call the on-ramp that have really worked well. The confidential submission process, the testing the waters concept, that's arguably made life a lot easier for companies that have gone public.

But the problem I have is that you have this great unwashed community of probably thousands of companies that are already public who went public before the Jobs Act was enacted and who are not entitled to take advantage of the same benefits that emerging growth companies that are newly public have.

And so what you have now is a situation where you could have two completely similar companies in the same business, the same type of revenue, the same structure or whatever you want. And they're subject now to completely different regulatory structures just because one went public after December 8, 2011, and one went public before -- sorry, before December 8, 2011. So as a general matter, I would love it if the staff could figure out some way to rationalize that regulatory scheme so that smaller public companies that are already public aren't structurally disadvantaged by that.

Specifically, there are things that I look at in my practice that I spend an inordinate amount of my time dealing with. And when I think about the things that I think could easily put me out of business, they all seem like they might be horrible for me, but they'd be great for smaller public companies.

So a couple of things that I'd like the staff to do would be for instance to expand the availability of the S-3 registration statement. It's been I think since 2007 when the Baby Shelf Rule was adopted. As for as I know, the experience under that rule has been excellent. I haven't heard anybody express any kind of regulatory concerns.

MR. HIGGINS: Just to be clear you're asking about the Commission to do this, right?

MR. HOGOBOOM: I'm sorry.

MR. HIGGINS: This isn't something the staff would be able to do.

MR. HOGOBOOM: I apologize.

MR. HIGGINS: I mean you're looking, you're directing your conversation to me. I can’t do that.

MR. HOGOBOOM: I guess my feeling is that the staff has some influence on the Commission's agenda, and if there was -- my understanding is that the Chairperson has indicated that facilitating capital raising by smaller public companies is a focus of her Chairmanship. I believe that she's on the record about saying that. And so I'm trying to give her some -- through you, since I can only talk to the staff and not the Commission, some suggestions.

So in any event, the Baby Shelf Rule has been in place for quite a while now. As far as I know, it hasn't triggered any regulatory concerns. I spend a tremendous amount of my time, including at least 90 minutes yesterday, helping companies try to figure out exactly how to measure what they're entitled to do under the Baby Shelf Rules, and particularly what happens if they issue warrants, and how that plays out, and how you have to value it, et cetera, et cetera. And it's totally meaningless.

As far as I can tell there's no regulatory reason why those conversations need to happen. So the first thing I think, like was the case when 415 was first adopted, the time has come to basically remove that restriction. At the same time, when the rule was adopted, the Baby Shelf Rule was adopted in 2007, it was limited only to companies that were listed on a National Securities Exchange which was a last minute head fake that caught a lot of us by surprise.

As far as I know, there's no reason why the availability of S-3 should depend on whether you're a listed company or not. The information that's available with respect to companies that are listed on the over-the-counter markets is the same as what's available for listed companies. It's just as robust, it's just as readily available, and so there's really no reason to restrict the access to that form to smaller public companies.

Similarly, right now Form S-1 is the only registration form that doesn't permit forwarding corporation by reference. And it's only smaller public companies and people who are impacted by that, because if you are an emerging growth company, it's not relevant to you in your IPO. And if you're over $75,000,000 in market cap, you go straight to the S-3 Form a year after you're public. And so it's only the smaller public companies that have to deal with the hassle of not being able to forward incorporate.

And because of the interplay with the Baby Shelf Rules, what happens routinely is a smaller public company like a life sciences company that is constrained under the Baby Shelf Rules has to file an S-1. And they regularly do it to raise money, and then the form basically ties their hands in terms of the costs and the delay in terms of preparing a full blown registration statement because you can't forward incorporate.

Similarly to that, the staff's interpretation of Rule 415 continues to be problematic, and it's really sort of gone highs and lows over the years. My understanding is that the Rule 415 interpretation came back into play because of a concern about toxic deals and the concept that existing stockholders could suffer overwhelming dilution.

And so a screening test was put into place that basically said, look when an issuer is trying to register more than a third of their public float, they need to -- the staff needs to stop and look and make sure that that's a true secondary offering and not a veiled primary on behalf of the issuer. In practice, it's gotten to the point where the staff immediately has a knee jerk reaction to any public offering that involves more than a third of the public float.

And I've in some cases spent months in dialogue with senior members of staff, trying to explain to them why it is that there is no way there could be a distribution of securities in the particular instance that I'm dealing with, that smaller public companies by definition have to raise a larger percentage of their float than bigger companies do and that in a lot of these cases the investors who are buying securities have no practical way to sell the stock even if they wanted to. So how can a distribution take place when for instance one of my investor clients is holding 10 years' worth of trading volume in the deal that they're buying and they're asking for registration more because of accounting reasons, so the way they have to carry it on their books, than because they have a present intent to sell the securities.

As I say there have been periods of time when the staff's been particularly sensitive to the effect that the interpretations had, but it's gotten to the point again now I guess that Tom Kim's gone, where it's not as much of a focus as it's been. And it has an obvious and disproportionate impact on smaller public companies, because it obviously would never impact the Googles of the world.

MR. HIGGINS: Okay. Yeah, I'm sure you can submit your written complaints in the -- maybe we can get out of the -- I won't say the weeds but yeah, out of the specifics and maybe -- I know we're probably past our lunch and wrap-up. We have some questions but maybe we can answer those.

MR. LYNN: Yeah. Here's a question that if I participate in a crowdfunding deal and it turns out that there's some bad apples in the crowd, what are the consequences to the company and to the investors? I guess this is presuming that the -- ultimately the rules are adopted as proposed.

MR. ELLENOFF: I'd like to think that's a big assumption. The way it's currently written is that the crowdfunding portal on page 280 is deemed to have the liability of the issuer, so under that theory of thinking, which to be clear I don't agree with, the complainant would have recourse against both the issuer and the crowdfunding platform.

MR. HIGGINS: What I don't understand, the question said what happens if there's bad apples in the crowd, which I assume that means that there are bad apples in the investor crowd.

MR. ELLENOFF: Okay. I was going to the --

MR. HIGGINS: Yeah, the bad apples.

MR. ELLENOFF: -- well the more -- the question that's asked often. But you can screen who's in your deal and who's not in your deal like any private placement. You can say in advance in the -- that who gets into your deal is up to the issuer. However, once they're in -- because the question is a timing related question -- can you get them out? And the answer is no. The bad actor provisions don't contemplate for that particular issue.

MR. HIGGINS: Right. And there was a question that says it's war between innovators and investors. How can the SEC protect the innovators? I'll assume it's a rhetorical question. I mean I -- capital formation versus investor protection. We're balancing both of those goals in trying to craft the rules that apply to all of the investments.

MR. LYNN: Well, thank you all very much. That was very informative and we appreciate it. Kim, do you want -- go ahead.

MS. WALES: Yeah. I just wanted to make a comment to something that John was speaking about, and we all talk about the liquidity event being an IPO for a crowdfunded company or a small emerging company. And I think that we need to think through other options for a company to have a liquidity event for their investors. So if we go back to just some simple principles about value investing, which is something that we should all be thinking about in terms of a sustainability model, we might think about companies coming up with issuing a dividend to their investors.

And so figure out what that framework looks like, because these companies have issued or will have issued securities to the investor. And technically, though they're not sitting on a stock exchange, they should be able to issue some sort of a dividend which would actually promote and show that they -- that the directors of the company feel confident about their balance sheets. So that's just one example I want to put forward, but I think that we need to just broaden our thinking about what this new marketplace actually delivers to us.

MR. LYNN: Thanks. Mauri?

MS. OSHEROFF: I just wanted to remind you, those of you who are going to be participating in the breakout session, that they begin at 2 o'clock. So please come back here at 2 o'clock, not to this room but to the multipurpose room which is also on this level. It's under the stairs, and we'll have signs up, people to direct you there. Some of you will be staying in that room, but other people will be directed to and escorted to other rooms for the breakout sessions.

If you're not at the SEC headquarters and you have registered, you will have received an e-mail with the call in code, so that you can participate in the breakout session by phone. Thank you all for coming this morning, and we do hope to see many of you back or listening at the breakout groups.

(Whereupon, at 12:13 p.m., the proceedings were concluded.)

PROOFREADER'S CERTIFICATE

In The Matter of: ANNUAL GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION

File Number: OS-1121

Date: November 21, 2013

Location: Washington, D.C.

This is to certify that I, Nicholas Wagner, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

__________________________ __________________________

(Proofreader's Name) (Date)

REPORTER'S CERTIFICATE

I, Beth Roots , reporter, hereby certify that the foregoing transcript of 130 pages is a complete, true and accurate transcript of the testimony indicated, held on November 21, 2013, at Washington, D.C. in the matter of: ANNUAL GOVERNMENT-BUSINESS FORUM ON SMALL BUSINESS CAPITAL FORMATION.

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

Date:__________________________

Official Reporter:__________________________

Diversified Reporting Services, Inc.