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U.S. SECURITIES AND EXCHANGE COMMISSION

TRANSCRIPT OF MEETING OF
ADVISORY COMMITTEE ON
SMALL AND EMERGING COMPANIES

Monday, October 31, 2011
9:00 a.m.

U.S. Securities and Exchange Commission
100 F Street, N.E., Washington, D.C.
Multipurpose Room, LL-006

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PARTICIPANTS:

COMMITTEE MEMBERS:

Stephen M. Graham, Co-Chair
M. Christine Jacobs, Co-Chair
A. Heath Abshire
David A. Bochnowski
John J. Borer, III
Dan Chace
Milton Chang
Joseph (Leroy) Dennis
Shannon L. Greene
Sean Greene
Richard L. Leza
Paul Maeder
Kathleen A. McGowan
Karyn Smith
Dan Squiller
Charlie Sundling
Timothy Walsh
Gregory C. Yadley

SEC PERSONNEL:

Mary Schapiro, Chairman
Meredith Cross
Kathleen Hanley
Vladimir Ivanov
James Kroeker
Gerald Laporte
Craig Lewis
Lona Nallengara
Jennifer Zepralka

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

2 MS. JACOBS: I'd like to call the meeting to
3 order. We have a quorum this morning.

4 On behalf of my co-chair, Stephen Graham, and
5 our newly-formed Advisory Committee, I'd like to welcome
6 Chairman Mary Schapiro. Chairman Schapiro is the 29th
7 chairman of the Securities and Exchange Commission, and
8 has a long tenure with the Commission. This goes as far
9 back as 1988 and the Reagan Administration. In those 23
10 years, she has witnessed and been a part of history in a
11 very specialized and critical economic arena.

12 Madam Chairman, the fact that you wanted to be
13 here with us today is yet another testimony to your
14 dedication and your willingness to create and change an
15 economic environment that needs assistance. Yet your
16 dedication doesn't stop there. There's your dedication
17 to the Commission, to the investors that you protect, and
18 to the U.S. companies, both large and small, who reside,
19 seek to grow, and create the underpinnings of our U.S.
20 economy, and lastly, your dedication to your country.

21 Chairman Schapiro, we appreciate the
22 opportunity that you have given our group of people here
23 today. It speaks volumes that you have assembled us and
24 that you have given us a voice and that you genuinely
25 want to see us succeed in our sectors, and you want to

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1 see us create jobs and to thrive in an already tough
2 environment. So welcome, and thank you for coming.

3 CHAIRMAN SCHAPIRO: Chris, thank you very much.
4 That is I think the nicest introduction I've ever had,
5 and I appreciate it greatly. And I want to thank you and
6 Stephen for co-chairing our Advisory Committee. And I
7 want to welcome all of you to the Securities and Exchange
8 Commission and to the first meeting of the Advisory
9 Committee on Small and Emerging Companies.

10 I want to start by thanking all of you for your
11 contribution to a very important SEC priority: Determining
12 how to appropriately balance our investor protection
13 mission against our mission to facilitate capital
14 formation when it comes to America's small and emerging
15 businesses.

16 I do know that in addition to service on this
17 committee, you have day jobs, running, nurturing, and
18 advising, or discovering and investing in the kinds of
19 enterprises we are trying to support with this committee,
20 that you already have another more than full-time job.

21 So I want to make clear not only how much we
22 appreciate your contribution to this committee, but also
23 that we're committed to making this a worthwhile
24 investment of your time and talent. Your opinions,
25 ideas, questions, and answers will have a real and

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1 important effect on SEC decisions that affect small and
2 emerging companies.

3 I'd also like to thank Gerry Laporte, Jennifer
4 Zepralka, and the Office of Small Business Policy at the
5 SEC for their work supporting the Commission's formation
6 of this committee, convening the meeting, and speaking
7 for small business within our agency. I also want to
8 thank Heath Abshire, Arkansas Securities Commissioner,
9 and Sean Greene from the SBA for joining us today.

10 I am the daughter of a small businessperson,
11 and I'm familiar with the unique challenges small
12 businesses face. I know that instead of planning year-
13 to-year or quarter-to-quarter, that sometimes it's day-
14 to-day. I recognize the challenges that a larger
15 business would barely even notice can be significant
16 drains on resources and time to an enterprise that needs
17 to focus everything on making its place in a competitive
18 market.

19 And I appreciate how much small business is a
20 driving force in our economy. Studies suggest that small
21 businesses have created a majority of new American jobs
22 over the last 10 years. But there is a footnote to that
23 statistic. The most vigorous small business job creation
24 comes from small businesses that get much larger. Job
25 growth comes from emerging enterprises trying to grow out

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1 of their warehouse space and into a corporate campus, or
2 to jump from a single downtown location into retail
3 districts nationwide.

4 And it is at this critical transformation point
5 when they need outside capital to fund expansion and job
6 creation that small businesses meet the Securities and
7 Exchange Commission. And that's why your work on this
8 committee is so important. This first interface between
9 business and regulator can have a significant effect on a
10 company's growth and direction.

11 For 77 years, the SEC has contributed to the
12 growth of small and emerging companies by supporting a
13 capital marketplace in which confident investors were
14 willing to take a chance on new business. We have worked
15 hard to create a culture of compliance which supported a
16 transparent market, one marked by high liquidity, strong
17 secondary trading, and investor protection. We helped
18 create an environment in which investors were willing to
19 take a chance on new ventures. The cost of capital was
20 low, and a growing enterprise could reach that classic
21 startup benchmark, a successful IPO.

22 We're proud of what we've done, but we
23 recognize that markets and participants change, never
24 faster than in the past two decades, and that regulation
25 must take into consideration new realities as well.

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1 Regulations that once encouraged confidence, investment,
2 and growth may now slow that growth unnecessarily.
3 Experience may have shown that regulations entirely
4 appropriate to larger concerns impose excessive burdens
5 on smaller companies. And dramatic changes in the way
6 businesses and investors communicate, organize, raise
7 funds, and grow profits may demand equally significant
8 regulatory attention.

9 One of my first priorities when I returned to
10 the SEC as chairman was acknowledging these types of
11 changes and bringing the agency up to date. That means
12 dealing with topics like complex derivatives and high
13 frequency trading, and it also means taking a fresh look
14 at Commission rules with particular influence on small
15 business growth, from our current rules about
16 communications around securities offerings to new ideas
17 like crowd funding.

18 I know that SEC staff brings passion,
19 experience, and a host of academic and legal tools to
20 this process, and there's nobody that I know of more
21 qualified to lead this effort than Meredith Cross and the
22 team she's assembled. But one of the reasons they are so
23 good at what they do is that they recognize, as I do, the
24 importance of looking outside these walls and the
25 Washington Beltway for new viewpoints and experienced

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1 voices.

2 The regulatory decisions affecting small
3 businesses must be informed by the real world experience
4 of people who are building a business, raising capital,
5 and complying with regulations. That makes your work,
6 providing counsel to our efforts and providing a conduit
7 through which others can contribute, vitally important.
8 Your experience will become a vehicle for better
9 understanding on our part of the impact a new regulation
10 or changes to old rules might have.

11 The structure of this Advisory Committee is one
12 sign of how seriously we take this task. First, it's
13 composed of a team from a variety of backgrounds with
14 differing perspectives that will be able to examine the
15 issues from all angles and offer opinions based not just
16 on what has worked in the past, but how things can work
17 better going forward. And second, rather than being
18 brought together to write a single report framed by a
19 single series of issues or static marketplace conditions,
20 the committee is structured to provide ongoing input to
21 the Commission. You can adjust priorities and the
22 guidance you give us as marketplace and regulatory
23 changes occur.

24 Today's meeting will focus on triggers for
25 registration and other public reporting and suspension of

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1 reporting obligations, scaling of regulations for public
2 companies, new capital raising strategies for private
3 companies, and restrictions on general solicitation. And
4 these are critical issues. Recent events, of course,
5 lend them urgency, and I'm looking forward to hearing
6 your insights.

7 But this is just a start. The issues
8 surrounding offerings and trading, public reporting, and
9 corporate governance are complex and varied. Your work
10 setting priorities, identifying challenges, and helping
11 to resolve them can bring significant benefits to smaller
12 businesses over many years.

13 There's been a great deal of focus on small and
14 emerging businesses as we attempt to spur job creation
15 during a time of modest growth. But really, this
16 committee and the issues it will examine concern far more
17 than the current recovery. This committee is really
18 about laying long-term groundwork, balancing the task of
19 encouraging capital formation with the vital need for
20 effective regulation that keeps markets stable and
21 encourages investor confidence.

22 I look forward to working with you to
23 invigorate the American tradition of enterprise and
24 growth, and to supporting the small businesses in the
25 important role in the American economy again.

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1 Thank you again for being part of this
2 important effort. And now I'd like to introduce Meredith
3 Cross, who will talk about the Division of Corporation
4 Finance's initiatives, the Commission staff with whom
5 you'll be working, and the Division of Corporation
6 Finance's role with respect to the committee. Thank you.

7 MS. CROSS: Good morning. Thank you very much,
8 Chairman Schapiro. We very much appreciate the
9 commitment you've made to the Advisory Committee. It
10 shows just how important this topic is to all of us. I
11 would also like to welcome all of you and thank you for
12 taking the time to be here with us today and share in
13 your experience and insight with the Commission and with
14 the public. I will be very brief, because we have a full
15 day of discussing important topics ahead of us.

16 My division, the Division of Corporation
17 Finance, is particularly interested to hear your thoughts
18 on the issues at hand, because we are hard at work on
19 several work streams related to the key topics on today's
20 agenda.

21 A few months ago, Chairman Schapiro instructed
22 the staff to take a fresh look at some of our rules to
23 develop ideas for the Commission to consider that may
24 reduce the regulatory burdens on small business capital
25 formation in a manner consistent with investor

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1 protection. The staff's review is focusing on a number
2 of areas that are on today's agenda, including the number
3 of shareholders and other triggers for public reporting,
4 the restriction on general solicitation in private
5 offerings, restrictions on communications in public
6 offerings, and the regulatory questions posed by new
7 capital raising strategies such as crowd funding, and the
8 scope of our existing rules that provide for capital
9 raising.

10 We are committed to carefully considering these
11 areas and developing thoughtful recommendations for the
12 Commission. A critical goal of the SEC is to facilitate
13 companies' access to capital, while at the same time
14 protecting investors. Your input will be invaluable to
15 the staff as we formulate recommendations for the
16 Commission.

17 I'll introduce my staff by name a little later,
18 but I'd like to echo Chairman Schapiro's thanks to the
19 Office of Small Business Policy, which is responsible for
20 coordinating this committee, and is also involved in much
21 of our rule-making -- rule-making that affects small and
22 emerging businesses. As advocates for small business
23 within the division, they are keenly interested in and
24 will benefit greatly from the advice you will provide.

25 I'd also like to thank Jennifer Zepralka, who's

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1 one of my counsels. Among her many other
2 responsibilities, I've asked her to assist with the
3 committee, and she has been hard at work on this project
4 for many weeks now.

5 Now I'd like to turn it over to Chris and Steve
6 to kick off today's meeting.

7 MS. JACOBS: Thank you, Meredith. Good morning
8 again. My name is Christine Jacobs, and I am the
9 chairman and CEO of a public company. We are an NYSE
10 company. We went public in 1986 with three subsequent
11 private placements. I've been a sitting CEO now for 18
12 years, and I have seen and dealt with most of the public
13 company issues that we'll discuss today and in subsequent
14 meetings.

15 Theragenics manufactures radioactive seeds that
16 are used for early stage prostate cancer, but we also
17 manufacture 3500 other medical devices in four factories
18 in four states. And at least as of today, all of the
19 jobs that we have created are U.S.-based and our product
20 is 100 percent made in the United States.

21 Rather than using my allotted time this morning
22 to tell stories or to whine, I thought I'd -- I thought I
23 would take a moment and provide some facts today. These
24 are coming from a recently released study at Ohio State
25 University where they defined the middle-market companies

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1 in the United States as companies with revenue of 10
2 million to a billion -- that's revenue, not market cap --
3 with no distinction to whether they were public, private,
4 or family businesses.

5 And the first fact that they provided in their
6 study, if middle-market companies in the United States
7 were a country, our GDP would rank the fourth largest in
8 the world, just behind Japan. These middle-market
9 companies contribute \$3.84 trillion annually to our
10 economy.

11 Another fact: 27 percent, or nearly a quarter,
12 of all the large companies in 2010 were middle-market
13 companies in 2005, so in the span of five years became a
14 larger company.

15 Another fact: From 2007 to 2010, the height of
16 the -- during the height of the recession, middle-market
17 companies in the United States, those that survived,
18 added greater than 2 million jobs. During the same
19 period, large companies shed 4 million jobs.

20 And the last fact comes from the Department of
21 Treasury study that was in our binder. The IPO Task
22 Force estimates the cost that being public in a post-IPO
23 situation, that these companies shoulder \$1.5 million in
24 costs to be public per year. As of this year, and over
25 the past five years, I went back and calculated what

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1 we've had to do at Theragenics, and our annualized costs
2 are 3.9 million per year. That excluded health care and
3 all benefits to employees.

4 So in sum, we're all here today because we care
5 about our respective businesses and our sectors. My co-
6 chair and I sincerely hope that this activity and this
7 committee, that our discussions are productive and that
8 this committee produces a work product that matters, and
9 it leads to actions and changes on behalf of small and
10 emerging companies. Thank you. Stephen?

11 MR. GRAHAM: Thank you, Chris, and thank you,
12 Chairman Schapiro. Thank you, Meredith, for your
13 remarks, and also for giving us this opportunity to
14 serve. And thank you, Jennifer, Gerry, Lona, and others
15 for all you've done to support the committee so far and
16 all that you will be doing down the road to support us.
17 And thank you, Chris. I would also, of course, like to
18 extend my own welcome to the committee.

19 First of all, by way of self-introduction, I'm
20 a partner in the West Coast law firm of Fenwick & West,
21 and Fenwick has always had a strong focus on small and
22 emerging high-tech and life sciences companies starting
23 with its incorporation of Apple way back when. And today
24 we are able to list among our clients companies such as
25 Facebook and Twitter, so we fully appreciate how small

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1 companies can become big companies, given the
2 opportunity.

3 And I spent the last 20 years or so serving as
4 general outside counsel to such companies handling
5 private and public offerings and M&A transactions, in
6 addition to corporate governance.

7 This is really our organizational meeting. And
8 as such, we will be spending a good part of today on
9 administrative manner -- matters and orienting ourselves
10 and placing ourselves in a position to do our real work
11 going forward.

12 It has been pointed out by others so far, you
13 know, none of you need to be told of the importance of
14 the small and emerging companies sector to our nation's
15 economic well-being. You know, Chris has cited some of
16 the statistics, more is in your background materials, and
17 you live it every day.

18 The health of that sector is critical. And one
19 very important piece to the puzzle, you know, has to do
20 with securities regulations, which impact these
21 companies' ability to raise capital in the first
22 instance, and then to deploy that capital in ways that
23 are truly productive. Clearly, dollars not spent on
24 compliance are dollars that can be spent on jobs and
25 research and development, and spurring economic growth

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1 and changing people's lives in a fundamental way.

2 The purpose of this committee has been
3 summarized in many different ways. And you've been
4 hearing a lot of that this morning, since you agreed to be
5 a part of this committee. But the way I see it is that
6 our purpose really is to keep an eye on things in that
7 regard, to identify issues, understand from a real world
8 perspective what works and what doesn't work, and advise
9 and make recommendations to the Commission accordingly.

10 Obviously, investor protection is a part of the
11 equation, and the right balances must be struck, but no
12 one said this is going to be easy. These are real
13 issues, and this committee is charged with being a part
14 of the solution.

15 We will spend, again, most of the morning on
16 administrative items and end with a broad discussion of
17 the issues confronted by small and emerging companies,
18 sharing your perspectives. And then we'll adjourn for
19 lunch and then begin the process of framing issues on our
20 agenda for the coming months.

21 As Chairman Schapiro said, in terms of the end
22 game, we will not be delivering, you know, one
23 comprehensive final report. Instead, during the life of
24 this committee, we'll be delivering a series of
25 recommendations to the Commission as those

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1 recommendations are formulated.

2 In terms of kind of thinking about how we might
3 be conducting our business going forward, I would
4 anticipate that we'll meet quarterly, if not more often,
5 if needed. And at least initially, I would anticipate
6 that all of our meetings would be in-person here at the
7 SEC.

8 And the last note is could you have your --
9 turn your cell phones off, and put your Blackberries and
10 all those other things in your pockets and your
11 briefcases.

12 So that concludes what I want to say as far as
13 introductory remarks. And I would like to take -- right
14 now take some time to give each of you an opportunity to
15 give a brief self-introduction to your colleagues. So
16 why don't we start with you, Dave.

17 MR. BOCHNOWSKI: Good morning. I'm Dave
18 Bochnowski. I'm the chairman and CEO of the Northwest
19 Indiana Bancorp. It's a public company. I took it
20 public in 1984. We have about 400 record shareholders,
21 shareholders of record. We operate through a subsidiary,
22 which is People's Bank. We're about 25 miles from the
23 City of Chicago, and approximately 50 percent of all of
24 our lending is to small business.

25 MR. BORER: My name is John Borer with Rodman &

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1 Renshaw. I run investment banking there. I've been
2 there 20 years now. Rodman & Renshaw is a brokerage
3 firm. It's been around 60 years this year, principally
4 focused in working with small emerging growth companies.
5 About 85 to 90 percent of the companies we work with are
6 public companies or companies that are coming public.
7 I've seen both sides of the coin on this thing. Our company,
8 in fact, is public, has been public twice during its
9 history. Went public again in 2007. And we're
10 principally focused in technology, life sciences, the
11 energy and resources areas, as well as clean tech in our
12 businesses.

13 MR. CHACE: Thanks. My name is Dan Chace. I
14 manage the Wasatch Micro Cap Fund, which is a fund
15 focused, as the name implies, on micro cap growth stocks
16 in the U.S. Wasatch Advisors is a \$10 billion money
17 manager out of Salt Lake City, Utah. Now we're
18 diversified across market caps and geographies. But
19 really, the history of the firm is small cap growth
20 investing. Been in business for 35 years. And I look
21 forward to providing insight on -- to this committee on
22 perspectives from an institutional investor in small cap
23 stocks.

24 MR. CHANG: My name is Milton Chang. I grew up
25 in Hong Kong and came over for college. I got my

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1 engineering degree from the University of Illinois and Caltech.
2 I'm currently a trustee of Caltech. I have joined two --
3 I had grown two small companies to IPO, and also have
4 been investing in many startup companies, and of which
5 quite a number were acquired, and six of them went IPO.

6 I'm very interested in entrepreneurship. I've
7 been writing a column for a technical magazine for over
8 15 years and, recently written a book called Toward
9 Entrepreneurship, which is getting very good reviews and
10 interest. And I hope to present a small company
11 operational perspective. Thank you.

12 MR. DENNIS: My name is Leroy Dennis. I'm a
13 partner in the national CPA firm of McGladrey & Pullen.
14 I'm based out of Minneapolis, Minnesota. My history with
15 the firm, I have served in a variety of roles, but our
16 firm serves mostly private and public small businesses.
17 We don't do any -- or I don't believe we do any Fortune
18 500 companies, so all of our practice is dedicated to
19 the focus of this group.

20 I had the privilege of serving with Gerry
21 Laporte about six years ago, I believe, on the Smaller
22 Business Advisory Committee that the SEC formed after the
23 Sarbanes-Oxley Act was passed. And my advice to this
24 group is you will seem a little -- you will be frustrated
25 at times by your recommendations. But I would say,

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1 Gerry, most of our significant recommendations were
2 eventually adopted, and so I feel very proud of that. So
3 look to the long term as you make recommendations in this
4 group.

5 MS. GREENE: Hi, I'm Shannon Greene, chief
6 financial officer with Tandy Leather Factory in Fort
7 Worth, Texas. We are a very small public company. We
8 went public in 1993 via a reverse merger. We run
9 company-owned stores selling leather and leather craft
10 supplies. We're in 40 states in the U.S., Canada, UK,
11 Australia, and are planning to open in Spain in the
12 fourth quarter.

13 We do about 60 million in revenue. Our market
14 cap's about 50 million, so I think we're at the very
15 bottom of what would be considered a small public
16 company.

17 I'm thrilled to be here and hope I have
18 something to add as the committee develops.

19 MR. LEZA: My name is Richard Leza. I'm from
20 the -- California. Basically, I've been in the venture
21 capitalist business about 30 years. I just retired, and
22 mostly I just sit on Boards, either private, public or
23 non-profit now. I'd like to say that -- you have my bio
24 there, but most of the things I'd like to bring up is
25 that when I came out of the Stanford Business School, I

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1 started seven companies in startup mode. Five of them
2 succeeded. One of them failed. And then after that, I
3 went across the table and I became a venture capitalist
4 for the last 15, 17 years, and I'm here to try to help
5 from my experience in the startup business.

6 MS. MCGOWAN: I'm Kathleen McGowan. I'm vice
7 president of finance for Tobira Therapeutics. We're a
8 small biotech in New Jersey where currently our one
9 product is in Phase IIb. It's an HIV drug. We're always
10 looking out for funding, and it's very important looking
11 at 404 and some of these other areas we're going to
12 discuss.

13 I have over 28 years of diversified financial
14 experience from Johnson & Johnson. I've significantly
15 gone smaller and smaller. My current company is 10
16 people. So I think I have a varied background in finance
17 and an understanding, and have been involved in the
18 implementation of 404 and small public companies as well.
19 Thank you.

20 MR. MAEDER: Hi, I'm Paul Maeder, general
21 partner at Highland Capital, a firm I helped get started
22 in 1987. We're a typical high-tech venture firm with
23 offices in Boston and Silicon Valley -- no surprise there
24 -- and Shanghai and Geneva. And we've probably funded a
25 couple hundred companies in our history. I'm on the

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1 board of nine private companies now, probably taken 6 or
2 10 companies public and sold a bunch more, so pretty
3 familiar with fundraising and that whole process.

4 I'm a card-carrying engineer. I worked for a
5 couple of startups before going over to the dark side,
6 both Bay Area startups. And the other relevant thing is
7 this year, I'm chairman of the National Venture Capital
8 Association, which is the venture industry's trade group.
9 We represent about 90 percent of the venture firms in the
10 country, and we're devoting ourselves this year almost
11 exclusively to trying to un-break the capital markets
12 that we seem to have gone a bit awry with.

13 MS. SMITH: I'm Karen Smith. I'm deputy
14 general counsel for a company named Zynga, which is
15 located in San Francisco. Zynga makes social games on
16 Facebook, primarily, and also mobile applications like
17 Farmville and Words with Friends.

18 Like Stephen, I spent 10 years before going in-
19 house representing small companies and emerging growth
20 companies in San Francisco, taking many of them public.
21 I'm very excited to be part of this committee. We've had
22 recent interactions with the SEC trying to get a no-
23 action letter, which we were happy to get earlier this
24 year, and we're actually currently in registration. So
25 look forward to being part of the committee.

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1 MR. SQUILLER: My name's Dan Squiller, and I'm
2 the CEO of PowerGenix. We're a company that makes
3 rechargeable batteries for electronic vehicles. I've got
4 experience on the venture capital side, co-founder of one
5 company that went public. We hope to take PowerGenix
6 public in the next couple of years. I also have some
7 experience with FTSE companies. I was the president of a
8 large division of a British company, and I was also
9 chairman of a Japanese public company. So I have a
10 perspective on what some of the other major markets and
11 what their regulations are.

12 MR. SUNDLING: Hello, I'm Charlie Sundling.
13 I'm the CEO of Pipeline Software. I'm a serial
14 entrepreneur and angel investor, which means I've never
15 really had an honest job. We do a lot of work in
16 different markets. And as you can see in my bio, I've
17 been involved in quite a number of startups. Currently
18 CEO of Pipeline Software, which is focused on the energy
19 sector, in particular oil and gas and commercial nuclear.

20 We are a private company. We're based in
21 California. And actually, our first outside counsel was
22 Fenwick & West over there, Steve.

23 MR. GRAHAM: What do you mean by ``first,``
24 Charlie?

25 MR. SUNDLING: And we have over the years been

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1 involved in various methods of fundraising, and in
2 particular had an interesting experience with the London
3 AIM exchange, which I hope to share with you folks as we
4 go along. Thank you.

5 MR. WALSH: Good morning. My name is Tim
6 Walsh. I'm the director of the New Jersey Division of
7 Investments. We manage the State of New Jersey's pension
8 fund for approximately 780,000 either current retirees or
9 future retirees. In addition, we manage approximately
10 another 15 billion in small cap equities, money market
11 funds, et cetera. We're based out of Trenton, New
12 Jersey, and we manage most of the money internally,
13 especially on the long-only side.

14 We're also fairly active in the IPO market.
15 We've participated in approximately 30 in the last year
16 or so. We actually do have exposure to the small cap or
17 the micro cap area. We have about 100 to 150 companies
18 that we follow, and we have investments of a little under
19 200 million. So like Dan from Wasatch, I hope we can --
20 I can provide an institutional viewpoint for small cap
21 U.S. companies. Thank you.

22 MR. YADLEY: I'm Greg Yadley. I'm a lawyer
23 with a medium-sized law firm in Tampa, Florida. My hobby
24 growing up was Indian lore, and I thought Tandy Leather
25 Company was one of the biggest companies in the whole

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1 world, because I was a very big buyer of leather goods
2 there.

3 I started my career here at the SEC and have
4 been in private practice for 30 years representing
5 businesses of all sizes. Went through the economic
6 cycles of tax shelter deals in the early days, then IPOs,
7 then taking some of those companies private, taking them
8 dark, taking them through bankruptcy. Been very active
9 representing small public companies and working on issues
10 on behalf of various committees of the American Bar
11 Association. I'm currently the chairman of the Middle-
12 Market and Small Business Committee of the ABA.

13 MR. ABSHURE: Good morning. My name is Heath
14 Abshure. I'm the Arkansas securities commissioner, also
15 the chairman of the NASAA Corporation Finance Committee,
16 as well as the chairman of the Small Business Capital
17 Formation Committee that's recently chartered by NASAA.
18 I've been securities commissioner for I guess about four
19 years, private practice before that, and also an employee
20 here at the SEC. So I've worked for the federal
21 regulator, the state regulator, and private practice.
22 The only thing I don't have is SRO, but it turns out my
23 wife worked for the SRO, so -- I'm very happy to be here.

24 MR. GREENE: Thank you. Sean Greene. I run
25 the investment innovation programs at the Small Business

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1 Administration. That includes both the programmatic
2 piece, so I run the Small Business Investment Company
3 platform, which is effectively a fund of funds with \$16
4 billion of assets under management. Then there's also an
5 advocacy role in working with high-growth companies in
6 particular who don't have lobbyists representing them in
7 Washington or time to participate in the policy process
8 to look to see how we can be advocates for their needs
9 here in D.C.

10 Prior to this, I have 20 years of private
11 sector experience. I've been at McKinsey for a while.
12 Then I don't know if it was Ben or Jerry who used the
13 line "Unencumbered by the burden of prior experience, I
14 became an entrepreneur." So I come to this from an
15 entrepreneurial perspective. And then also spent time as
16 a seed-stage investor.

17 MR. GRAHAM: Okay. Well, thank you all. As
18 you can see, this committee represents a lot in the way
19 of broad and varied relevant experience, and we look --
20 we all look forward to sharing each other's views. They
21 are all important. I know you don't have to be reminded,
22 but I would just say so. Just don't be bashful about
23 expressing yourself.

24 Okay. Let's go -- let's move on to our -- oh,
25 now? Well, sure, we can do that. Sorry about that.

0029

1 Yeah.

2 MS. CROSS: Yeah, I'll do that quickly. I also
3 will -- just to get this on the record. I don't think
4 anybody's given the disclaimer yet for all of us. So for
5 whenever the SEC or the staff members talk, we have to
6 say that the views we express are our own and don't
7 represent the views -- or don't necessarily represent the
8 views of anyone else on the Commission or on the
9 Commission's staff. Said for all. So very --

10 MR. GRAHAM: And by the way, Meredith, we are
11 ahead of schedule now, so don't feel rushed.

12 MS. CROSS: I know. This is the most efficient
13 committee I've ever seen. I'm very impressed. It's
14 great. And I'm not rushing, but I'm just going to do
15 quick introductions, because -- and then I think maybe
16 we'll -- after that, I think we're going to be doing the
17 bylaws? Is that --

18 MR. GRAHAM: Right, right.

19 MS. CROSS: Yeah. And then if we're ahead of
20 schedule, we can go ahead and hear from Craig, I think
21 would be the -- our chief economist.

22 So anyway, now I wanted to let you know who's
23 here with us and involved in the work of the committee.
24 Many, if not all, of you have been in contact with Gerry
25 Laporte, who's the chief of our Office of Small Business

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1 Policy, and Jennifer Zepralka, who's one of my counsels.
2 They're down on the end. They, along with Johanna
3 Losert, a special counsel in Gerry's office, and Chris
4 Sheedy, who's the business -- with our business
5 management staff in CorpFin, and Michelle Oglesby, who is
6 acting as the committee's travel coordinator, and an
7 intern, B.J. Pivonka, have worked hard to plan this
8 meeting.

9 We also have here today Lona Nallengara, right
10 here, one of my deputy directors. Lona oversees the
11 regulatory and policy offices, including the Office of
12 Small Business Policy. He also has under him -- so you
13 can see the breadth of his work -- the Chief Counsel's
14 Office, the Office of International Corporate Finance,
15 and the Office of Mergers and Acquisitions. So he has a
16 lot to do. He joined us last year -- no -- this year.
17 He's still new. Sorry. I had to beg him to come. He
18 joined us. He was a partner at Sherman and Sterling in New
19 York, and has provided great real-world experience to us
20 here.

21 Mauri Osheroff, who's over there in the
22 audience, is the associate director, regulatory policy,
23 and she has under her the small business office and the
24 M&A office and the international office. And then other
25 office from the -- other staff from the Office of Small

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1 Business Policy, Tony Barone and Karen Wiedemann are in
2 the audience as well.

3 From other divisions, we have Ignacio Sandoval,
4 a special counsel in the Office of Chief Counsel in the
5 Division of Trading and Markets, and Kathleen Hanley and
6 Vlad Ivan -- I'm sorry -- Ivanov from the Division of
7 Risk, Strategy, and Financial Innovation. And also,
8 Craig Lewis, who's the director of the Division of Risk,
9 Strategy, and Financial Innovation, and also our chief
10 economist, is here.

11 And Jim Kroeker, the Commission's chief
12 accountant, is coming to join us later in the afternoon.
13 And now we're -- I'm going to turn back over to you to
14 talk about the bylaws.

15 MR. GRAHAM: Okay, thank you. Now on to that
16 kind of -- that first kind of key administrative point.
17 As you know, we are governed by our charter and by the
18 Federal Advisory Committee Act, as well as our bylaws.
19 You should have received the charter and materials that
20 were sent to you several weeks ago. You also all should
21 have received a copy of the proposed bylaws by last week,
22 I believe. As you know, they state our purpose, they
23 kind of point out the SEC support responsibility, and
24 address governance and administrative matters.

25 Could I have a motion?

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1 MR. CHANG: So moved.
2 MR. GRAHAM: Okay. Is there --
3 PARTICIPANT: Second.
4 MR. GRAHAM: Okay, thank you. Any discussion?
5 MR. MAEDER: Who's the CFO?
6 MR. GRAHAM: The DFO.
7 MS. CROSS: I am.
8 PARTICIPANT: You are.
9 MS. CROSS: Unless one of you want to be.
10 MR. GRAHAM: No, we don't.
11 MS. CROSS: And I have the ability to sub-
12 delegate my responsibilities. And you're seeing the --
13 PARTICIPANT: Where are the sub-delegees?
14 MS. CROSS: They're my sub-delegees. But I'm
15 responsible, so I'm the one whose fault it is if
16 something goes astray.
17 MR. NALLENGARA: Whether with regard to this
18 committee or anything else.
19 MS. CROSS: Or anything else. I just take
20 responsibility for anything that goes astray.
21 MR. GRAHAM: And Chairman Schapiro is our
22 sponsor. This is my understanding.
23 Okay? Shall we vote? All those in favor?
24 (Chorus of ayes.)
25 MR. GRAHAM: All those opposed?

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1 (No response.)

2 MR. GRAHAM: Abstain?

3 (No response.)

4 MR. GRAHAM: We now have bylaws. According to
5 our agenda, we can have a break. But since we have --
6 since we're ahead of schedule, do you want to just --

7 MS. CROSS: So we'll have Craig Lewis, our --
8 the chief economist of the Commission is going to get --
9 provide some remarks.

10 MR. LEWIS: Yes, I'm clear. So thank you very
11 much, Meredith, for giving me an opportunity to present
12 here this morning, and I want to welcome everybody who
13 are willing to participate in this.

14 Just to follow up on a comment that Greg made
15 earlier. Shannon, I also thought Tandy Leather was one
16 of the largest companies in the universe when I was a
17 youngster. There's the infamous Christmas where all my
18 relatives received coasters and key-holders. That still
19 lives in infamy, actually.

20 MS. GREENE: Maybe you should repeat that this
21 year.

22 (Laughter.)

23 MR. LEWIS: But what I wanted to talk about
24 this morning was basically the results of a staff study
25 that RiskFin prepared that looks at unregistered security

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1 offerings that are made possible through the Reg D
2 exemption process. And this is an analysis that was put
3 together by Scott Baugess and Vlad Ivanov, who are in the
4 room this morning. And I've already given the
5 disclaimer, so I think we could skip to maybe the third
6 slide? Great.

7 And so as far as the discussion I'd like to
8 make, I'd like to speak briefly about some results. So
9 the -- what happens is there is a Reg D exemption that is
10 provided to companies who would like to avoid the normal
11 registration process. And there are essentially five
12 exemptions that qualify for -- that allow firms to go
13 through this process. There's a -- they're Rule 504,
14 Rule 505, and Rule 506. And essentially, these different
15 rules provide different levels of clearance.

16 So you can -- so the Rule 504 basically gives -
17 - it restricts investment amounts, or if you want to
18 raise capital of under a million dollars. And if you've
19 done this, raise under a million dollars in the last 12
20 months, you have an opportunity to make this type of an
21 offer. And then the rules just go and increase the
22 amount of capital that you're able to raise through this
23 process.

24 So the 504 exemption restricts it to under a
25 million, the 505 exemption restricts it to under 5

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1 million, and then the 506 exemption is an unlimited
2 amount of capital that you're able to raise.

3 Now, corresponding to these different levels of
4 capital formation, we have different sort of screens that
5 we place on the investors who are actually able to
6 participate in these types of offerings. So for the 504,
7 because it's a relatively small amount of capital, anyone
8 could actually invest in these type of offerings. As we
9 go to the 505, it becomes all accredited, but less than
10 or equal to 35 non-accredited investors. And then for
11 the 506, you have to be -- it's all accredited and less
12 than or equal to 35 sophisticated non-accredited
13 investors.

14 So on the one level, we raise the amount of
15 capital that is able to be raised under these different
16 exemptions. At the same time, we increase or heighten
17 the sophistication of the requirements for those that are
18 able to participate in these type of offerings.

19 Now, interestingly enough, of all these
20 different offering rule exemptions, the 506 is the
21 dominant one, and 92 percent of all these offerings
22 actually go through the 506 rule.

23 So if we could -- so what I would like to do is
24 talk briefly now about some of the results of the study.
25 So what -- the study was based on a Form D filing that

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1 anyone going through this process is required to file
2 with the SEC. And filing the Form D itself requires the
3 issuer to provide a lot of information about who they are
4 and where they're located. It also allows us to ask how
5 much capital are you trying to raise through the process,
6 and just give some basic sort of demographic information
7 and a relatively limited amount of financial information
8 about the filer.

9 So from this, we have then compiled some
10 aggregate statistics. And I think some of the results of
11 this analysis are maybe a little bit surprising. I
12 thought we'd try to share some of those results with you.
13 So we're going -- I'm going to talk briefly about what
14 does the aggregate capital formation that's coming from
15 these unregistered offerings look like, and how does it
16 compare to the universe of other types of public filings
17 and private filings that are made possible, you know,
18 through the SEC.

19 I'd like to speak briefly about what appears to
20 be a shift that's taking place from public to private
21 financing, and also talk as well about the participation
22 of foreign issuers in this process as well. So briefly -
23 - next slide, I guess.

24 So one of the things that we have found is
25 that, historically, debt offerings have been the dominant

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1 source of capital that firms have used. And in -- the
2 study that we looked at covers 2009 through the first
3 quarter of 2011. And what we have found is that going
4 from 2010 to 2011 that debt offerings have been replaced
5 by sort of unregistered security or private security
6 offerings for the first time. And this would include not
7 only debt offerings, but IPOs and other sources of
8 capital that small businesses would look at.

9 So next slide, please. I can show you a bar
10 graph that demonstrates this. So if you're looking at
11 this slide, you'll notice that on the left-hand side, we
12 have capital that has been raised through public debt
13 offerings. And then just going from left to right, you
14 see public equity, the unregistered, sort of the private
15 Reg D offerings. We have 144A offerings, which are
16 shelf registrations. And then finally, we have Reg S
17 offerings, which are foreign offerings.

18 And this slide demonstrates to you, I think,
19 the importance historically, or at least in 2010, of
20 public debt offerings. So that tall spike on the left-
21 hand side represents \$1,131,000,000 in capital have been
22 raised through public debt offers. That is the largest
23 amount of capital. Historically, that's the way things
24 have looked across all markets.

25 And if you look at the Reg D offering, you'll

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1 notice that it has now become the middle bar is the 2011
2 result. You can see that it is now actually larger than
3 any of the other types of capital formation that have
4 occurred. So that's, I think, an interesting and new
5 result, sort of the substitution of sort of debt offering
6 for equity offering, but most notably going through
7 private markets.

8 So the next slide I'd like to talk briefly
9 about is the private or public financing. So now the
10 choices when we look across the entire spectrum that we
11 saw on that first slide, there is a combination of
12 private and public sourced debt. What you'll see there
13 is that you'll notice that public issuances fell from
14 2009 to 2010. So what I have done in this slide is I've
15 just aggregated across the different forms of financing,
16 those that are public and those that are private. And
17 what we find is that they -- that what's going on here is
18 that the public issuances fell 11 percent, right, which
19 is not surprising, given what we've seen in the popular
20 press.

21 We're all aware of the fact that public
22 issuances of debt and equity have gone down. But what is
23 taking place, to a certain extent, is a substitution away
24 from public markets into private markets.

25 And so the next slide shows you a bar graph

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1 that was similar to the first one in which it sort of
2 demonstrates this result in a graphic manner. And so the
3 left side, the left two set of bars, represent 2009, and
4 the dark bar represents -- it's going to represent
5 private. And the left -- then the right side -- I'm
6 sorry -- is public, and the right side is private. And
7 what you can see is there's a -- it's a substitution
8 effect that we're talking about.

9 We go to the next slide. I'm going to talk
10 about some other findings in that. And what we're trying
11 to address here is just some other summary statistics
12 that we have calculated based on these filings. And the
13 question, essentially, we're asking is, does Reg D meet
14 the capital formation needs of small businesses, which
15 was the intent of the original role.

16 And there have been a large number of smaller
17 offerings, 37,000 unique offerings, since we started
18 collecting this data in 2009, and the median size of the
19 offering is relatively modest. It's about a million
20 dollars. So there are a lot of issuers who are making --
21 are availing themselves to the unregistered security
22 market, and they're going for relatively modest amounts
23 of capital.

24 I think one of the other things, if we can go
25 to the next slide, is sort of the participation of

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1 foreign issuers in this market. So what we see from this
2 slide is that there has been, I think, some discussion
3 about U.S. issuers losing out to or moving to foreign
4 capital markets to raise money. But what we're finding
5 here is there is significant participation on the part of
6 foreign issuers in U.S. capital markets, but through this
7 Reg D exemption process.

8 So the results, if we can go to the next slide,
9 sort of demonstrate some of these graphically. What you
10 can see here is that, basically, for the period that
11 we're looking at, 25 percent of all the capital raised
12 through this process is coming from foreign issuers
13 themselves, and it increased almost a third from 2009 to
14 2010.

15 So to some extent, the argument that U.S.
16 capital markets are not as competitive as they've been
17 historically is based on looking at public activity.
18 When you actually take and examine what's going on in
19 these unregistered offerings, you see a different story
20 begin to emerge, that foreign issuers are using U.S.
21 capital markets to raise capital, and at some level,
22 we're competing effectively with international capital
23 markets.

24 So those are the comments that I had prepared,
25 so I'll turn it back over.

0041

1 MS. CROSS: Thank you, Craig. I wanted to note
2 that while some may find the new electronic Form D
3 annoying, because you have to go to all this trouble to
4 fill out this form that you didn't use to have to fill
5 out, and you used to be able to send in your paper form,
6 it has many benefits, one of which is we can now get this
7 data so we now know a lot more about what's happening in
8 Reg D, and it also facilitates the Blue Sky filings
9 throughout the country. So I think that once people get
10 used to filling out the new form, you will hopefully see
11 the benefits that we're seeing in it.

12 MR. GRAHAM: Okay. Well, we are still ahead of
13 schedule, but I think we'll go ahead and we'll take --
14 what do we need, 15 minutes? Do you want to do that
15 before I jump into -- let's take a brief break, and then
16 go to the issues, okay? So back on at 10:15.

17 (A brief recess was taken.)

18 MR. GRAHAM: Okay. Let's see if we can't get
19 restarted. We want to spend the balance of the morning
20 with a broad discussion of some of the key issues facing
21 small and emerging companies in the securities regulation
22 context. What we will do is Meredith Cross and perhaps
23 others with the Commission will lay some context with us
24 back to some of the key issues that we expect to drill
25 down on later on today.

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1 And as part of that, one of the things that we
2 would like to do is to, you know, hear your thoughts, at
3 least your initial thoughts on some of the issues that
4 are being teed up, and also get some of your thoughts on
5 some issues that may -- may not be mentioned in that --
6 in the course of that discussion.

7 We will see where that takes us, but the -- and
8 we might end up doing part of this afternoon's work this
9 morning. Because again, this afternoon, we wanted to
10 take -- you know, certainly beginning with the key issues
11 that we've already kind of teed up for you, take those
12 issues and, you know, spend some time, you know, drilling
13 down as a group.

14 So for now, I guess I'll turn it over to you,
15 Meredith.

16 MS. CROSS: Thank you very much. The -- and I
17 want to thank the committee in advance. We started off
18 with the topics, some of which we're doing today, which
19 are essentially assignments that we've given you. We
20 have issues the chairman had asked us to look into where
21 we wanted to get the input of the Advisory Committee in
22 addition to the work we're doing on the staff in studying
23 the issues ourselves.

24 So this first one that I'm going to talk about,
25 which is the triggers for public reporting, is one of

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1 those. And it's -- I'll run quickly through what the
2 requirements are, and then I think it would be very good
3 if we could at least start the conversation around the
4 table as to how you think we should be thinking about
5 this.

6 I'll begin by saying that we are in the middle
7 of a big study, which is very challenging. Because it's
8 extremely difficult to get information about private
9 companies that would be necessary in order to inform our
10 study. So that's one of the big challenges of this and
11 one of the reasons we wanted to get your input on it.

12 So as you probably know, companies that have to
13 be reporting companies in several different ways. If you
14 do an IPO, you have to report for at least a year after
15 the IPO because of Section 15(d) of the '34 Act. If you
16 are listed on an exchange, like NASDAQ or the New York
17 Stock Exchange, you have to be a reporting company
18 because of Section 12(b) of the '34 Act.

19 And then the one that's been getting all the
20 attention lately is Section 12(g). And 12(g) requires
21 that a company register its securities and start filing
22 reports if its securities are held of record by 500 or
23 more persons and the company has total assets exceeding
24 10 million. Now, the 10 million was increased by the
25 staff to 10 million back in -- by the SEC, sorry, not the

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1 staff -- in the early '90s and hasn't been adjusted since
2 then. The 500 number has always been there, since the
3 beginning of the rules.

4 Section 12(g) was adopted in 1964 following a
5 rigorous special study of the securities markets that was
6 done in the early '60s, and it was commissioned by
7 Congress and conducted by the SEC. The concern had been
8 that there had become an active trading market, which
9 eventually became NASDAQ, an over-the-counter trading
10 market, in which investors had no information because
11 the companies weren't listed and the company hadn't done
12 a registered offering. So there was a very opaque market
13 in which securities of companies were trading.

14 There's interesting corollaries to today,
15 because now we have what's known as the OTC Market --
16 used to be the Pink Sheets -- where you also don't have
17 to be a reporting company if you -- unless you otherwise
18 trip the 12(g) levels. And that's one of the issues that
19 we'll want to talk about today is what is the right test
20 there when you look at the OTC Market.

21 Following the adoption of Section 12(g), one of
22 the first things the SEC did was needing to define "held
23 of record." And the definition counts as holders only
24 the people identified as owners on the security holder
25 listing maintained by the company or on its behalf in

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1 accordance with accepted practice.

2 And so what that means is that companies that
3 are held in street name, only the nominee, the broker-
4 dealer who holds for the street name holders, counts as a
5 holder of record. So you'll have -- you could have
6 literally tens of thousands of investors in a company,
7 and if it's held in street name, then you may only have a
8 hundred holders if it's held at a hundred broker-dealers,
9 for example.

10 The -- that's in contrast to the private
11 companies. So in private companies, most pre-IPO
12 companies, not all -- and that's one of the things we're
13 trying to learn about now, and we'd love to talk with you
14 all about. Most private companies, holders are holders.
15 You keep track of your holders, because you want to make
16 sure you don't go up over 500.

17 You also want to -- I mean, frankly, from what
18 I understand, you'd like to know who your holders are.
19 So even if you could be held through DTC, you -- you'd
20 like to -- you want to know who your owners are, so you
21 don't allow your securities to be deposited in DTC. And
22 you -- and so for you, for those kinds of companies,
23 500's really 500. So you could be -- you could be at
24 499, you need more money, and you can't get any more
25 holders or you're going to cross 500. So for companies

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1 that are held directly, the 500 level is a much harder
2 level than for companies that are held not that way.

3 An interesting fact that we've been learning
4 that I was very surprised to learn -- and again, we're at
5 the early stages of studying it -- is that there are not
6 an insignificant number of pre-IPO companies that
7 actually are held through DTC. So they are not companies
8 that are the sort of typical venture-backed pre-IPO
9 companies where you wouldn't be held in DTC, but some
10 other kind -- other companies where once the holding
11 period has expired on the shares so they can be freely
12 traded in compliance with the '33 Act, securities are
13 deposited in the DTC, and they can trade in the OTC
14 Market even though they never went public. They never
15 were a reporting company. And then they will never get
16 to 500 holders, because they're held by a small number of
17 brokers who then facilitate trading in those securities.

18 So it's an interesting anomaly where you have
19 pre-IPO companies that are the classic venture-backed,
20 very controlled in the ownership, and the -- what we
21 understand to be other pre-IPO companies that are widely
22 traded in the OTC Markets and never were reporting
23 companies.

24 The group -- the latter group, I think, has
25 been featured in some of our Micro Cap Fraud Task Force

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1 cases, because those companies, there's just no
2 information, yet they're trading, you know, in great
3 volume. So that's a concern. It shows, in part, what
4 the problem is with our 500 holders of record test and
5 how one deals with the street name ownership, and is one
6 of the questions that we are looking at.

7 The other interesting thing with the 500
8 holders test is that you get to stop reporting if you
9 drop below I think it's 300. This doesn't have the
10 number, but -- yeah, 300. So if you drop below 300
11 holders, you get to stop reporting. People call that
12 ``going dark.``

13 Just like we are constantly getting hollered at
14 for the 500-holder being too hard of a threshold, we're
15 also hollered at for it being too easy to go dark.
16 Because investors are very concerned. They make an
17 investment in a company. They think the company's going
18 to continue to be a reporting company. And then either
19 through a stock buyback program or just because the
20 securities are held in DTC, and so the number is more
21 easy to drop below 300, the number drops below 300 and
22 they stop reporting. They go dark.

23 And there's been many investor complaints about
24 that practice, and there are -- including we've gotten a
25 rule-making petition asking us to change the rules for

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1 going dark. So we have a -- it's a problem on both
2 sides, as far as I can tell.

3 So people have been pushing us hard to think of
4 ways to address this 12(g) issue. There's currently
5 bills pending in the House and the Senate relating to
6 Section 12(g). I've testified many times, it feels like
7 at this point, about these issues. There's one on the --
8 two that passed the House Financial Services Committee,
9 one for community banks that would raise the number to
10 2,000, and then one for non-banks that would raise the
11 number to 1,000 but say that you don't count accredited
12 investors. No, you don't count employees. You do count
13 accredited investors.

14 Neither one of those would change how you
15 count. And as you can imagine, the how you count may
16 even have a bigger impact than the absolute number. And
17 -- yes?

18 MS. JACOBS: Meredith, can I ask you a
19 question, a logistic question on this issue? Let's say
20 we have our discussion today, and we're giving input and
21 we're telling you where we're coming from. Is the
22 solution going to be a legislative fix? Because there's
23 already laws now and things coming through, like you just
24 mentioned, in the House and the Senate where these issues
25 are being dealt with. Or is it in a silo where the

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1 security in the OCC can make the change on its own? Or
2 is it a legislative fix?

3 MS. CROSS: The answer could be yes. In
4 general. The -- okay, first off, the SEC has authority
5 to change this. So for example, the SEC could provide an
6 exemption from 12(g) reporting conditioned on a certain
7 number of holders counted in a certain way. And we can
8 do that on our own without regard to what Congress is
9 doing.

10 There is a lot of uncertainty in the
11 legislative process. If Congress changes the numbers,
12 that's, of course, going to change the number. So the
13 baseline number would be different. Instead of 500, it
14 would be either 1,000 or 2,000, and it would say you do
15 or don't count certain people.

16 But that wouldn't -- we'd still be faced with
17 the issue of how should we define held of record.
18 Because the bills don't address that. So we'd still have
19 to figure out how do you count. So if it goes to 2,000,
20 let's say, for a community bank, is it 2,000 holders,
21 beneficial holders? You know, how should that be done?
22 So that's one issue that is important for us to weigh in
23 on.

24 And then, frankly, in light of the
25 uncertainties of the legislative process, just generally,

0050

1 where do we think the number should be? We are -- in the
2 course of the study that Lona is running from CorpFin's
3 perspective, the -- we are looking at facts like -- and
4 facts I think you all would have information about --
5 what is the makeup of companies who are getting ready to
6 go public? How many holders do they have? Is the 500-
7 holder threshold actually a problem? Is it only a
8 problem because you have to count employees? Things like
9 that are not -- there's not a study going on behind the
10 legislation.

11 For us, if we're going to move forward with a
12 rule change, let's assume that legislation doesn't pass,
13 which -- total uncertainty about whether the legislation
14 would pass. What should the number be? We feel like
15 it's important for the Commission to study it at this
16 point and come up with a recommendation, and you're a
17 very important part of that. Did that help?

18 So one of the issues, I think, that's made this
19 an even more complicated question for us right now are
20 the pre-IPO secondary trading markets that have
21 developed. Within those markets, there -- you know, I
22 think there was another article this morning. There's an
23 article every day, or almost every day, it seems, about
24 these markets and SharesPost, SecondMarket, and Gate
25 Technologies. There are a number of them now that trade

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1 -- where people can trade in the securities of pre-IPO
2 companies.

3 I think a lot of these are situations where
4 employees got equity through their investment, you know,
5 over the years as they worked for the company. The
6 holding periods have run; there are rights of first refusal,
7 normally. But there's limits as to how much the company
8 wants to buy back, so the trading occurs in these
9 markets.

10 One of the phenomena that has developed in
11 these markets is that the -- there are single-stock funds
12 with many people behind them that are purchasers in these
13 markets. Again, under the record holder test, they would
14 count as one, unless it's a means to circumvent the 12(g)
15 limits. There's essentially no case law on what it means
16 to circumvent the 12(g) limits, and there's -- so there's
17 very little out there in the way of guidance for how one
18 should treat these single-stock funds. They push a lot
19 on this question of how should we count.

20 If you're looking at a pre-IPO company that
21 has, you know, 450 investors, and 10 of them are single-
22 stock funds with 300 holders each or something like that,
23 you're already looking at an awful lot of people who are
24 exposed to a company as an equity investor without the
25 benefit of reporting or information. Some of them are

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1 imposing information requirements so that you're starting
2 to see more information in these markets.

3 But I think it raises an interesting series of
4 questions for all of us that we want -- we'd love to get
5 your thoughts about. And I think there's going to be
6 different perspectives, depending on where you come from.

7 You know, for the corporate community, you
8 might just assume you do not have to report, and the trading
9 in those markets can provide important liquidity. For
10 others who facilitate companies like that going public,
11 the ability to trade in these markets with very little
12 information may not seem so logical. And for those of us
13 charged with investor protection, it raises interesting
14 questions.

15 You know, there's an awful lot -- there's
16 apparently many billions of dollars changing hands in
17 these markets, and it's not clear how much information
18 there is and what basis there is for those trades to be
19 occurring.

20 So that's the background of this 12(g)
21 question. As you can imagine, this is one of the hardest
22 questions that we're dealing with, because it impacts the
23 full range of, you know, from pre-IPO company to
24 companies that go dark to how one invests in these
25 companies. And we'd like to start the conversation with

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1 this one.

2 MR. MAEDER: May I ask you a quick question or
3 make a comment? So it seems like you and Congress are
4 both responding to a rising chorus of letters,
5 complaints, people concerned about this issue. I would
6 imagine that chorus has grown more and more vocal as time
7 has gone on since starting around 2000, which was the
8 year I mark as the year when the IPO market as we knew it
9 disappeared. So it's basically been a very unhealthy IPO
10 market since then, or no IPO market. I mean, it wasn't
11 healthy from '95 to 2000. I'm not suggesting the bubble
12 was norm. That was very strange.

13 But the venture industry returns for the last
14 20 years have been 26 percent, which is great. It's
15 about what you need for healthy venture industry, given
16 the people are giving you their money for 13 years with
17 no control. For the last 10 years, the returns have been
18 minus .1 percent, so clearly something is badly broken.
19 And it's not cyclical; it's structural. It might have
20 been cyclical the first three or four years, but
21 hangovers only last so long.

22 So my question, these things seem to be a
23 symptom of the fact that you can't get companies public.
24 So companies keep raising money more and more as private
25 companies, they grow bigger and bigger, they get to the

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1 size of Zynga where they have 1,000 employees and they're
2 still private. And that is the underlying -- that is the
3 underlying cause of all of these phenomena. Should we
4 be addressing the phenomenon or the underlying cause?

5 I feel like we've got -- the interstate highway
6 system is broken, and our response is to raise the speed
7 limit on secondary roads. Why don't we fix the highway,
8 and then people won't need to be zipping around on the
9 secondary roads. I just feel like this takes our eye off
10 the ball.

11 MS. CROSS: I guess I would say that I think we
12 need to do both. I think that the -- from what I
13 outlined, I don't think very many people would believe
14 that the current rules for when you have to report make
15 any sense because of the way you count. I mean, if
16 nothing else, the counting is -- it's illogical. And
17 when I have to explain it to people, they -- so I don't
18 think -- the fact that the system for going public has
19 problems with it that we would be discussing,
20 particularly on the scaling of regulations and the other
21 issues. I still think that the question of when should
22 one have to report is still a critical question. And it
23 does -- I'll give you examples where I've heard about it
24 significantly.

25 So if you have, for example, community banks

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1 where stock changes hands because of inheritance,
2 essentially, and you get more and more and more holders
3 through that process, is 500 always the right number? I
4 mean, should -- and, you know, 10 million in assets
5 doesn't help a bank, because they've got -- their assets
6 are their loans.

7 So I think that we -- I think we should be
8 willing to look at all the different issues and not just
9 say, well, that one is just a -- it's a symptom or a
10 sideshow to the bigger issue. I think there's still very
11 much of a need to look at this one.

12 MR. YADLEY: Meredith, just picking up on that
13 comment, part of this depends on what's happening with
14 the company and really what's the business plan.
15 Historically, you were going to go public at some point.
16 That was one of the things you aspired to do when the
17 time was right. So it really was a matter of timing.

18 Now, lots of companies don't want to be public
19 for other reasons that we'll discuss. You know, too much
20 regulation, too much compliance, too much scrutiny from a
21 business perspective.

22 So when you talk about a single-stock fund, for
23 example, as a holder, it sort of depends on what kind of
24 holder is it to me. Because the purpose of having
25 companies register is not so the SEC can have another

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1 public company. It's so that investors will have
2 information. Otherwise, it is crazy to me.

3 I represent companies that their stock is
4 trading on the Pink Sheets, and I know that we're giving
5 no information out. And I know the board is not giving
6 any information out. And you can't do anything. Unless
7 you get your stock basically terminated through some sort
8 of recapitalization, you have a trading symbol, and
9 you're out there.

10 Community banks represent a different sort of
11 area and one that's pretty important. And I think there,
12 for those of you that don't follow this issue that much,
13 one of the points that people make that would like the
14 limit to be raised is these banks are already regulated
15 by federal regulators, for the most part, and they are
16 already publishing financial information on a quarterly
17 basis.

18 It's not perfect because it's at the bank
19 level, and many of these companies are bank holding
20 companies and generally have the same bank holding
21 company level information, and you don't have all of the
22 governance. You don't have any of the governance issues.
23 It's just numbers. But at least it's a basis that you
24 could make a distinction between these types of companies
25 where investors do have information, the companies are

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1 being inspected by the FDIC or the Fed or the
2 comptroller, and other companies.

3 MS. CROSS: Well, and then these Pink Sheet
4 companies that you're referencing, are they held through
5 DTC?

6 MR. YADLEY: Yes. Because some of them -- some
7 of them never went public, but some have gone dark, or
8 gone private. And so there are legacy shareholders and
9 there are DTC holders.

10 MR. BOCHNOWSKI: If I might add to the
11 discussion from the community bankers' point of view. In
12 the interest of full disclosure and confession, I
13 actually headed the American Bankers Association
14 Government Relations Council during Dodd-Frank. And this
15 particular issue as it impacts -- the registration issue
16 as it impacts community banks was clearly present and
17 discussed at great length in both the Senate and the
18 House, and unfortunately, it didn't make it into the
19 legislation.

20 A couple of things. One, I think this is an
21 issue that the SEC and staff has looked at very clearly
22 and I think has a very good understanding of the issue.

23 To echo Greg's point, banks are required,
24 whether you're a large bank, community bank, or whatever,
25 you file quarterly reports, and those are available

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1 through the FDIC. And so you can go on the Internet
2 today and look at the quarterly filings for every bank in
3 the United States, so there's disclosure that way.

4 MS. CROSS: Are those the call reports?

5 MR. BOCHNOWSKI: The call reports, right. And
6 second, under banking regulation, we're required, if
7 you're a bank of over \$500 million, to have an external
8 audit by independent auditors. And you're also required
9 -- and Sarbanes-Oxley to some extent modeled a particular
10 piece of what they did -- we're required to have a CPA on
11 our boards as a financial expert. That was outside of
12 Sarbanes-Oxley.

13 And the third point that Greg raised, in my
14 company's case, we hit the trifecta. Unlike all other
15 small businesses that are registrants, the SEC has no
16 ability to go in and look at what really goes on inside
17 that company. But as to all banks, we get regulated by
18 the State of Indiana, the Federal Deposit Insurance
19 Corporation, and the Federal Reserve. They all have the
20 right to come in annually and take a look at what's in
21 the books and what's in the records and make sure that
22 the reporting is accurate for the obvious reason, deposit
23 insurance.

24 But lest I sound, as Chris warned us, like I'm
25 whining here as a banker, the reality is is that this

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1 issue is not about banking. This issue is about capital
2 formation in small business.

3 I was present last week at a speech that the
4 new chairman of the Federal Deposit -- Marty Gruenberg,
5 the Federal Deposit Insurance Corporation chairman, made.
6 And he said that 40 percent of all small business loans
7 in the United States are made by banks under a billion
8 dollars.

9 And it's the banks that are under a billion
10 that are caught up in this particular issue, because if -
11 - many banks today would like to raise capital. We're in
12 the leverage business. And so for every dollar that we
13 raise that's capital -- and in this particular era, it
14 can be through retained earnings, because it's very
15 difficult to raise capital -- you can leverage that up
16 eight or ten times. You can do loans to that extent.

17 In our case, we spend about \$300,000 a year in
18 compliance. I'm not whining; I'm just stating facts. If
19 you do that over 10 years, that's 3 million bucks. And
20 if you multiply that by 8 or 10, depending on which
21 multiple you want to use, that's 24 or \$30 million of
22 lending that could be available at the community level
23 for small business loans. And ultimately, we all know,
24 and that's why we're here, the employer of choice in
25 America is small business. It's job creation.

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1 So all this gets down to not necessarily
2 banking, per se. And banking is important to me and to
3 my colleagues. But it's really important to the American
4 economy. So we would hope that this issue, while it's
5 clearly in front of Congress right now, and there's going
6 to be a vote in the House this Wednesday, which we think
7 will be successful on this issue, it's also, as Meredith
8 has pointed out, it's within the purview and the
9 authority of the SEC to move forward on this, because it
10 is a regulation and could be promulgated at this level.

11 I would only point out that in 1964, when all
12 this was done -- and now I'm going to stop -- I was a
13 sophomore at Georgetown University. A lot has changed
14 since then in the world, a lot has changed in finance,
15 but this particular regulation has not changed. It needs
16 to be modernized in some way.

17 MS. CROSS: One thing that would be helpful to
18 the conversation is to understand how the -- if we are
19 correct in our thought that shares of community banks are
20 held directly and not through intermediaries. Is that a
21 fair assumption, or are they in DTC as well, and so 500
22 might be 20,000?

23 MR. BOCHNOWSKI: Not at the community bank
24 level. Certainly not in our case. I wouldn't want to
25 deny, Meredith, that we have record holders. But that's

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1 because in 1984 when we went public, not a whole lot of
2 the public held shares in street name. But as they've
3 grown their portfolios, it's just easier for them to
4 manage by having it in the name of a nominee.

5 But that doesn't change the fact that we don't
6 know they're shareholders, our shareholders. And I
7 suspect that I see them at church on Sunday. I see them
8 at the football games on Friday nights. We have 400,
9 roughly, record shareholders, and I suspect that I know
10 90 percent of them, regardless of how they hold their
11 shares.

12 MS. CROSS: Mm-hmm. And so for -- but for
13 banks that have not gone public, so they've not -- do you
14 think they are, for the most part, held directly?

15 MR. BOCHNOWSKI: Again, it's anecdotal, but I
16 think that's correct. And I think that the issue that
17 they're running against right now is that if they would
18 like to raise capital, they're going to trip that 500
19 shareholder requirement, and then they're going to jump
20 into that 250 to \$300,000 cost of compliance. And so
21 whatever they might gain by raising the capital they're
22 going to offset because of the new cost that they've
23 taken on.

24 MR. YADLEY: Just one more point on this,
25 because the community bank is a pretty interesting

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1 example. There's been incredible consolidation in banks,
2 and you would have the statistics better. But, I mean,
3 the number of banks has declined about 40 percent.

4 The FDIC has assisted takeovers of banks. And
5 although community banks have grown up, as the name
6 implies, in the community with locals, shareholders, and
7 borrowers and directors, most of the takeovers recently
8 have not necessarily been so close geographically.

9 So you now sort of bring two shareholder bases
10 together, and if you try and raise capital, you're
11 bumping up against 500 very, very easily.

12 MS. CROSS: Are there contrary points of view
13 on this? And then in addition, are there other areas of
14 regulated entities that should be thought about
15 similarly? I mean, I think, while I can't speak to why
16 the Commission hasn't done what it hasn't done in the
17 past, one of the questions that comes up is if you start
18 looking at this, well, why aren't you looking at the
19 issue generally? If you just go do a thing that's for
20 community banks, what about all the other companies who
21 are finding the numbers to be problematic? What about
22 companies that don't want to become public when all they
23 have is a lot of employees who hold the stock? Things
24 like that come to mind.

25 So I think one of the questions is are there

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1 issues common between the community banks and other
2 companies that we should think about while we're doing
3 this? And then are there investor protection concerns
4 that are raised by the idea of, for example, relying on
5 the call reports as the information that's available to
6 bank shareholders.

7 MR. DENNIS: Well, let me just -- if I can add
8 a couple comments. One, the bank system does work very
9 well. I recently opened up a deposit account in a place
10 where I have a vacation home, and I was able to go to the
11 FDIC's report for two banks in this little community.
12 One had a very nice facility; the other wasn't so nice
13 looking. And you could tell which one had the better
14 capital ratios and which one made more money, and was
15 able to make the decision. So it does work pretty well.
16 You know, the --

17 MS. CROSS: There are pieces of information
18 missing that you --

19 MR. DENNIS: Well, it's a call report, so it's
20 a form. You know, it's -- it doesn't have the
21 disclosures that are in a financial statement report or
22 an SEC filing. But, you know, it does have net income.
23 And it does have operation expenses and capital ratios
24 and financial strength that gives troubled assets, and so
25 you can get some kind of flavor for how well the bank is

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1 performing.

2 You know, the street name issue, I think, is --
3 I don't like issues where you have people that have
4 effectively the same business model with -- structured
5 differently and get different results. I mean, that
6 seems fundamentally unfair. The only thing I -- you
7 know, and I'd love to have a system where you could say,
8 well, a shareholder's a shareholder.

9 The concern I have with that is that I'm not
10 sure all of the companies that have shareholders trading
11 in street names know who all those shareholders are, and
12 they may be very volatile as to who they are.

13 So I'd be careful about -- you know, we're all
14 about not burdening smaller companies with more
15 regulation. And if we put a rule in that said 2,000, but
16 a shareholder is a shareholder, you know, do they have
17 that information available to be able to gather with very
18 limited cost effort what those active shareholders are in
19 those street names? So I think that's something we've
20 got to be careful of if we go down that road.

21 The employee issue concerns me, because I
22 firmly believe an employee that invests in a company
23 thinks they're a shareholder as much as a person that's
24 not an employee. And absent the CEO, CFO, and, you know,
25 some major players in the company, I doubt they get the

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1 information that a shareholder would normally want or
2 desire to make an investment decision. So I think we
3 have to be careful about excluding employees from a
4 definition of a shareholder.

5 The Pink Sheet issue -- and I know I'm just
6 rambling here. But the Pink Sheet issue, you know, the
7 thing that I think about when I think about the Pink
8 Sheets is those shareholders have made a decision to
9 invest in a company that is trading on the Pink Sheets.
10 And so, you know, if they've made that investment
11 decision, then it seems like they've made the risk that
12 we're not going to get all of this information that
13 normally we would get as a public company. So they
14 should live with that decision.

15 Now, I'm a little concerned about somebody that
16 invested in a public company and then it goes dark. And,
17 you know, I don't really like the 300 rule. I'd rather
18 have it be, you know, 500. You know, it seems like if
19 you're -- if it's 500 to be public, it ought to be 500
20 not to be public, and maybe there's a time period or a
21 shareholder vote or something like that that takes you to
22 a non-reporting company, you know.

23 And the last statement I'd make is, you know,
24 whether the 500 is right or not, the asset definition
25 makes no sense to me. And maybe it's just because it's

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1 there and it's easy to get. But revenue would seem to be
2 a better -- market cap would be best, if you had some way
3 to accurately get that. But revenue would be a second
4 best, which might solve the bank issue, if you measure
5 based on revenue versus assets. But assets make no sense
6 to me as a measurement for the value of a company in
7 today's market. A lot of rambling, but --

8 MS. CROSS: No, I think that's really helpful.
9 To follow up on the question about employees -- and I
10 think we should talk about this some more this afternoon
11 -- are there ways to deal with the employees as
12 shareholders issue that don't require public reporting,
13 but could still protect employees through non-public
14 reporting, for example, is one thing that's been
15 suggested.

16 We have a variety of -- we have a rule and some
17 staff no-action letters that facilitate providing equity
18 to employees through employee stock option plans and
19 through RSUs, where even though the employees certainly
20 are investors, they've -- it was through their sweat
21 equity, if nothing else. They don't trigger reporting if
22 the options can't be exercised, if the shares can't be
23 had, if they can't be traded. There's a whole lot of
24 tests for that. And we've done that, in part, because
25 there's -- it has not seemed rational to force the

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1 company into public reporting when all it has for the
2 numbers that will trip it over are things like options
3 and the like.

4 So I think that's one of the questions for this
5 afternoon. Even if you get past the issue of how do you
6 feel about employees generally as shareholders, is it
7 enough to have the relief that we have around options and
8 RSUs and the like, or should it be broader?

9 MR. DENNIS: It seems to me when you're talking
10 about employees -- you know, a shareholder has a choice.
11 They can invest in the company, they can not invest, they
12 can sell their shares, they can't -- or, you know, or
13 they can hold their shares.

14 An employee that has a restricted stock option,
15 if they have no choice, then whether we give them
16 information or not is somewhat irrelevant. If an
17 employee has a stock option and its under water, you
18 know, there really is no choice there that they're -- and
19 no one's going to exercise an option and sell it for
20 less, so there's -- so, you know, it would seem to me
21 you'd count them once they head to the -- once they get
22 to, 'I can make a decision that affects me individually
23 as an investor. So my stock option's in the money. I
24 have the ability to exercise it. Now I have a choice to
25 make, and I should have the same information that every

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1 other shareholder should get.''

2 MR. YADLEY: I think the Commission did a great
3 job on the options and the RSUs, and that was a very
4 logical response, and for some of the reasons that you
5 just said.

6 I just had an interesting transaction and
7 learned something. You asked about other categories that
8 may have special treatment. I don't know if this is one
9 or not. But a lot of companies have ESOPs, Employee
10 Stock Ownership Plans. Sometimes they've been useful as
11 a company's founder has wanted to sell the company. And
12 a lot of good firms, including McGladrey, have said,
13 ''You know, this is a pretty good way to do it. You can
14 get your employees and your managers to own the company
15 over time.''

16 But if you terminate an ESOP under the Internal
17 Revenue Code, the participants have the right to take
18 employer stock. So I was in the middle of a transaction,
19 and some very good larger law firms were also involved.
20 And it sort of was a surprise to us when we realized if
21 we terminate the ESOP, we might have more than 500
22 shareholders. So we didn't.

23 MR. CHANG: It seems to me that counting
24 employee options after they've been exercised is a
25 deterrent to a company growing the business. Because you

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1 hesitate to give employee because you don't want at some
2 point later on in time to trigger the 500 number.

3 So I think the -- if you're going to determine
4 how to count, I think employees who got their shares
5 through options should be exempt from this reporting.
6 And I think the issue that you presented this morning, I
7 think they are two separate issues. One is how to count
8 and one is, you know, at what point do you have to report
9 and so forth. The two are really quite separate. And I
10 think in determining how to count, you have to go back to
11 the intent. The intent is how many shareholders.

12 So through reporting, it's just in the sense of
13 a broker, so to speak, to a street name, holding in
14 street name, it's just a convenience. And in today's
15 computer world, that can be easily handled. And whereas,
16 if you -- and the world is very smart. It will find ways
17 to compensate whatever rule you put in.

18 And so if you make that difficult in the sense
19 you have to go with stock held in street name would be
20 counted, then people are going to form partnership to
21 invest as a group. In that case, you have intermediary
22 that provides some degree of control. So then you can
23 eliminate a problem that the partnership would be counted
24 as one, but held in street name would be counted as
25 separate.

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1 MR. LEZA: From the venture capital side, I've
2 never seen the sense of having the stockholder limit. It
3 just doesn't make any sense. Because like Milton was
4 saying, you know, you can always form other things, and
5 this is exactly what the venture capitalist has been
6 doing. It should be some other kind of limit that you
7 have, an actual gate, but it opens up at the time.
8 Revenue would be good. Market cap would be another one.

9 But I don't see what the difference is,
10 especially in our business, whether you have 500
11 shareholders or you have 2,000 shareholders, and it
12 depends how you're counting. It really to me doesn't
13 make any sense to have a limit on shareholders position.

14 MR. MAEDER: I think the challenge you have is
15 that it's -- the 500 shareholder limit is a proxy for
16 ignorance, right? It was put in place because the
17 presumption is if you go from 400, you draw the line
18 somewhere and you say, ''Well, that fifth hundred person
19 is probably the proverbial dentist in New Jersey who
20 hasn't got a clue what he or she is buying, and that's a
21 dangerous situation.''

22 So because there was no way to measure
23 knowledge about the company, you created this arbitrary
24 number, and now we're talking about arbitrarily
25 increasing it to 2,000. Now, maybe you could argue today

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1 people are less ignorant because of the Internet, so you
2 can increase it to 2,000.

3 Very clearly, employees are far less ignorant
4 than the dentist in New Jersey about what's going on with
5 the company. So I think you can make a pretty good case
6 that lumping all the employees together as one is
7 reasonable, and that solves the disincentive issue that
8 was mentioned earlier, which is a real problem. So --
9 but I wish we just solved this all by making it all moot
10 and having these companies go public when they should.
11 I'll say that many times.

12 MR. NALLENGARA: As we've been looking at this,
13 we've been talking to a number of people, and we get --
14 frankly, we do get differing views from venture
15 capitalists. We get some who tell us that the 500-holder
16 threshold isn't really a problem for them. Companies
17 don't find that as a challenge. That's, again, anecdotal
18 -- anecdotal that we're getting.

19 So Charlie, you've been doing this for a long
20 time. Do you -- have you had the problem? Have you done
21 things differently? Have you not raised capital from
22 certain places because of it?

23 MR. SUNDLING: Right. So I guess I have a
24 somewhat different perspective on the whole topic, what
25 you might call more of a Ron Paul version, which is the

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1 numbers do seem very arbitrary. I know that somewhere
2 along the road, somebody probably determined that 500
3 shareholders and \$10 million made some semblance of sense
4 around when you should be reporting. But to me,
5 reporting is more of a feature of a stock, right?

6 So, you know, we've talked about these Pink
7 Sheet companies and billions of dollars of transactions.
8 Well, what does that mean? There's been billions of
9 dollars in liquidity created for these investors. And
10 when you look at -- you know, nobody's forcing anybody to
11 make an investment. And you invest in companies where
12 there's transparency and information, and you may have a
13 more risky part of your portfolio where there's not going
14 to be so much transparency.

15 And there are a lot of companies who have
16 adopted Sarbanes or parts of it who don't need to, but
17 they do it because it's an investment feature of their
18 stock, right? So in terms of a forced reporting of any
19 kind, I guess my whole perspective is, you know, other
20 than maybe some protections around employees and some of
21 the certain specifics on how options vest and, you know,
22 you've got to exercise that option or not, right, you
23 need some information on what's going on inside the
24 company.

25 But for the outside investor and their decision

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1 to invest, when that information is available, they'll
2 take it into consideration in their investment. When
3 it's not, they may not invest. And so the motivation of
4 a company itself to provide more information that can be
5 consumed by prospective investors, I think, is an
6 internal decision that many will make.

7 I think there's a bigger issue with going dark
8 after you've decided to provide this information now to
9 all of a sudden arbitrarily, whether you legally can or
10 not, go dark, and investors have made decisions based on
11 being able to get those regular reports, and now they
12 can't get them. I think that's a bigger issue. But
13 again, I think a gentleman mentioned earlier, your option
14 is dump the stock, right?

15 So in summary, to me, the whole notion of these
16 numbers in forced reporting, I think, is something that
17 should be looked at fundamentally in this day of -- you
18 know, in 1964, I don't think you could go to any one of
19 100 web sites and get information about the company and
20 its customers and all the things that are going on. It was
21 much more of a black art than it is today.

22 MS. CROSS: It's an interesting perspective.
23 Because what you're essentially saying is that the notion
24 that a certain amount of public interest and trading in a
25 stock should not then equate to you have to have

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1 information available. That you could have, essentially,
2 parallel markets where investors are choosing whether or
3 not they care about information, which is -- that's a
4 pretty fundamental change, as you can imagine, and
5 certainly a perspective that it's good for us to learn
6 about.

7 I do worry. The baseline for requiring
8 reporting that at least Congress decided in '64, which
9 was a certain level of public interest, should then get
10 you the protections of the securities laws. I would have
11 thought that our aim would be to figure out what that
12 level should be in this day and age, rather than deciding
13 that there could be just an election, that you want --
14 that you're going to invest with no information, which
15 is, I think, what you're suggesting.

16 MR. SUNDLING: It is. It is. And I would say
17 that if there were going to be thresholds that triggered
18 reporting, they would -- 500 shareholders, you know,
19 again, if these are group interests. I don't think the
20 500 shareholders is the biggest issue, but the \$10
21 million is. I mean, that would have to be significantly
22 higher for the whole thing to really make sense, in my
23 opinion.

24 MR. DENNIS: I like what Charlie said. You
25 know, the challenge for the SEC in all this is, you know,

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1 the 99 percent of the companies that try to do the right
2 thing, they start out on the Pink Sheets. Their goal,
3 like you said, is to eventually be a reporting company.
4 Because if they do that, they get an automatic pop in
5 their stock, or they should, because of the increased
6 liquidity, the increased disclosure of information out
7 there.

8 The challenge for the Commission is the 1
9 percent that don't necessarily try to do the right thing.
10 And, you know, the companies that go from being a
11 reporting company to go to being dark, the companies that
12 are intentionally withholding information from
13 shareholders. And so how do we craft a rule that
14 addresses that 1 percent, at the same time not punishing
15 the other 99 percent that are out there?

16 And I think the example we have of maybe not
17 doing that correctly was when we passed Sarbanes-Oxley,
18 you know, we addressed the 1 percent out there, but we
19 punished the other 99 percent that were trying to do the
20 right thing all along. And so how do we have that right
21 balance?

22 MS. CROSS: I think another challenge for that
23 conversation is how to deal with intermediaries who are
24 not necessarily acting in the interest of their clients.
25 So if you have what are, you know, colloquially known as

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1 pump and dump schemes, pump and dump schemes can work
2 because of the absence of information. If you have good
3 disclosure, then you're not going to be able to have this
4 crazy spiral upward until the music stops, and then the
5 intermediaries back out of it, and the stock goes to
6 nothing.

7 So one of the concerns that I have is if you do
8 just raise -- if you essentially let the markets continue
9 as they currently are, where you might have thousands and
10 thousands of holders, but they don't count because of the
11 way we count -- you know, look through to count the
12 actual holders, what can you do about that problem?

13 MR. YADLEY: Meredith, this is sort of a hard
14 one. I have to think about, Charlie, what you said.
15 Because part of me says, ''Yeah, we're in America. We
16 should be able to let people make those decisions.''

17 But I think there's also -- we're looking at
18 trading and liquidity, but we started talking about
19 capital formation and helping companies grow. In that
20 respect, I think you're absolutely right in terms of
21 numbers, venture capital, venture capitalist and private
22 equity firms that are investing in companies. And
23 they're not looking for trading in and out. They're in
24 there for, it used to be seven years, and now it's
25 longer. It doesn't really matter how many people are in

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1 that fund if it's a real fund, because those investors
2 aren't looking directly down to the company for
3 information. They're trusting their managers.

4 And so I think a system that would recognize
5 the investment numbers. Because going public should
6 happen at the right time, and that's different for each
7 company. So I think you can let those investors sort of
8 grow.

9 So it's similar to employees as a pre-IPO
10 company grows, and now you have lots of employees, and
11 you don't have cash and you're awarding them equity-
12 based incentives, that all makes sense.

13 On the trading side, that's a lot harder. And
14 we have not just the investors, but the intermediaries.
15 And in there, I think we should be a little cautious in
16 backing away from information requirements.

17 MR. SUNDLING: I'd just like to comment on the
18 pump and dump, that it's not necessarily just those
19 companies that are not reporting, right? So if you have
20 a bad actor, of which there are many, they've made a lot
21 of money pumping and dumping full reporting companies.

22 MR. CHANG: I was looking over the material you
23 sent, and I think Justice O'Connor said it's really a
24 matter of trade-off between cost and benefit. And I
25 think the substance of all the discussion here is that

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1 we're trying very hard to provide safe harbors for people
2 to make decisions. And in the process, we leave room for
3 the 1 percent to hide behind the safe harbor. I think
4 that's something we should keep in mind when we have
5 these discussions.

6 MR. GRAHAM: Does anyone else have anything to
7 say about this? Karyn, I know it affects you. Do you
8 want to just wait until this afternoon and --

9 MS. SMITH: No. I mean, I can weigh in from
10 the company's side. We spent a lot of time -- I mean,
11 when I joined Zynga two years ago, we had 400 employees.
12 Today we have almost 3,000. So that's a tremendous
13 amount of growth in a really short period.

14 And the no-action letter that we were, you
15 know, happy to get from the staff earlier this year
16 related to the fact that we chose to switch from options
17 to RSUs for this very reason, so that we didn't have
18 employees start to exercise and put us over, you know,
19 the 500 threshold. We're not even close to having 500
20 holders of our stock that when you start to aggregate the
21 option holders exercising with, you know, your actual
22 stockholders, we spent a lot of time and jumped through a
23 lot of hoops and spent a lot of money figuring how we
24 could deal with that issue. So it is a real issue for
25 companies when you add employees to the count.

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1 MS. CROSS: So in your situation, the reason
2 that you needed to go to RSUs was because if employees
3 exercised options, then you would have had too many
4 holders.

5 MS. SMITH: That's right.

6 MS. CROSS: So to relieve that issue, if one
7 were to decide -- like if one were to look at the
8 economics of being an RSU holder versus the economics of
9 being a holder of an exercised option, so you got the
10 share, I think one question for the group is, is that
11 different or not different? If you have an RSU, are you
12 essentially as exposed to the company as if you had
13 exercised your option?

14 MS. SMITH: Well, with an RSU, you don't pay
15 anything for the stock, right? So you're not making an
16 investment decision. That's something that you get.
17 When in our case, you have an IPO, which is a liquidity
18 event, and you've put in the right amount of time.

19 So it is different, I think, than exercising an
20 option where you're making an investment decision and
21 you're actually paying for those shares. And, you know,
22 now we're dealing with a whole bunch of different tax
23 consequences associated with RSUs that option holders
24 don't have to deal with. So it has impacted our company
25 a lot.

0080

1 MR. MAEDER: So the answer to Meredith's
2 question is yes, there's no difference between having an
3 option -- not having exercised it, having an option and
4 having an RSU. Either way, you haven't put any capital
5 at risk. You've got all your sweat equity, and that's
6 your participation in the growth of the business. So
7 logically, they ought to be treated the same. It's just
8 an artifact of the regulation that caused you to go
9 through this exercise that undoubtedly cost quite a lot
10 in legal fees.

11 MS. SMITH: That's right. And ultimately, we
12 got the no-action letter, and they are effectively
13 treated the same. But, you know, we did have to go
14 through that exercise.

15 MR. MAEDER: And do a lot of explaining to your
16 employees when instead you could have been talking to
17 them about strategy.

18 MS. SMITH: Yes, that's right.

19 MS. CROSS: And I would be a little bit
20 provocative here and even raise the question of whether
21 yes, if you exercise the option, either you're doing that
22 exercise or you have to put in cash, you're still -- I
23 mean, you're exposed to the company's equity. That's --
24 and you -- and you're an employee, and you -- maybe
25 you're a little more exposed than if you have the RSU.

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1 But I think if you ask an employee at one of these
2 companies, they certainly feel like investors in the
3 company. They are -- they are at that company in large
4 measure because they view it as a potential good
5 investment.

6 And so I think -- I'm, again, being a little
7 provocative. If one were to compare -- if you actually
8 let them go ahead and exercise and be employees, do you
9 need to count those people differently? I think it's at
10 least a fair question as to where do you -- I don't think
11 it's fair to say they're not investors just because they
12 have an RSU.

13 MR. MAEDER: Right. But the issue isn't
14 exposure. The issue is information, right? Because in a
15 reporting company, you're still exposed. The point is at
16 which point should you be getting information or not?
17 And I posit that employees get a lot of -- actually, the
18 whole topic really is -- you know, from 1964, it is a
19 different world.

20 I was doing due diligence on a company the
21 other day that we were thinking about investing in. And
22 first of all, to Charlie's comment, we don't invest in
23 companies if they don't show us everything so that we can
24 do due diligence. So it's a little bit of question. You
25 can't regulate dishonesty and you really can't regulate

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1 foolhardiness. If I were investing in a private company
2 as an individual, I would demand that stuff before I'd
3 invest.

4 But that notwithstanding, I was doing due
5 diligence on a company, and I found a blog, or a BBS,
6 where I could see comments written by people who had left
7 the company, former employees. And there it all was to
8 see, all the whining about why this sales guy left and
9 what a terrible company it was. It was way more
10 information than you could have possibly gotten in 1994,
11 let alone 1964. There's just so much more information
12 available today. And in my view, some of that
13 information was more relevant than anything you'd get
14 through regulatory reporting.

15 So, you know, it's buyer beware and it's --
16 it's a little -- if you start to regulate stupidity, you
17 end up restricting opportunity.

18 MS. SMITH: And, you know, on the disclosure to
19 employees, I mean, we provide for somebody who's
20 exercising the 701 disclosure that's required. They're
21 not exercising in a vacuum of information. But that's
22 very different. Providing that information to employees
23 is very different than providing it to the public.

24 MS. JACOBS: Could I just jump in and ask that
25 we consider the stock options and the RSU discussion a

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1 tad differently? When you grant those, and you're in
2 your early emerging phase with your employees, you have
3 more stock than cash. And it's compensation, pure and
4 simple. And that's the way they treat it.

5 There are those that have this sweat equity
6 feel, but the reality is it's compensation. And when
7 it's in the money and it's liquid, it's gone. It's not
8 the same reasoning for an outside investor who will
9 invest money and need the disclosures. I think employees
10 are a total different class because of the reality that
11 that stock is compensation.

12 MR. GRAHAM: Yeah. I think these are all great
13 comments. I think this is a good kind of first round, if
14 you will. Shall we flip to the next topic?

15 MR. NALLENGARA: The next topic is broadly
16 titled ``Scaling of Regulations.'' Paul had keyed us to
17 this earlier. What we'd like to talk about here is a lot
18 of -- we've been hearing a lot of, and the chairman has
19 asked us to look at, issues relating to the -- to
20 companies going public, challenges that are faced by
21 private companies as they consider -- consider going
22 public, consider -- consider the -- considering the
23 regulation and the reporting requirements that a company
24 will face as they go public, and whether the burden that
25 a newly public company will face as it becomes a public

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1 company and an IPO or if they trip the 500-holder
2 threshold. Those burdens, whether they are so great that
3 companies are choosing to not go public, companies are
4 looking at the regulation that they are facing and making
5 an assessment to delay an IPO.

6 We've looked at a lot of information in this
7 area. Some of it says exactly that, that the burden of
8 the regulation is significant and it's made decisions
9 change. Other reports have said that although a
10 significant decision maker, it was never a -- it was not
11 -- you know, the cost associated with going public wasn't
12 the factor that a company either used to or not to decide
13 to go public.

14 So what we'd like to look at here is, first,
15 primarily whether the burden of the regulation of being a
16 public company or the requirements to follow to become a
17 public company, whether those are appropriately
18 calibrated, whether they -- whether we should consider
19 scaling those regulations for newly public companies in
20 their infancy. And if yes, how would we do that? What
21 are the things that are the hardest for newly public
22 companies to deal with?

23 Many people have talked about the Sarbanes-
24 Oxley 404(a) and (b) requirements, whether those are
25 things that should be looked at, whether the compensation

0085

1 disclosure, the extent of the compensation disclosure,
2 whether those things can be phased in over time.

3 I think in the materials, you have the Treasury
4 Department's -- or the Treasury Department sponsored IPO
5 Task Force. They've put a detailed set of
6 recommendations on the scaling regulation of taking a
7 company that's newly public to a more seasoned company --
8 I think they call them emerging companies -- and looking
9 at what kind of less stringent regulation could be
10 imposed in the first year and how that could grow over
11 the course of the years.

12 I think the slides here show some of the
13 examples of the scaling disclosures that we already have.
14 We have a small reporting company category, which, if you
15 stay within the threshold, the 75 million public float
16 threshold, you can continue as a -- you can continue
17 filing under the smaller reporting company forms
18 throughout your existence. And it's not a scaled
19 disclosure; it could be a permanent disclosure. And then
20 we also have phase-ins of our 404(a) and 404(b)
21 disclosures.

22 But for the most part, the general disclosure
23 requirements for a newly public company are consistent
24 with those for a seasoned public company. So with that
25 brief introduction, I'll turn it back over to Steve and

0086

1 Chris to maybe start the discussion on -- Steve, your
2 practice, you know, the companies that you've nurtured
3 from pre-IPO to IPO, how have they looked at the
4 requirements that they will face as they become a public
5 company? Had they looked at that as being a gate, you
6 know, sort of a gate with which they were questioning
7 whether to cross because of it, or is it just one of the
8 things that they look at as part of a growing company?

9 MR. GRAHAM: Well, it certainly is one of the
10 things that people look at, and it's part of the -- it's
11 part of the equation. It's part of the calculation. But
12 I really don't see there's that much of a hindrance. It
13 seems that -- and, you know, this is one thing that we'd
14 like to certainly get the perspectives of the group. You
15 know, to what extent -- I mean, as you point out, we have
16 a smaller reporting company regime. Some other things
17 have been done with respect to 404 to kind of try to
18 recalibrate with respect to smaller companies.

19 And I think it is important to note -- and the
20 IPO, you know, Task Force report is in your materials.
21 It's a pretty good document, and, you know, I recommend
22 that you read that, and that's something we can talk
23 about later on this afternoon.

24 But I think it's important that we don't -- as
25 we talk about kind of scaling with newly public

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1 companies, that we don't kind of lose the concept of a
2 small company, of the smaller company. That is, it's not
3 a question of how long you've been public; it's a
4 question of, you know, again, how big you are.

5 But, you know, because there's so much talk
6 about the cost of SOX and that sort of thing, you know,
7 over the years, there's -- I think there's this lingering
8 perception that things, you know, cost more than they, in
9 fact, do. But that hasn't changed the fact that -- it
10 doesn't -- it doesn't change the fact that there is a lot
11 of cost associated with becoming -- with going public
12 and, you know, continuing to kind of, you know, be a
13 public company.

14 But I think at the end of the day, if all the
15 other things are lining up in terms of the success of the
16 business, the interest in the company through the
17 markets, I don't think people are going to get to that
18 point and say that everything -- we can check all the
19 boxes, but it's so expensive to go public, we're not
20 going to do it. That's kind of our perspective.

21 I know that I've spent a lot of time talking
22 about Chris, about, you know, her company, and just, you
23 know, the costs that are associated with just being
24 public. And maybe you'd like to share some of those
25 insights.

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1 MS. JACOBS: At the risk of perhaps being too
2 absolute, I don't know why anybody would want to be
3 public with revenue under a billion. I mean, I've
4 explained -- well, I said in my comments, I've got
5 annualized costs of 3.9 million. I have 33 million
6 shares out. That is other people's money, and that's the
7 way I look at it.

8 And -- but I have to say something to the SEC.
9 Thank you for the \$75 million market cap exemption. It
10 made a huge difference from everything from print of the
11 annual report to time to create -- we didn't have to do
12 say-on-pay, we didn't have to put in a CD&A. They're all
13 there from prior years. And I think we still even
14 contributed some information we didn't have to.

15 But the burden, it's 20 to 30 percent of my
16 time, and the burden is huge and very costly. And every
17 new rule is this great opportunity for our auditors and
18 our attorneys to create another layer of bureaucracy,
19 another round of meetings. And at three to \$400 an hour,
20 the attorneys -- I mean, it just goes on and on.

21 And it was -- it was really sad. Because say-
22 on-pay, literally, people were licking their chops to
23 come in and tell us how we were going to comply. And all
24 of this was just take out the checkbook and write it.
25 And it is just such a shame.

0089

1 Because, you know, in my letter, my comment
2 letter, you know, I said, you know, we're not Enron.
3 Everybody got painted with the same brushstroke with the
4 Sarbanes-Oxley, and yet here were the little guys that
5 are suffering, because we've got economic issues now, and
6 the burden is really tough.

7 So but thank you for the \$75 million exemption.
8 So other public companies, please, you know, join in.
9 That's just my experience.

10 MS. CROSS: And I think that --

11 MR. GRAHAM: At the risk of, I guess, booning
12 myself, in fact, it sounds to me like you're complaining
13 a lot about lawyers and accountants. And --

14 MS. JACOBS: But I need you all. I can't
15 maneuver without you.

16 MR. MAEDER: If I could answer Chris's
17 rhetorical question, which I think she knows the answer
18 to, why would anybody under a billion dollars want to be
19 public? The answer is so they can grow. So they can
20 raise capital and grow. Ninety-two percent of job
21 creation in venture-backed companies occurs after they go
22 public. I should -- it is past tense, occurred.

23 The commission investigating the Columbia space
24 shuttle disaster had a great quote. They said, ''Complex
25 systems almost always fail in complex ways.'' So there

0090

1 isn't a single reason why the public markets are broken
2 for technology companies today. There are a number of
3 reasons. But this is, to be sure, a big one.

4 A company, Steve, would not go through the
5 whole process and then say it's too expensive. They'd
6 never have that opportunity. I'm on the board of a \$50
7 million company that's got a \$3-1/2 million EBITDA this
8 year. And the investment bankers say, ''Come back when
9 you're a hundred million, because with 3-1/2 million of
10 EBITDA, all your EBITDA would be soaked up in accounting
11 fees to go public.''

12 It's just the markets are not open to sub-100-
13 million-dollar companies. The average holding time for
14 venture capitalists now, the average time for a company
15 to go from founding to IPO has gone from 5.4 years in
16 1995 to 9.4 years. And at 9.4 years, the -- first of
17 all, the private capital markets, venture capital, don't
18 work anymore, which is why our industry is shrinking so
19 rapidly. And we're threatening to shut down this
20 unbelievable source of competitiveness and jobs in this
21 country because of things like this.

22 So it's tab 17, the Task Force -- I can't
23 remember what it's called in here, but it is worth
24 everybody on this committee reading. It is a very
25 readable report, as you said, Steve. It's

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1 uncharacteristic. IPO Task Force Report. It's the 17th
2 tab.

3 I agree with the recommendations, which say,
4 essentially, that under a billion dollars, let's have
5 some kind of an on ramp. Because my little \$50 million
6 company simply can't afford to engage in the same degree
7 of compliance as General Electronic, nor should it. It
8 doesn't present systematic risk to the economy or the
9 capital markets. And these regulations do apply
10 systematic risk to its ability to go public, continue to
11 grow, and create jobs.

12 Let me just say one last thing on this. I've
13 had people say, ``Well, why don't these companies just
14 get sold?'' Well, imagine where we'd be today if Apple
15 had gotten sold, IBM when it was a \$30 million company,
16 if Intel had gotten -- believe me, we wouldn't have
17 iPads.

18 The challenge is venture capitalists go out and
19 they fund 10 or 15 companies in a segment. That's
20 experimentation. And then we let Darwin take hold. And
21 what happens, what used to happen, is out of those 15
22 companies, the top three or four would get out in front,
23 they'd go public, and they'd rationalize the market.
24 They'd buy the next five or six companies, and the bottom
25 four or five would go out of business. And now you'd

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1 have three or four companies in a market, of scale, all
2 profitable, growing, going out, and that continue to grow
3 the market.

4 What happens today is none of the 15 can get
5 public. So the losers start to cut price, so they
6 destroy the market for everybody. And now you have 15
7 subscale companies limping along, big tech public buyers,
8 of which there are really only half a dozen, now sit back
9 and say, ``Well, we'll just sit back and wait until these
10 silly venture capitalists get tired, and then we'll buy,
11 you know, buy what's left of the technology in some of
12 these companies.'' And in so doing, we don't have the
13 next Apples and the next Googles and the next Intels.

14 So it's a very serious issue, and it really
15 needs to be addressed. None of this happened out of
16 malice. It happened -- we are collateral damage. But
17 it's very impactful on the long-run prospects for the
18 U.S. tech economy.

19 MS. HANLEY: So can I follow up on that for a
20 moment? So there's been some research that's recently
21 been done on the profitability of smaller public
22 companies, and the argument being made in this research
23 is that M&A transactions are more profitable as an exit
24 strategy for venture capitalists and others to do, rather
25 than the public marketplace. But it's not because of

0093

1 cost of regulation, but because of the underlying
2 business model of these companies now do not support
3 public presence.

4 So I was wondering if there was something that
5 the Commission could do in that aspect. Why are M&A
6 transactions other than -- it seems that, Paul, you were
7 saying that they were feeding, essentially, on these
8 companies. But I think a lot of companies do choose that
9 as an exit strategy rather than the public markets. It's
10 been used as an indicator that we need something more in
11 the regulation space perhaps to encourage more public
12 companies.

13 But I was wondering if there was any indication
14 that there were other systemic problems in smaller public
15 company land that would make it more difficult for them
16 to even get to the size to go public.

17 MR. MAEDER: No, the short answer. I don't
18 believe that study. We would much rather take our
19 companies public than sell them, not just because of the
20 economic benefit, but because that's what we work for, to
21 create companies that become great big companies. Our
22 fantasy is to create the next Google. So -- and there's
23 absolutely nothing in business models that's changed that
24 would suggest that acquisitions are more likely.

25 In the first 20 or 30 years of institutional

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1 venture capital, the United States is split between IPOs
2 and M&A as exits, which was relatively equal about
3 50/50. If you look at the IPO Task Force, you can see
4 the IPOs just drop off a cliff since 2000. No, we would
5 rather go public.

6 Now, you do have a phenomenon where CEOs -- I
7 was at Harvard Business School in 1984, and I remember
8 John Cunningham, the then-CEO of Wang, coming in and
9 giving a speech about his three lifelong ambitions when
10 he was young, and one of them was to be the CEO of a New
11 York Stock Exchange company, an ambition which he
12 realized.

13 Today, that ambition does not exist among young
14 entrepreneurs. They are all saying what Mark Zuckerberg
15 says, which is, ``Why on earth would I want to be
16 public?''

17 So we now have a situation where the people
18 that need to go public can't, and the people that can, like
19 Facebook, don't want to, because of the unpleasantness of
20 actually being public.

21 So there are two effects at work. It's hard to
22 go public, and on top of that, it's very unpleasant to be
23 public. But it's not an issue of business models. It's
24 not an issue of the economy. It is an issue of capital
25 markets and the environment.

0095

1 MR. LEZA: It's one issue of perception.
2 Because everybody likes to see something that happens
3 that's very good.

4 If you look at the 1995 to 2000 period in the
5 venture capitalist business, you could open whatever you
6 wanted, no revenue, no nothing, and it could go public.
7 And VCs, don't forget the good stuff. The problem is
8 that that was not normal, okay? So the thing is that
9 we're going to look at it, and yes, IPOs have dropped
10 like crazy, because, you know, investors have gotten
11 scared because of all these things that happened during
12 the bubble. And you look at it, and the thing is that,
13 you know, people do want to go public. But in the sense
14 in the last 10 years, the way things have been going,
15 M&As have become more profitable. You know, people are
16 willing to pay 3, 4, 5, 6 multiple on revenue, so they're
17 going to where the money is, the easiest money is.

18 Now, people still want to build these huge
19 IPOs, and they'll still exist, but they're not as easy to
20 create as they were before.

21 So I think we have to keep both the positives
22 and the negatives in perspective, and we need to remember
23 that 1995 to 2000 from the venture capitalist business was
24 just a pie in the sky. And it was good for us, but it
25 was not good for the economy.

0096

1 MR. MAEDER: I think in any numbers you look
2 at, you should just take the period from 1996 to 2000
3 with a shovel and throw them out. That's not what I'm
4 talking about. That was a bubble. That was silliness.

5 I'm talking about the current -- the level of
6 IPOs in the last 10 years relative to 1985 to 1995. And
7 it is -- it's way, way down. The rule of thumb when I
8 got in this business was if you were profitable for four
9 or five quarters, and you had a \$20 million run rate, you
10 could go public. And that set a lot of the innovation
11 that we saw during that period, and that rule is long
12 gone.

13 MR. CHACE: I do think there's a structural
14 issue on the banker's side where these small deals and
15 small public companies, micro cap companies, just aren't
16 relevant as a profit driver anymore with decimalization
17 and just trading volumes. So I think that is a challenge
18 that I don't know if it's within the scope of this
19 committee to address. But it's certainly a factor. I
20 think you don't see the bulge bracket firms underwriting
21 micro cap IPOs, typically, unless there's a relationship
22 involved.

23 There are regional firms doing it, but there
24 are fewer. And I do also think that there's a demand
25 side issue for these small deals as well in terms of

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1 mutual funds and other investors that are willing to
2 invest in small liquidity deals. We do them. We like
3 them. We see them as our pipeline for future larger
4 companies.

5 But I think there's been consolidation on the
6 fund side too. That's worth thinking about in terms of,
7 you know, a \$50 million deal isn't relevant to a \$2
8 billion fund, given allocations and the stock you're
9 likely to get. So I think that's worth considering down
10 the road as well.

11 MR. CHANG: Addressing Kathleen's question
12 about business model, at least in the early stage startup
13 company, I really believe it's much more capital
14 efficient in the M&A, and the reason, that a small
15 company is very capital efficient in creating value and
16 in developing a business that's much more efficient
17 within the existing infrastructure.

18 MR. SUNDLING: So I wanted to comment on Paul's
19 comments, which I think are absolutely dead on. What's
20 happened between probably 1995 and now is that it used to
21 be the dream of every entrepreneur to do the whole, you
22 know, IPO on Wall Street, right? It was the thing that
23 your career was about. And now if you talk to anybody,
24 myself included, it's why in the world would you ever
25 want to be public? Because a very, you know, quick, easy

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1 exit -- well, not quick and easy, but a better choice
2 today is through M&A.

3 And I think that if you look at what the
4 drivers are around, you know, people coming to this
5 conclusion and forming these opinions, yeah, it's a
6 combination of the regulations, the liabilities and risks
7 brought on by Sarbanes, which I think torpedoed the whole
8 industry back in 2001.

9 And you really just don't have the opportunity
10 that you had before to realistically get to an exit, as
11 Dan's comments here around, you know, the investment
12 community's not interested, which is a shame. Because
13 part of my opinion is, you know, if you look at the IBMs,
14 Oracles, Apples of the world, I mean, how much more could
15 they conceivably grow? How do you take a market cap from
16 300 million? What, are you going to double it and make
17 it 600 million? Whereas, a \$10 million, \$50 million
18 value business could easily give you 10X and provide all
19 that return to the public, but they just don't get the
20 interest of the investment community anymore because the
21 fees aren't there, right? The deal isn't big enough.

22 So when you add all these things together, you
23 end up with a real problem, which is that the IPO market
24 is broken. And I don't think it is -- you know, again,
25 to Paul's point, it's broken for a number of different

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1 reasons, not one in particular.

2 MR. GRAHAM: You know, I think that's exactly
3 right. And as Paul said, we're dealing with a complex
4 set of issues. And just to reiterate, the work of the
5 IPO Task Force, that if you haven't had a chance to take
6 a look at the report in your materials, please do. It's
7 well written, and there's a lot of information there.

8 But that -- and, you know, certainly from my
9 own experience, I would say that the IPO market is
10 broken. Certainly the kinds of deals that I used to do
11 routinely 10 years ago, 12 years ago, just don't happen
12 anymore. But that's -- and that's a set of issues that,
13 you know, I think it probably makes sense to, you know,
14 spend some time -- I think there's probably something
15 that we can give as a committee toward coming up with
16 solutions to that set of issues.

17 And I think, you know, one of the things that
18 we should figure out how to do as a committee is to --
19 you know, how to coordinate, you know, our efforts with
20 the efforts of some of the others that -- like the IPO
21 Task Force, that are focusing on the same or similar
22 issues.

23 But all of that is different from the cost to
24 regulation question, I think. And from -- I guess from
25 that standpoint, I'm just wondering if any others in the

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1 room have any comments about, you know, to what extent --
2 to what extent is just the cost of going public something
3 that ends up being a deterrent? And, you know, to what
4 extent -- is there something that we could do in terms of
5 regulation to make the burdens of going public or the
6 burdens of remaining public less? And, you know,
7 Shannon, you might have a view on that.

8 MS. CROSS: And I'll weigh in real quick on
9 that question just to help the committee think about it.
10 I think there's two questions. One is should there be
11 the on ramp idea for newly public companies, just to take
12 away one deterrent? If it was longer before you had to
13 pay more money to comply, would that perhaps encourage
14 more companies that are otherwise ready to go public to
15 go public?

16 And then secondly, for companies that are in
17 the other category, the smaller reporting company group,
18 is the regulatory structure for them correctly calibrated
19 now? We redid it a couple of times recently, most
20 recently in 2007. There used to be this system for the
21 smaller businesses that had some taint. It was not a
22 popular system. We took all those regulations, put them
23 into the regular regulations, so you don't have to label
24 yourself on the forms that were otherwise perceived as a
25 bad thing. And we provided more breaks, so more breaks

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1 in the compensation disclosure, more breaks in MD&A,
2 other places.

3 Is that -- has that been successful? Is more
4 needed? Are there places we can do, just for the
5 continuing smaller -- we have two kinds of companies
6 we're talking about here, the emerging companies and then
7 just the ones who are going to be small. And they are --
8 you know, we want our system to work for them too. So I
9 think there's two -- there's really two very different
10 questions that this is getting at.

11 And the IPO Task Force Report basically says,
12 ``Let's use the smaller reporting company system as an on
13 ramp for companies going public, and then they'll grow
14 out of it.'' And so it doesn't address the question of
15 is it the right set of rules to start with.

16 MR. YADLEY: I think it's really important to
17 keep that distinction in mind, because it is different.
18 And I thought the IPO Task Force Report was excellent
19 also.

20 I sort of objected to Charlie's earlier
21 comments about before you're going public and creating a
22 market where people can decide to trade on almost no
23 information. You might not have exactly said that, but -
24 - but I do think I can easily drift towards that in terms
25 of a more permanent disclosure regime for smaller

0102

1 reporting companies.

2 I've got to tell you, me personally, I don't
3 think it's probably calibrated right. In part, because
4 in order to get rid of the stigma, it's confusing. And
5 with fewer companies going public and more companies
6 going private, it's almost not worth learning the
7 differences for securities lawyers outside of New York,
8 LA, Washington.

9 So I don't think it's really done a lot in the
10 marketplace, but I think it could. And certainly I'm
11 interested in New York Stock Exchange companies, so maybe
12 that's a little different.

13 But the smaller companies I represent, legal
14 fees are not huge, in part because they don't ask us as
15 many questions and they don't let us make as many
16 presentations. Accounting fees are, and so I think that
17 would be probably an area to look at first is how much
18 the audits should be. And the IPO Task Force and some of
19 the other materials mention that, PCAOB rules and so on.
20 I think that's a huge area.

21 Compensation, the whole proxy issue. The say-
22 on-pay for my smaller companies was just they didn't
23 understand why we had to do it. And many of them just
24 said, ''Just tell me what to say. Do it the cheapest way
25 possible.'' You know, they get -- 90 percent of the

0103

1 shares are being voted. There's very little
2 institutional following for the reasons that you said.
3 There's just -- you know, you can't invest enough in a
4 company that has a smaller market cap.

5 So I think there is some real benefit to
6 saying, okay, there's going to be a smaller class of
7 companies where we're going to have basic financial
8 disclosure and much more simplified compensation and
9 governance rules. And if people want to invest in those,
10 they will. And I think the natural occurrence will be
11 for companies that can get a bigger following, they'll
12 make more disclosure, because they want investors and
13 they want analysts following.

14 MR. BORER: I've got a couple points here to --
15 first of all, in answer to your question about revisions
16 a few years ago, the change in SBA filing rules,
17 especially the expansion of the use of the S-3 for small
18 companies, I think was one of the few things that I've
19 seen in my career in banking that actually helped people
20 raise money. And it's become the product of choice with
21 respect to conventional follow-on, fully marketed general
22 solicitation offerings. So to some degree, it's killed
23 that side of the business, but it's made it far easier
24 for companies to access capital.

25 MS. CROSS: The rules how you count for

0104

1 purposes of using S-3 for the smaller companies, are they
2 workable?

3 MR. BORER: I think the rules, compared to what
4 it used to be, are very, very workable. Now, if we could
5 just get FINRA to get the comp approval and those types
6 of things moving, especially for the smaller companies
7 that don't have same-day clearance. Because that
8 system's just completely broken down, and I know that's
9 not for this venue. But with respect to the way the
10 rules work generally, yes, very, very effective.

11 I spend as much of my time counseling public
12 companies on going dark and going private, selling
13 themselves, putting themselves up for sale, as advising
14 them to go public. And to a couple of the comments that
15 have been made here, the micro cap IPO market is dead.
16 The entire infrastructure and market structure of the
17 boutique investment banks -- and I know we don't want to
18 talk about them here -- has dissipated in the last 10 to
19 15 years to a consolidation up of the Hambrecht & Quist,
20 Montgomery, Robertson Stephens, Alex Brown, and even the
21 regionals into the big ones, because there was no market
22 in a lengthy period. That level of participation by the
23 broker-dealers has not been reinvigorated. There are no
24 new broker-dealers of size or import. The dislocation in
25 research, sales, and trading, lack of profitability has

0105

1 made it, as someone just said a few minutes ago, so that
2 the small companies don't matter. And we actually do
3 small company IPOs.

4 But interestingly enough, I use this expression
5 when I'm counseling people, that they don't want to pay
6 the penance before they can enjoy the sins, meaning
7 access the capital, provide the liquidity to grow your
8 business, provide incentives to your employees, et
9 cetera.

10 And many of the CEOs and finance chiefs, et
11 cetera, when we walk through what they have to do to
12 become public, they're saying, ``Well, I really have to
13 be public to be able to do that.'' Because of the pre-
14 audit work, upgrading their auditors, retaining separate
15 counseling, in many cases if they're in various parts
16 inter-land of the country, because they don't have
17 lawyers that have sophisticated SEC practice, et cetera,
18 there's a million dollars spent before you can go on the
19 road. And the market windows, et cetera, have made it so
20 that very few companies are willing to take that step
21 unless they're being underwritten by Credit Suisse,
22 Goldman Sachs, JP Morgan, Morgan Stanley, et cetera, you
23 know, the Groupons of the world.

24 So we've even seen -- and this is the report on
25 the -- you know, the on ramp recommendations. We've seen

0106

1 an alternative in these reverse mergers for a lot of real
2 operating companies with substantive revenues, management
3 teams, advisors, and businesses that are just saying,
4 ''I'm going to either go direct file and become a
5 reporting company on Form 10,'' or ''I'm going to do a
6 reverse merger into a reporting shell and just go public
7 with training wheels.'' Let the market develop on a very
8 small float, and use that as an alternative to a \$40
9 million, \$50 million IPO. And I think that that's the
10 get public.

11 The counseling of people who oftentimes want to
12 become un-public I think is caused as much so by lack of
13 interest in micro cap companies, generally, the big
14 volume of high speed trading, which is providing
15 liquidity in the markets today, is going towards big
16 companies with big market caps, lots of volumes and
17 volatility, et cetera. And the small companies have been
18 pretty much put on the side. And I think that's part of
19 the reason for the substantial reduction in the number of
20 reporting public companies over the last 10 years.

21 MR. NALLENARA: John, is the reason a company
22 would -- the clients you work with choosing the Form 10
23 route, is that because they don't see a market for their
24 -- or is it cheaper? It seems to me at the end, they're
25 underpaying. They've got the same buildup as they would

0107

1 if they did an IPO. What they don't have is they don't
2 have the registration process, but they still have the
3 Form 10 process. I'm not -- what's the decision making
4 for a company?

5 MR. BORER: Well, first of all, for a company
6 that's just filing a Form 10 to become public is much
7 more rare than the second, what I mentioned, which is the
8 reverse merger. And they know they can become a publicly
9 reporting company through filing the Form 10.

10 So to the extent that they may be a company
11 that has 200 shareholders, they've been around for a
12 while, they've given out shares through various capital
13 raises and otherwise, over time they can provide a means
14 for liquidity. If they go public that way by themselves,
15 they don't have a CUSIP, they have not filed the 211 et
16 cetera, so there's no real market for their stock. But
17 that can evolve. They can actually have a broker file
18 the DTC papers, the 211, get a CUSIP authorized, and then
19 do either private placements, PIPES, or other types of
20 things, or file an S-1 after they become a reporting
21 company. They've had comments from the SEC, so they're
22 not going to be waiting getting comments for a
23 significant period of time, and then go to the market
24 after that.

25 And it's not for the Groupons of the world,

0108

1 because there's a significant audience for those types of
2 opportunities. But for the company that has a market
3 value of 50 to 100 million that maybe has the \$20 million
4 in revenues, is profitable, and needs access to capital,
5 it's a path which isn't conventional.

6 But I would venture that even some of the
7 venture capitalists in the world today in private equity
8 groups are considering these things. And we've seen it
9 in life sciences transactions where they've used these as
10 springboards to public offerings, et cetera. And some of
11 those companies have become substantial exits three to
12 five years later through sales to strategics, which
13 you're going to get a much better value when you've got a
14 500 to \$750 million market cap than when you have a 50
15 million and you aren't yet at commercial scale.

16 MR. GRAHAM: Dan, you are in kind of a pre-IPO
17 position, I believe. And want to share some of your
18 thinking?

19 MR. SQUILLER: A couple of thoughts. One is
20 the thing that's driving our exit is strictly based on
21 revenue and market traction, you know, business
22 fundamentals that haven't changed much, except the
23 thresholds where, to the comments made previously, \$20,
24 \$30 million of revenue, good profit, you know, you're
25 well positioned. Now our view is that we probably need

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1 to be closer to 100 million in order to attract the
2 attention. So that's item 1.

3 Item 2 is that, you know, Sarbanes-Oxley isn't
4 what it used to be in that the expense -- the expense and
5 the burden certainly is real. However, if you look at
6 what's happened over the last number of years, it has
7 been somewhat systematized. So there are ways to comply
8 that are still unpleasant, but less unpleasant than they
9 might have been years ago.

10 But right now, I think for a lot of emerging
11 companies, VC-backed companies, at least in our stage,
12 we're more concerned about the additional value that we
13 have to build in a company today to be attractive to the
14 public markets versus what it was 10 or 15 years ago.
15 And I think certainly, most of that is systematic, rather
16 than just based on what's happening with economic cycles.

17 MS. GREENE: So can I jump in real quick? I
18 know we've got to go to lunch.

19 MR. GRAHAM: Oh, no, not at all.

20 MS. GREENE: And my mind is kind of racing, so
21 I'll try to say something succinct.

22 First of all, I totally agree with Chris. I
23 don't know what the threshold should be to consider going
24 public. Is it a billion dollars? Is it a hundred
25 million in revenue? I don't know. Whatever it is, I

0110

1 know we're not there. We're doing about 60 million in
2 revenue.

3 We're already -- we've been public since '93.
4 We did the reverse merger because we didn't need cash at
5 the time. Our founders were looking for a long-term exit
6 strategy at some point. They got that.

7 I can kind of talk out of both sides of my
8 mouth. I feel like if you're going to be in the public
9 game, get in it. So dress down disclosures, whatever, I
10 don't really like that. You know, my goal in our
11 disclosures is if I can disclose enough that I have no
12 questions from stockholders, then I've probably done it
13 right. So we try to tell everything as much as we can.

14 What Charlie said and what Dan said, I think
15 the issue once you're public in a small company is how do
16 you get anybody's attention. And our problem is we're
17 too small. We don't have enough volume. We don't have
18 enough liquidity. We're a, I believe, a fundamentally
19 sound company. We've been profitable for 20, 30 years.
20 I don't know. You know, revenue's growing. We're slowly
21 opening stores. We're expanding internationally. We
22 don't have a lot of debt. We've got lots of cash. We've
23 got a very conservative management team. We have no
24 competition. We've got barriers to entry. And all those
25 things that you hear that are supposed to make companies

0111

1 successful and attractive, I think -- based on my
2 experience, I think we're doing all of that. And yet
3 there's no deal for an investment banker.

4 So how you compete for attention when
5 institutions like -- well, you know, you trade 500 shares
6 a day. It will take me three years to get in. And it
7 will take me that long to get out when I'm ready. I
8 mean, how do you -- I don't know that going public is so
9 hard, or once you're there, you should be scaled down
10 because you're small.

11 But the bigger issue, I know, for us -- for me
12 is how do you even compete in a market where business,
13 fundamentally you're doing all the right things and
14 you've got a good solid company, but the public market
15 such as it is, we can't seem to do anything to attract
16 investors unless we want to spend all of our profits on
17 road shows. And then people aren't going to like us
18 anyway, because we're not going to make any money.

19 So how do you -- I don't know where you go with
20 that or how you get there. But, you know, I would say
21 why would any little -- why would any small company want
22 to go public? Because if you raise the money and you
23 don't do well, you're going to get beat up anyway. And
24 if you do well, you're so small you can't compete against
25 companies. And the sell side guys and the buy side guys

0112

1 and the investment bankers, they only want to talk to you
2 if you've got a deal. And, you know, if you don't --
3 because I get it. They're in it to make money. And they
4 can't -- you just can't trade enough in our stock for
5 anybody to want to pay any attention at all.

6 So I don't want to whine, because we're in the
7 game and we're going continue to be in the game and we're
8 going to do everything that we can and do it right. But
9 I think if I was talking to any company, small company,
10 fundamentally sound, think twice before you get in there
11 unless you've got a hell of a story that's the next
12 Google or the next IBM or whatever, because obviously,
13 leather craft is not the next big thing. We'll survive.
14 We'll do well. But it's not even worth -- I mean, we
15 don't stand a chance to compete in what is capital
16 markets or in the public sector now.

17 MR. SUNDLING: So I had a comment. I think one
18 of the questions was around would an on-ramping process
19 be helpful, right? And I think the answer to that is
20 yeah. I mean, it's better than nothing, that's for sure.

21 But I think one of the issues that I see in
22 reading all this material and following this topic is
23 that it may not address more the fundamental problem,
24 which is that we broke, as this gentleman said, the micro
25 cap, nano cap IPO market is gone. All the boutique

0113

1 investors that followed that space and cared are gone.
2 And how did that happen?

3 You know, I think I would subscribe to it was
4 at least partially driven by Sarbanes-Oxley. It scared
5 everyone out of the market. Now there are these
6 incremental changes that we're looking at making to the
7 laws to kind of mitigate some of the effect of what was
8 put in place.

9 But you have a huge marketing problem here,
10 right? If you go anywhere in the world, everybody says
11 the same thing. You don't go public in the U.S., right?
12 So 60 percent of our revenue is from outside the U.S.
13 It's Europe, it's the Middle East, it's Asia. As you
14 travel around these places and you just get involved in
15 discussions around being a U.S. publicly traded company,
16 and small business opportunities for IPOs, everyone has
17 the same thing, which is, yeah, you don't do that, right?
18 You do Singapore. You do OFEX, AIM. You do Toronto.
19 Anywhere but in the U.S. Yeah, maybe it's a false
20 perception because we are incrementally making it better.

21 But how do you un-break what was broken, right?
22 It will take years to do that, I think, unless, you know,
23 along with these legislative tweaks and the rule tweaks
24 that are going to happen, there's some communication that
25 goes back out to the world that, you know what, you can't

0114

1 actually go public in the U.S. as a small company,
2 assuming it's true, for a reasonable amount of money and
3 at a reasonable pace.

4 And I think one of the issues that I've always
5 had with Washington in general is that there's no
6 competitive analysis, right? The competition here is not
7 NASDAQ versus NYSE versus Pink Sheets. It's the U.S.
8 exchanges versus every other option you have out there in
9 the world, and there's nothing in here that addresses
10 that.

11 I know my time in London and working with the
12 folks there in the shark tank, it was that when you
13 looked at -- and this was 2002'ish -- exchanges like the
14 AIM, they're direct competitors to the, you know, to the
15 boards here, and they had a phenomenal marketing story,
16 right? You could be public in 10 weeks. You get a
17 nominated advisor, real-life process, you file one annual
18 report, and you're done. And here, all we're doing is
19 kind of incrementally taking off some of the badness.
20 But I think it will ultimately, to be successful, need to
21 be, you know, A, very material changes, and B, somehow
22 effectively communicated out to the world again that this
23 is the place you want to try to get listed.

24 MR. GRAHAM: Thank you, Charlie. There's --
25 I'm sure there's much more to talk about and other

0115

1 comments you'd like to make. But it is 10 after 12:00,
2 and so it might be time for a lunch break.

3 (Whereupon, at 12:10 p.m., a lunch recess was
4 taken.)

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

6 MR. GRAHAM: Why don't we try to get started.
7 I was stalling for Meredith Cross. She's -- I'm sure
8 that she'll be here shortly.

9 You know, I guess we left off the morning
10 talking about -- I guess the way the conversation started
11 was just kind of the cost of going public and the cost of
12 staying public, and we ended up lapsing into a lot of
13 discussion about how the market is just simply broken for
14 the smaller IPO, which is good conversation. And there
15 are some real issues there. It would be great if we can
16 find some real solutions, because that is a real issue
17 for us who are involved in the business, a real issue,
18 and more fundamentally, I think it's an issue for the
19 overall economic, you know, health of the country.

20 But before we flip to the next topic, again, we
21 started that conversation talking about, or at least
22 posing the question about the cost of, again, going
23 public, the cost of staying public. And of course, it's
24 never going to be free. And whenever your people are
25 writing checks for compliance, it's -- they tend not to

0116

1 be happy about it, whether it's \$1 or \$1,000.

2 But that said, I just wanted to start the
3 afternoon by just, you know, first of all asking if there
4 are any additional comments, you know, relating to --
5 relating to those costs, and any ideas about how they
6 might be adjusted.

7 MR. MAEDER: Let's make a quick summary
8 comment, which is I think there are -- you know, I said
9 earlier it's a complex problem, complex issues causing
10 it. I think there are four -- at least four causes.

11 Number one, Sarbox; number two, Spitzer, which
12 is why Shannon can't get any coverage for her company,
13 because it's illegal for analysts to get paid by
14 investment banking fees, and that pretty much killed
15 research coverage. So those are two things that are
16 addressable.

17 Number three, decimalization, which has taken a
18 lot of the money out of that end of investment banking.
19 Not going to turn that back, obviously. And number four,
20 consolidation in investment banking and it being more fun
21 and profitable for investment banking to manage money for
22 rich people -- i.e., private wealth management -- than to
23 provide services to small companies.

24 I think that is either a cause or an effect,
25 that last one. And if you fix the first two, there may

0117

1 be a reemergence of small investment banks like the Four
2 Horsemen that John mentioned. But, you know, you start
3 by fixing the things you can start and hope the things
4 you can affect will come around.

5 We had an offline discussion about if research
6 ever comes back for small companies, it will probably
7 come back completely differently from what it used to
8 look like. It will probably be some kind of an online
9 research thing, self reporting, or who knows. Maybe some
10 loosely regulated, loosely structured form of analyst
11 coverage that was crowd sourced, but that would still
12 benefit small companies that don't get coverage now.

13 But it's very clear. The first two are
14 something that we as citizens can do something about, and
15 that's Sarbox and Spitzer.

16 MR. GRAHAM: Thank you, Paul. Do you have any
17 thoughts on this, Kathleen?

18 MS. MCGOWAN: We're a much smaller company.
19 We're venture backed. Down the road, we were at some
20 point thinking IPO was a potential exit. At this point
21 for venture-backed firms, IPOs are not necessarily an
22 exit, so we would probably do more of the M&A. If things
23 opened up, it would be -- IPO would be a potential exit
24 down the road. But we're in an earlier stage at this
25 point.

0118

1 MR. GRAHAM: And when you say ``if things
2 opened up,`` you mean if the markets would improve?

3 MS. MCGOWAN: If the markets were to open up,
4 and also that some of the regulations and some of the --
5 you know, some of the other things we're talking about
6 were not such an onerous part of that activity, of going
7 public and the -- I'm in total agreement with what
8 Christine said earlier today.

9 MS. CROSS: So let me ask, on the Sarbanes-
10 Oxley issues that you're raising, I think there's perhaps
11 some labeling confusion that goes on around what's meant
12 by the Sarbanes or the Sarbanes-Oxley problem. So for
13 the -- under 404(a), companies have to assess their
14 internal controls, and under 404(b), there's an audit of
15 the internal controls. The audit never did apply to
16 companies below 75 million, and now permanently will not
17 apply to companies below 75 million, because that's what
18 is in Dodd-Frank.

19 There have been debates about whether the audit
20 for the next group of companies -- say 75 to whatever --
21 is a deterrent to going public. And I think at least the
22 staff study found that from the questions that were asked
23 and the like that that was not a particular deterrent.
24 But what I -- I think perhaps what the reference to
25 Sarbanes being the problem is is just the general notion

0119

1 of a lot of difficult regulations that apply when you're
2 a public company, as opposed to it just being 404(b), for
3 example.

4 It's certainly the case that when the internal
5 controls assessment and audit was rolled out, it was much
6 more expensive than anyone expected. There was then a
7 major effort to change the auditing standards so that the
8 audit of internal controls was far less expensive. That
9 did come down a lot in cost. And we remind ourselves
10 that a lot of these requirements came in because of sort
11 of crushing investor concerns that came out of the early
12 in the 2000s problems.

13 But I do think, you know -- and maybe we can
14 ask some specific questions -- that there's other parts,
15 not just 404(b), but other parts of the regulations, the
16 disclosure regulations, that apply to being a public
17 company that might be also the problem if there's a
18 problem with these rules. And I think it might help if
19 we sort of talked a bit about if you go through the -- we
20 can do this more at another meeting when you've had a
21 chance to read the IPO Task Force Report. But it talks
22 about things that are burdensome that people look ahead
23 and say, ''Well, that's going to be so burdensome, I
24 don't want to be a public company,'' and talks about
25 having, essentially, a five-year on-ramp before you'd

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1 have to do these things.

2 And one of them was 404(b). We -- that would
3 have to be Congress. The exemptive authority around
4 404(b) is not with the SEC. That's with Congress. And
5 there's bills that have been introduced that would
6 provide more exemptions for 404(b).

7 Then there's also, if you look at the IPO on-
8 ramp report, it talks -- I mean the Task Force Report, it
9 talks about the three years audit being a major
10 deterrent, that it's expensive to get three years of
11 audit. Smaller reporting companies get to do two years
12 of audit.

13 I guess I would like to open up a conversation
14 about that. Is the time period required for the audit,
15 similarly the five years of selected financial data, are
16 these major deterrents, or are they, you know,
17 incrementally so costly that they are -- the costs don't
18 out -- the benefits don't outweigh the costs? And then
19 look into the investors' side from the standpoint of the
20 people who invest in these companies. Would the absence
21 of, say, three years of audit compared to two, and three
22 years of selected data instead of five, things like that,
23 would that make a difference in your willingness to
24 invest?

25 Any thoughts?

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1 MR. CHACE: I can speak a bit. I did read the
2 IPO, or most of the IPO Task Force Report, and I
3 generally -- I mean, this fits into the idea of scaled
4 regulations. I generally agree with scaled regulations
5 as an investor in IPOs.

6 I was saying earlier, one of the -- you know,
7 Sarbox 404(a) or (b) compliance is kind of low down the
8 list on the stuff that I look at on a new issue. You
9 know, it's really the -- it's the business, it's the
10 management, and it's the industry. Because I think these
11 -- there's bigger fish to fry for a lot of these emerging
12 companies than having an auditor attest to internal
13 controls.

14 I agree with most of the ideas in the IPO Task
15 Force Report. Some of the parts I might disagree with
16 are on the historical financials. I think it's important
17 to see more disclosure rather than less in terms of
18 financial information.

19 And I'm not totally clear on the two-year
20 audited versus three-year, because I presume all these
21 companies already have audited financials. But I think
22 there might be some twist in terms of getting another
23 auditor to sign off on those historicals?

24 MS. CROSS: The smaller reporting companies,
25 when they go public, only have to have an income

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1 statement that covers two years.

2 MR. CHACE: Two years? Okay.

3 MS. CROSS: And two years balance sheet. And
4 not smaller reporting companies that go public have to
5 have three years of income statement, two years balance
6 sheet. So there's -- it shaves off one year from the
7 audit. That's -- already, smaller reporting companies
8 get that.

9 And so the question -- the recommendation in
10 the report is that that be extended as an on-ramp, so for
11 one year, essentially. Because by the next year, you'd
12 have another year. So that you -- apparently, they talk
13 about when you go get your new auditor to go public, the
14 expense of bringing on the new auditor and having to go
15 back and look for one extra year may be daunting to an
16 IPO company is one of the thoughts in the report.

17 MR. DENNIS: I think that's right. I think one
18 of the things that happens, I mean, if a company does it
19 properly, they plan their IPO and they do that three
20 years or so in advance. And so you're putting your
21 management team in place, you're putting your board in
22 place, you're putting your audit firm in place, you're
23 putting your law firm in place, and all that works.

24 You know, in some cases, you see IPOs or you
25 saw IPOs where it was more of a spur of the moment type

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1 situation, and maybe the firm that was an audit firm
2 wasn't registered with the PCAOB or may not be acceptable
3 to the investment bankers. And in that case, then you're
4 looking at going out and hiring another firm that goes
5 back in time and re-audits some of those older years.

6 I'm not sure incrementally how much cost saving
7 you're talking about there, especially when you compare
8 that with investors' need to know. And I guess you get
9 into the question of if you go three years back, how
10 important is that information? Five years back, how
11 important is that information? Clearly, last year is
12 very important. And so you have to balance that.

13 But I think that's the cost issue that's being
14 referred to. It's not -- if companies properly plan, I
15 don't think there's a big incremental cost issue. It's
16 the ''Let's go public next week. Oh, by the way, we need
17 to have a different audit firm. Now we got to go back
18 and audit the last two years.''

19 MR. BORER: And I just have a little bit of
20 perspective here. We went through over the last year
21 working with a company that had been a private company
22 profitable for 25 years and they wanted to go public. We
23 convinced them to do it. Because in that case, it made
24 sense for their capital needs and those types of things.

25 And in fact, they had auditors for years, but

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1 not certified audits. So they had reviews. And in fact,
2 we had a view on that audit firm, which wasn't
3 appropriate for a company who was going to be coming
4 public. And we actually, incidentally, had them hire
5 McGladrey to come in and do the work.

6 But in no instance, that or others, do I see
7 somebody saying, ''Well, I only have to do two years
8 versus three. Let's go public.'' And especially since -
9 - and this would be something more for the auditors in
10 the room. The auditors have become very competitive on
11 the front end in pricing their upfront work to be able --
12 in my view, to be able to win the ongoing issuer audit
13 work.

14 And there's something I had read very recently
15 about some proposal to make -- you had to audit -- or
16 rotate the auditing firms every couple years. That would
17 totally do away with that, you know, the cost
18 effectiveness on the front end of getting a new audit
19 firm in to have to come in and either re-audit or to
20 upgrade reviewed numbers.

21 One other thing, too, but this is more once the
22 company's public, is this whole idea of having the
23 quality enhancement by virtue of having the audit firm
24 come in every quarter and spend one to three weeks inside
25 the company doing a review, which they don't really stand

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1 behind anything anyway.

2 And it's usually, at least in the case of most
3 of the companies I see, the same work they did last
4 quarter and the quarter before, because there's no change
5 in accounting methods and those types of things. It's
6 almost like we've imposed four times a year audit
7 intrusion into a company instead of just one, which I
8 know does increase the costs of not only the auditor
9 time, but the company's internal time.

10 MS. CROSS: I think one of the points of the --
11 if you work your way through the IPO report, I don't
12 think any one thing is going to make the difference on
13 whether you're going to go public or not. But I think --
14 and part of, I think, the goal of this group should be to
15 think in terms of in the aggregate. Is there some
16 combination of change that would not impair investor
17 protection so people will still feel confident investing?
18 Because if they're not confident in investing, you've
19 done nothing, because you're not going to get investors.

20 But if investor protection is appropriately
21 calibrated with the cost, is there some combination? And
22 it doesn't have to be the combination that's in the IPO
23 report. It certainly can be any other combination. And
24 I think you all have your own life experiences on what
25 would be the things that would make a difference in cost,

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1 perhaps.

2 You know, going through the IPO report, they --
3 for example, no compensation discussion and analysis for
4 an IPO. You know, certainly putting a compensation
5 discussion analysis together for an IPO, from my prior
6 life before I came back to work at the Commission, is a
7 little complicated, because a private company doesn't
8 really think like a public company on their compensation
9 decisions. So that's a challenging thing. You'd
10 probably have to pay lawyers \$20,000 to write that, you
11 know. So if you start going through the costs.

12 Those are the kinds of questions that I would
13 encourage you all to think, maybe one, the extra year of
14 audit. Maybe the extra year of audit is something very
15 important to everyone, and that that's not quite right,
16 what they've got in there, that that isn't something
17 anyone would want to recommend, but instead, there's some
18 other thing that you think would be helpful on the
19 disclosure front. So I would encourage you to think in
20 terms of both individually and in the aggregate.

21 MR. DENNIS: You know, I just want to -- it
22 really comes down to it's kind of like the economy and
23 the recession, you know. It's not one thing; it's a
24 mindset. And so I think Charlie made the statement and
25 some other people made the statement that people don't

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1 view an IPO as the success factor anymore. In fact, it's
2 almost deemed as not the success factor. ``That's not my
3 goal in life.``

4 And the one thing we -- you know, so it's --
5 Christine's mentioned, you know, as opposed to being able
6 to make a business decision on her own, she can't do that
7 as a public -- you have to consult with the lawyers, you
8 have to consult with the accountants, you have to consult
9 with -- you know, everybody that you're -- you're used to
10 as an entrepreneur, you make a decision, you go. And
11 that is different now than it used to be in the public
12 world. It used to be you could still be an entrepreneur
13 and use those markets, where today you can't.

14 The other thing that we haven't mentioned is
15 the legal system we're under. Now, I'm not sure we can
16 do anything about that today. But that's a big factor,
17 in my mind, of that mindset of, you know, it's not when
18 I'm going to be sued -- or it's not if I'm going to be
19 sued; it's when I'm going to be sued as a public company,
20 you know. And so somehow -- I mean, I still think that's
21 a big factor in that mindset of being a successful public
22 company.

23 If people were of a mindset that I could be
24 successful, and yeah, if I take risks, I could win, but I
25 could also fail. But understand that people that take

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1 risks do fail, and that's not necessarily criminal. And
2 we've lost that aspect in our regulatory factors in our
3 markets today of you can't fail without it being criminal
4 some way.

5 And to me, we've got to change that mindset
6 before we'll ever get to the point of it being deemed a
7 success again to be the CEO of a public company.

8 MR. CHANG: Let me present a simplistic
9 viewpoint, and then we can build on it to make it more
10 complex.

11 I think one of the practical reasons for not
12 wanting to go public is, in fact, the lack of support in
13 the -- in the sense of at the end of the day, if I go
14 IPO, I'm burdened with all the costs, but my stock prices
15 are going to be in the dumps. And somehow that seems to
16 me very simplistic.

17 Why couldn't the SEC help companies come up
18 with a one-page list of reporting that they can post on
19 the web that everybody can see that can help the
20 investors make decisions? You don't have to make a
21 jillion dollars on your returns. But if you can get a
22 steady 5, 10, 20 percent return based on earnings, that's
23 encouragement. So there will be a class of investors who
24 would be interested in that kind of a low profile stock
25 to invest, only if they have the information.

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1 MS. JACOBS: I totally agree with this line of
2 discussion where the costs are concerned, but I agree
3 with Meredith that I don't think it's just the audited
4 financial question. It goes well beyond that. And you
5 can point to SOX. You can point to those changes in
6 governance where the D&O questionnaire for our
7 independent directors went from zero or one page to 15
8 now, and that is the license to print money for our
9 attorneys. Because the D&O questionnaire is something
10 that is now discoverable.

11 If you have had the bad luck of going through
12 securities litigation, which I have, the cost of D&O
13 insurance can just cripple a small company. And we had
14 maybe 30 -- my recollection is maybe 30 million in
15 revenue, and going through securities litigation because
16 -- I mean, it's one thing adds to another adds to another
17 adds to another.

18 And, you know, when you talk about governance,
19 the independenc standards, the D&O questionnaires, you
20 need to be able to attract independent directors, and
21 that isn't cheap anymore. And they're going to want
22 meeting fees. There are all these things that just keep
23 piling on, and it does go beyond audit. You are correct.
24 It's a compilation of, what I think, issues that have
25 become additive.

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1 MR. LEZA: Well, there's also a learning curve.
2 Just to give you an idea, I'm the chairman of Exar
3 Corporation, and they were public. And before Oxley --
4 or SOX came in, we -- when you add everything up,
5 including D&Os, we were at about \$1.5 million. And then
6 SOX came into play, and we shot an expense up to \$3
7 million. Okay? And a lot of the things they do is, you
8 know, whether you have a question or not, who do you ask,
9 CPAs, or stuff like this. And we jumped up from
10 something like 170 internal controls to 500 controls
11 issued by the CPA that says, oh, with all these new laws,
12 you have to do that.

13 But we got in a trend here that we said within
14 two years or three, we're going to take it back down, and
15 we're going to look at it very carefully. So now we're
16 back, including D&O and all that stuff, we're back to
17 \$1.5 million as an expense, and we're back down to 137
18 internal controls.

19 So there was a learning curve there.

20 But I think that it can be done. The question
21 really comes whether if you've got an issue, you know,
22 you can't just jump and ask everything of the lawyers and
23 the CPAs. Sometimes you've just got to make your own
24 decision and run with it, as long as you feel you're
25 running within the white and gray area. But if you stop

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1 to talk to your CPAs at every turn and the lawyers at
2 every turn, that bill's going to go really high.

3

4 But here's an example of a company that revenue
5 is 150 million, market cap is 300 million, and we went,
6 like I said, from a million-and-a-half up to 3 million.
7 And within a three or four-year period, we're back to a
8 million-and-a-half.

9 MR. NALLENGARA: From the institutional
10 investor side, if you see two companies, one with -- I'm
11 just wondering, what's the impact, Tim and -- what's the
12 impact to you on seeing companies with different levels
13 of disclosure? Are you spending the -- does it matter?
14 Are you doing your own work? And so it doesn't really
15 matter if there's detailed executive compensation
16 disclosure, there's detailed governance stuff? Or are
17 you just not going to spend the time looking at the
18 company with less information, because you have another -
19 - you have a viable option with more information?

20 MR. WALSH: That's a good question. Obviously,
21 more information is better. We have much more interest
22 in the financial side of it as opposed to the corporate
23 governance and executive compensation, et cetera.

24 But going back to some of the other points that
25 were made here, we rely heavily on research. You know,

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1 we have five to seven different people doing portfolio
2 management of domestic equities, and there's -- I don't
3 know -- 5,000 publicly traded equities out there. Maybe
4 1500 of them are institutional quality, and, you know,
5 700 of those are a billion dollar and under market cap.

6 That goes back to the Spitzer concept. That's
7 where we've noticed the biggest problem we have is we
8 can't get the research we want for these smaller
9 companies.

10 MR. DENNIS: If I can just ask maybe a follow-
11 on question to that. It seems like everything we're
12 talking about here is what do shareholders want. And so,
13 you know, if you think about a company's life cycle, it
14 starts out as an idea. And the financial statements and
15 the internal controls and the governance around that are
16 probably not as critical to an investor at that point in
17 time. They're worried about the idea and how do you get
18 to the idea turning into an actual business.

19 But when in the cycle does the financials and
20 the historical information start to be important to an
21 investor?

22 MR. WALSH: Well, you know, just from my
23 perspective, I think the size is what matters, you know,
24 when it becomes a significant part of the portfolio.

25 You know, one thing that's pretty interesting -

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1 - I think it comes this Friday -- is the Groupon IPO.
2 And I'm not sure we're going to be a participant in it or
3 not, but we're just sort of following it out of interest.
4 And it's just sort of stunning what's going on with that
5 company in the last month or so, with all the scrutiny on
6 their accounting methods, et cetera. I have a feeling in
7 the long run, that's going to be good for the company is
8 all the extra scrutiny they've had here on their
9 accounting methods and how they're running the business,
10 et cetera.

11 It's the size. I mean, it's the \$20 million
12 market cap company is to an institutional size, outside
13 of maybe a Dan that does the micro cap. But the bigger
14 funds, unless it's under a billion, they're not going to
15 get that granular.

16 MR. CHACE: I'd just say, I mean, to us, the
17 financials are important day one, you know, even if
18 they're not -- even if the company's not at a mature
19 stage. Seeing the path the numbers are taking and trying
20 to understand the path they will take in the future is
21 pretty critical to us.

22 But the other, kind of in line with what you're
23 saying, the other stuff is less important. You know, the
24 maturity in terms of internal controls and that, it's
25 less important, in my opinion, at early stage companies

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1 to get that perfect than it is to know your market well.

2 So that's kind of why I think loosening
3 disclosure on financials, in my opinion, is not
4 necessarily the way to go. But scaling on other factors
5 makes a lot of sense.

6 MR. GRAHAM: Well, you know, I think -- I think
7 we might be on to something here. I do think that it's
8 likely to be kind of the aggregate effect of all this --
9 of a number of things that eventually lead to the
10 conclusion that it's too costly to go public, or that --
11 or too costly to continue to be public. And I think it
12 would be good for this committee to kind of focus on what
13 kind of that bundle of changes, if you will, we might
14 think about, you know, suggesting that they might have a
15 real effect here.

16 And I don't know what comes first. But, you
17 know, you begin taking steps in these directions. And
18 who knows? You might get to the point where we begin to
19 see, you know, some of these issues that are affecting
20 the -- kind of the absence of the small IPO resolve
21 themselves. And, you know, given time, you know,
22 incrementally, we might get to the point where we can,
23 you know, play an important role in having a significant
24 effect in that regard.

25 Should we switch to another topic now, or --

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1 MS. CROSS: Bear with me one -- a couple
2 minutes. One, I'm going to call on Karyn, even if she
3 doesn't want me to. Since she's in the middle of an IPO,
4 obviously, I have to be sensitive to what she can talk
5 about. But I guess I am curious. As a company that's
6 currently going through it, are there parts that are
7 particularly expensive in the disclosures compared to,
8 you know, all the compensation disclosures? Difficult?
9 Not difficult?

10 MS. SMITH: I mean, CD&A, that's not
11 something we ever thought about until we had to. So
12 going back and trying to sort of recreate what we were
13 doing on the compensation front and, you know, making
14 sure we're putting that in place going forward.

15 MS. CROSS: Any other areas that are
16 particularly --

17 MS. SMITH: I think just generally getting
18 ready to be Sarbox compliant, you know. I mean, there's
19 a whole -- we have a whole -- we hired a whole team for
20 that. A whole group of people that wouldn't otherwise
21 work for the company have come in to help us get ready to
22 be compliant.

23 MR. YADLEY: Can I ask a question following up
24 on that? Just because -- and not necessarily for you,
25 since you're doing it now. But most of the smaller

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1 public companies that I represent don't have a lot of
2 institutional investors who are relying on ISS and others
3 for grading. So we don't -- they don't really care what
4 ISS is going to say about various items, so it's a matter
5 of coming up with good disclosure that fairly describes
6 what happens in the compensation committee and what the
7 goals are. And if they're performance oriented, then
8 that's pretty easy. If they're more subjective, that
9 actually takes a little more lawyer time to try and get
10 the flavor of that.

11 So I think there's a lot of gradations here
12 about what -- you know, who's your audience? And is your
13 audience retail investors? Is it somebody like Tim,
14 who's going to do some of their own research or piggyback
15 on other people's research? And do you have longer term
16 institutions where there's less liquidity in the stock,
17 but it's a good small cap growth stock?

18 And funds will be -- I've got one company where
19 funds are in it for a couple years, four or five years.
20 And then even if the company continues to do well, some
21 of these funds will move out, find other investments.
22 But, you know, they've got their parameters of what they
23 want out of the companies and just don't really pay that
24 much attention to a corporate governance scorecard, and I
25 think that's a distinguishing factor. And I don't know

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1 for guys like you whether that matters at all. You're
2 looking at the fundamentals and the growth prospects,
3 right?

4 MR. CHACE: Yeah. I mean, that's the
5 fundamental goal. We focus on the quality of management
6 too. But it's not so much guided as by a scorecard as it
7 is our impressions from meeting with them and getting to
8 know them over time. So it's a different -- it's not a
9 box to check, in that sense.

10 MS. CROSS: And I wanted to welcome Jim
11 Kroeker, who's our chief accountant, has joined us.
12 Unfortunately, he wasn't here when we were talking about
13 404, but I'm sure the issues will come up as the
14 afternoon goes on. And so we can keep on it. And you
15 all have the opportunity to ask him questions as well
16 while he's here.

17 MR. GRAHAM: Was Jim going to make a
18 presentation or --

19 MR. KROEKER: I didn't have one. Just here to
20 listen and learn.

21 MR. GRAHAM: Should we have Jim make a
22 presentation or --

23 (Laughter.)

24 MR. GRAHAM: Okay. So we can --

25 MR. KROEKER: 404, or more broadly, or --

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1 MR. GRAHAM: No, I was just giving you a hard
2 time.

3 MR. KROEKER: Okay.

4 MR. GRAHAM: But feel free to speak if there's
5 something you'd like to talk about. Shall we go to the
6 next topic now?

7 MR. MAEDER: Could I just -- sorry -- make one
8 last point on this whole -- if you look at the IPO Task
9 Force, which is -- if you could -- could you look at page
10 6 of the IPO Task Force Report. It's worth taking a
11 look, because there's an important point embedded in this
12 data. These data, as one should say.

13 So this is a graph in number of IPOs, okay?
14 The lower bars are sub-50 million IPOs. That's the size
15 of the capital raised, which are typical tech IPOs. We
16 typically raise \$30, \$40 million in a tech IPO. The upper
17 bars are bigger than \$50 million deals. And a lot of
18 those -- and there's been relative stability in the
19 numbers of those.

20 What's instructive about this graph is it's
21 done by number of IPOs, not by capital. So if you did it
22 by capital, you'd see an enormous bubble from 1995 to
23 2000, during the dot-com bubble years. But you don't see
24 that bubble the number of IPOs. It's certainly up from
25 1992 and 1993, but not in a crazy way.

0139

1 What went crazy during that period was
2 valuations and how quickly companies went public. A lot
3 of companies went public that never should have. They
4 didn't have business models. They weren't profitable.
5 They just shouldn't have gone public. As I said earlier,
6 love to throw out all data from 1995 to 2000, because
7 it's misleading.

8 What's important here is to look at the '91,
9 '92, '93, '94 data, which is pretty reasonable periods of
10 time, and then compare that with what's going on now. So
11 what happened after the bubble burst in 2001 was IPOs
12 disappeared, and they disappeared because the buyers of
13 those IPOs said, you know, "I got taken. Never again."
14 You know, the people managing funds at Fidelity said, "I
15 am off tech."

16 Those people are all -- everybody knows the
17 latency of a career on Wall Street is about 10 years.
18 Those people are all gone. Nobody who remembers that
19 period is still doing that.

20 And starting -- so the IPO market got depressed
21 because there was irrational exuberance, as Alan
22 Greenspan said. But then it stayed down, because it's
23 being stomped on by something. And that's the important
24 point. It has not recovered as one would have expected
25 after four or five years of getting over the hangover,

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1 and it hasn't recovered because of some of the burdens
2 we've talked about, all the little straws that are
3 breaking the camel's back.

4 And so we're in a situation now where if you
5 look all the way out on the right bar, 2011, effectively,
6 almost nothing. Yeah, the Zyngas and the Groupons, they
7 may get out. This isn't a period where we went in terms
8 of innovation through Web 2.0, Web 3.0, social
9 networking, search engine marketing, the poor biotech
10 industry starving for capital, and basically venture
11 capital turning its back on biotech, because you can't
12 get these companies public anymore. There's no shortage
13 of innovation during this period, there's no shortage of
14 entrepreneurs, no shortage of customers. Pretty much no
15 shortage of anything except an IPO market. And that's
16 what we're really talking about.

17 And it's a lot of straws that broke the camel's
18 back. We're going to have to start pulling these straws
19 off one at a time. There's no way of knowing which
20 straw's going to allow the camel to stand up again. But
21 we've got to start somewhere. We've got to start pulling
22 these straws off, because this has very far-reaching and
23 damaging consequences.

24 MR. GRAHAM: Okay. Thank you, Paul.

25 MR. BOCHNOWSKI: Could I just add one --

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1 MR. GRAHAM: No, Dave.

2 MR. BOCHNOWSKI: Okay.

3 MR. GRAHAM: No. Please, please.

4 MR. BOCHNOWSKI: We've been talking a lot about
5 with the institutional investors as to what the investing
6 public is looking for. But for those of us that are
7 living with the existing regulations who have very few
8 shareholders, I've never gotten a question on the
9 efficacy of our financial controls. I don't get
10 questions on the footnotes that are in any of the public
11 filings that we do.

12 And I think that at that size, the investor
13 just wants to know is the company okay. And all those
14 details rarely ever get read by anybody. They get read
15 by us, they get read by your staff, but do they make a
16 difference on the investing side. And possibly not.
17 Because they know the company that they've invested in.
18 They know the people that are running the company. It
19 goes to the management question.

20 MR. WALSH: And in your case too, you get
21 visits every three months by various federal, state
22 regulators, correct?

23 MR. BOCHNOWSKI: Once a year, at least. They
24 don't come every three months. I don't -- I'm not inviting
25 that.

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1 MR. DENNIS: David, what does happen, though,
2 is when something goes wrong with the company, then all
3 the lawyers pore over that. And they look for that one
4 missed disclosure that you had, whether it was relevant
5 or not. Then they use that against you.

6 MR. BOCHNOWSKI: Well, I think that's the
7 potential.

8 MR. DENNIS: Your shareholders probably aren't
9 doing that.

10 MR. BOCHNOWSKI: I think that's potential. I
11 think that's potential.

12 MR. DENNIS: But what's happened is the, you
13 know, the MD&A that was supposed to be a description of
14 the company has become a legal document. You know, the
15 footnotes have become, rather than a description of
16 what's happened to the company, become a legal document.

17 And so it's all about protecting the company
18 from a lawsuit, as opposed to disclosing what's
19 appropriate for the shareholders. And that's why we end
20 up with 30-page disclosures about interest rate variances
21 and, you know, all of that stuff in there that is
22 probably relevant when you're in court, but may not be
23 relevant to an individual shareholder.

24 MR. GRAHAM: Okay. I think we probably really
25 should move on to the next topic.

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1 MR. NALLENARA: Thanks, Steve.

2 MR. GRAHAM: So Lona?

3 MR. NALLENARA: Yeah.

4 MR. GRAHAM: Okay.

5 MR. NALLENARA: Actually, we're going to talk
6 about capital raising ** So we're going to change gears a
7 little bit here and sort of look at the efforts or the
8 thinking we can do around getting companies to the stage
9 where they can consider an IPO.

10 And what we've been talking about, and the
11 Chairman's asked us to look at, is whether there are ways
12 within our rules that we can -- we can -- keeping in mind
13 the investor protection concerns, whether we can make it
14 easier for smaller companies to raise capital in
15 different ways. And we have a variety of different
16 exemptive rules that allow small companies to raise small
17 amounts of capital. And what we've been told is that not
18 all of them work as well as they could.

19 And one of the ideas that a lot of people have
20 been talking about is something called crowd funding. In
21 practice, it's not something I ever came across or even
22 knew what it was. But what crowd funding is, in a
23 nutshell, it's raising a small amount of capital from a
24 lot of people, and each individual making small
25 investments. And this is designed to help that very,

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1 very small business grow, you know, build that next
2 factory or buy that next truck or open the next retail
3 location.

4 There's real interest in this to capitalize on
5 the social networking phenomenon. There's a way to
6 access capital that didn't exist 10, even 5 years ago,
7 where you can find investors in your company through the
8 Internet. And they don't necessarily have to be your --
9 someone you know, but it could be just someone who's
10 heard about your company or likes your idea.

11 And this is also -- there's interest in this in
12 Congress as well. There's a bill currently that left the
13 House Financial Services Committee and will go to the
14 full House, I think, next week -- this week -- which lays
15 out the framework for an exemption from our rules that
16 would permit crowd funding. And what the parameters of
17 that exemption would be, it would allow, effectively
18 would allow you to have a web site that would allow you
19 to solicit investors in your business, in your idea.
20 Each individual could invest up to \$10,000 or 10 percent
21 of their yearly income, and the company, the business,
22 the idea, could raise up to a million dollars.

23 And the idea, it's designed, although it
24 doesn't have to be that. It could be run off a web site.
25 There's a -- you would learn about this investment idea

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1 by going to a web site that would house the -- house this
2 investment and other investments. It would facilitate
3 the connection between the investor and the company.

4 And what the exemption is designed to do, it's
5 designed to allow for you to broadly solicit investors,
6 which under our rules now you wouldn't be able to. You
7 wouldn't be able to have a web site that would allow you
8 to solicit investors. And the idea behind the limited
9 dollar amounts is that you're designing these to be small
10 amounts. And because they're small amounts, the
11 regulation associated with that, the investor protection,
12 there is the -- the idea behind this is that the investor
13 protections can necessarily be ratcheted appropriately
14 for the investment amount.

15 The concern we have from the staff perspective
16 is ensuring that there are investor protections. We want
17 to encourage the capital formation through strategies
18 like crowd funding. But to the extent that there is
19 insufficient investor protections where investors aren't
20 secure in investing in the market, what you'll have is
21 you'll have a market sort of rife with fraud. And the
22 goal you're trying to have of raising capital through
23 something like crowd funding would never be achieved.

24 So we are trying to -- as we look at this,
25 we're trying to balance the need for something like crowd

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1 funding with sort of tailoring our rules to get the
2 appropriate investor protections. That's crowd funding.

3 There is another bill that's working its way
4 through the House as well. It's a modification on the
5 existing Regulation A. Regulation A presently allows you
6 to do -- it presently provides an exemption from the
7 registration requirements. It allows a company to raise
8 up to \$5 million. It requires an offering document to be
9 filed with the SEC. It allows a public offering, the
10 review from the SEC is -- the offering document
11 requirements are much less. There isn't an audited
12 financial statement requirement. And the securities that
13 are issued, which is an important part of this, are not
14 restricted securities.

15 The challenge with Regulation A for a lot of
16 people who have argued for change in this area has been
17 that they argue that the dollar amount associated with
18 Regulation A is too low. For the work required to
19 actually do a Regulation A offering, \$5 million isn't
20 enough anymore.

21 So the cost associated with doing a Regulation
22 A offering doesn't warrant doing it when all you can
23 raise is 5 million. And the bill in Congress would have
24 that amount raised to \$50 million. It would require
25 audited financial statements, and then potentially, it

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1 would be left with the Commission to provide a variety of
2 different investor protections mandating some form of
3 disclosure, possibly interim reporting requirements.

4 And again, this is something that Congress is
5 looking at. It's also something that we're looking at,
6 among others. These are just really two examples of
7 taking our existing rules, our existing exemptions, and
8 seeing if there's ways we can modify to provide access to
9 capital.

10 So the questions for all of you are whether --
11 I know for some of you, this is really outside of the
12 range of companies you work with, or the range of dollar
13 amounts you're working with. But for those that are, are
14 these things that make sense, or raising small amount of
15 capital from a large number of people. Is that really
16 something that's going to help capital formation at the
17 micro company level?

18 And the other question is is there -- are there
19 other things that -- are there other ways we can modify
20 our existing exemptions that could -- keeping in mind our
21 investor protection mandate, but that could help
22 companies raise capital?

23 MS. CROSS: I'll mention after we talk about
24 this, we're going to talk about the restrictions on
25 general solicitation that apply in the context of private

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1 offerings. So that's not part of this. That's the next
2 topic.

3 So this is exemptions that are not the usual
4 Reg D 506 exemption, which is, as you heard from Craig
5 Lewis this morning, is a very widely used, I think pretty
6 successful exemption that we are going to be talking
7 about, whether there are any modifications needed for
8 that. This is for other kinds of perhaps innovative ways
9 that one could access funds to grow your business or to
10 get your business started from public investors through
11 public means.

12 And right now, there's very little ways you can
13 do that under our rules. There's the Reg A offering that
14 Lona mentioned. We only -- we get like a dozen of those
15 a year. It's not a well traveled path. If we made it
16 bigger, you know, would people use it? That's a good
17 question. And I'd love for you all to discuss that a
18 bit.

19 The crowd funding the analogy people use is you
20 can go on a web site, you know, and fund some actor or
21 singer's beginning of their career, and give them \$100
22 and they give you a hat. But if they also gave you a
23 share of stock, that would be illegal.

24 So that's the question that the crowd funding
25 raises. Is there some level at which you don't need the

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1 protection of the securities laws to give somebody a
2 share of stock? That's arguably different from \$10,000,
3 and, you know -- those are all the kinds of questions
4 that are being floated around these.

5 But I think for the group, the question is is
6 there -- do you have thoughts about innovative capital
7 raising or money fundraising that might get that extra,
8 you know, \$100,000 to an entrepreneur trying to get
9 started, where they could do it with securities? And
10 then on the upper end of the scale, the Reg A area. If
11 you made Reg A work better, is there some way to make Reg
12 A work better so that that limited public offering that
13 doesn't give you a reporting requirement might be
14 attractive?

15 PARTICIPANT: Is the difference between Reg A
16 and Reg D the fact that Reg D's not traded, or they're
17 restricted stock?

18 MS. CROSS: There's a -- Reg A and Reg D have
19 very little in common. So Reg D, it's a private
20 offering. The securities are restricted. It's available
21 to public or private companies. So for example, Reg D is
22 used for 144A placements of large amounts of debt. Reg
23 D is used by startup companies to do a private offering
24 to their -- to venture capitalists. Reg D is used in a
25 whole lot of ways.

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1 Reg A is a -- it's not surprising. I couldn't
2 do -- I bet you all mostly have never heard of Reg A. It
3 is a -- it's a -- it's called the limited offering
4 exemption, and it is a limited public offering. So you
5 file an offering statement with us, which eventually gets
6 cleared. It has sort of registration light disclosure.
7 It's not required to be audited. You file with the
8 states, who also review it, the states where you want to
9 offer and sell the securities.

10 When you finish it, you are not -- you don't
11 get a reporting obligation. So unlike an IPO that you
12 register under the securities laws, when you come out of
13 the Reg A offering, you don't have to make any more
14 public disclosures. You're done. You've got your money
15 and you go back home.

16 But you can do it publicly by general
17 solicitation. You can also do something called a test
18 the waters disclosure where you can go out even before
19 you file and see would people be interested in this
20 before you go spend the money.

21 You know, it's a little complicated, because
22 with the Reg A, if you're not going to be -- if you're
23 not going to provide disclosure afterwards, investors may
24 have concerns about that. So making it bigger, will that
25 make it -- will you be able to find investors through it?

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1 I don't know.

2 These are all questions that we would have to -
3 - we would have to tackle. Right now Reg As aren't even
4 filed on EDGAR. They're filed in paper. So we would
5 have to come up with an EDGAR -- an SEC public form.
6 So people could actually see these. Right now you
7 don't even see them when they come in. And we've had
8 them come in handwritten, not typed.

9 So yeah, it's not a -- it's not currently a
10 vibrant market. But if you take it up to \$50 million,
11 maybe it gets more vibrant.

12 MR. YADLEY: I think Leroy said earlier you've
13 sort of either got to be in or be out. That's been a
14 huge problem with Reg A is that is it a registration or
15 is it a private offering, you know, in practice? The \$5
16 million has certainly been a limitation. Probably more
17 importantly is you still have state regulation. And, you
18 know, if you do a 506 Reg D deal, you don't have state
19 issues, except for filing or paying a fee. So that's one
20 thing.

21 One of the commentators -- I can't remember
22 which materials it was in the notebook -- talked about
23 the possibility of a quiet filing. That may be something
24 worth thinking about. Could you file a registration
25 statement under Reg A without any attendant publicity?

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1 Maybe that, along with state preemption and a higher
2 offering amount, might be something that people would be
3 interested in.

4 Also, if you then have the on ramp for post
5 offering disclosures, that would seem to me to be pretty
6 beneficial. And if you're going to go to all the work of
7 doing a registration statement, unless you're going to
8 use the score form or one of those smaller types of
9 disclosure, you're already most of the way there. And I
10 think a lot of going public is just gearing up and
11 getting everything in place, and then the maintenance
12 doesn't have to be that expensive.

13 MR. BORER: You know, I've been doing this long
14 enough to have had brushed up against Reg A a couple
15 times. I was going to ask the question of how many
16 filings you actually get a year. Because I would --

17 MS. CROSS: A little north of 20 a year. I
18 actually did a Reg A in the '80s, just by myself.

19 MR. BORER: Well, like I say, I'm dating myself
20 also. But if I went out to my 50 bankers and said,
21 ``We're going to talk about Reg A,`` they'd think of Bob
22 Marley. Because it truly is an obsolete -- those of you
23 who don't know who Bob Marley is, I've really dated
24 myself.

25 It's truly an obsolete item right now, the 5

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1 million, the fact that it's -- it doesn't get you Blue
2 Sky. You've got to go do all these other things. And
3 the fact that if you go back and you read the way Reg A
4 was used I think when it was truly intended to be used,
5 it was a way of truncating somewhat the review process at
6 the SEC. Not getting around it, but having a limited
7 disclosure that does not take the full-on review process
8 like an S-1 does.

9 And if we have our lawyers call and say, ``Talk
10 to somebody out at CorpFin and say what they would do in
11 this situation,`` they'd say, ``Well, that's just like an
12 S-1. You file it, we give you comments, you come back to
13 us,`` et cetera, et cetera. So we're talking still a two
14 or three-month period. And so at \$5 million, it doesn't
15 make sense.

16 If you could take it to 50, which is the
17 current proposal, and you still leave it such that you're
18 going to have the full SEC review á la S-1, then for an
19 offering of that size, it does no better, in my mind,
20 than just doing a full-on registration and doing an IPO.
21 There's no benefit for the average issuer that is of a
22 substantive enough size to be able to withstand market
23 scrutiny to actually get out there. And especially if
24 you don't get the Blue Sky. So you've got to go to all
25 the states and file with the state securities

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1 administrators as well.

2 MS. CROSS: So do you think there's a place for
3 something that's in between full-on registration and a
4 public exempt offering that has definitely disclosure
5 light? I mean, if you look at Reg A, it's intended to be
6 the score form. All these things are intended to make it
7 easier. And so I guess a question is is that -- if you
8 have to go through SEC and the rest, then that's simply
9 not worth it? Nobody would do that? Or -- because, you
10 know, you talk about scaling regulations. You could
11 scale all the way from, you know, the IPO of a billion-
12 dollar company down to the crowd funding that Lona will
13 talk about. Somewhere in between there, is there a place
14 that should -- that should have a different kind of
15 regulation?

16 MR. BORER: Well, I think there's -- there are
17 some new rules which are, I think, currently being out
18 for notice by I think it's FINRA with respect to private
19 placement reporting. And they -- you have to -- and the
20 final, at least the latest I've seen, is the private
21 placement documentation. Depending on who you're selling
22 it to, it scales, has to be filed. But it's not to be
23 reviewed and commented on prior to being able to actually
24 sell the securities.

25 I think Reg A would be useful if you could

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1 increase the size, help with the Blue Sky, truncate
2 somewhat, or abbreviate the disclosure within all the
3 appropriate rules, and maybe requiring brokers, et
4 cetera, á la the NOMAD system on AIM that was mentioned
5 earlier, and then allowing the community, the companies
6 and the broker-dealers, the brokers, et cetera, to use
7 that as another pathway to becoming a fully reporting
8 company. Because I think unless you have that as an
9 intent in your design, your corporate finance trajectory
10 as an issuer, you're not going to be able to get \$50
11 million of capital from real investors, because you're
12 not going to get that from retail investors, given the
13 scale of what's out there. You're going to need the
14 institutions, the mutual funds, the family offices,
15 endowments, and other, you know, QIBs and accredited, you
16 know, sizeable investors in order to be able to
17 accomplish that.

18 MR. NALLENGARA: John, is the disclosure, you
19 would think, is a disclosure that would allow retail
20 investment, or is it -- or do you see that the place in
21 between something where you'd just be going to
22 institutional investors?

23 MR. BORER: I think if you could expand it to
24 the non-accredited investors with appropriate disclosure,
25 and perhaps even including audits, because I don't think

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1 that's a big gating issue for a lot of these companies
2 that would have that size, I think you could go that way.
3 But even if all you did was leave it with institutional
4 investors, and maybe even QIBs, you could probably
5 accomplish the first task of creating a public company
6 image and initiating the compliance with various things
7 without having to go through the full, you know, three to
8 nine-month process of preparation for a regular way IPO.
9

10 MR. NALLENGARA: Sorry to keep -- but how do
11 you see them -- after they've done the offering three
12 months, six months, are they -- are these companies
13 having reporting obligations? Do they -- is there
14 information requirements? Or is that something -- is
15 that something that the investor negotiates at the time
16 of purchase or --

17 MR. BORER: I think the only way this becomes a
18 truly useful product is if those follow-on things are
19 built into either the corporate charter or some other
20 requirement. Because the institutions are not going to
21 put up 50 million and then just, you know, ''I hope you
22 do okay,'' and ''I see your products on the shelves.''
23 And so I think that may be a means to allow, again, a
24 more truncated way of getting this done.

25 MS. CROSS: For the traditional venture-backed

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1 followed by IPO trajectory, are there other kinds of exit
2 strategies like what we're talking about here that would
3 have any legs if you -- you know, that would be a less
4 expensive exit strategy that would make sense? Or is
5 this only for companies that essentially would never
6 attract venture capitalists and never would attract --
7 never be able to go that way? I think that's part of --
8 part of what we're trying to figure out is who is the
9 audience for this.

10 MR. GRAHAM: Doesn't this kind of depend on,
11 again, the nature of the company? And it seems like what
12 we're talking about is a means for doing all the things
13 that -- getting all the benefits that you get when you go
14 public in terms of access to capital and incentivizing
15 employees and all the rest. And essentially, then, I
16 guess in a broader sense, again, just gaining access to
17 capital.

18 So if this is -- as John says, if it really is
19 just kind of another on-ramp almost, it seems to me that
20 there probably would be some merit and some utility in
21 figuring out how to make adjustments to Reg A to
22 facilitate that. Because essentially, then, what you'd
23 be doing is -- this is just stating the obvious -- is
24 putting a company in a position where they can, you know,
25 go public, in a sense, almost incrementally.

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1 MS. CROSS: If you look at what's happening
2 with the secondary markets for pre-IPO companies, a lot
3 of people have been talking about maybe what you need to
4 do there is add in some structured disclosure
5 requirements and come up with a regulatory scheme that
6 fits that -- the companies during that stage of their
7 lives. And this seemed like another idea like that, if
8 you try to think completely differently about --

9 MR. GRAHAM: Right.

10 MS. CROSS: -- the current process. Is there
11 some category? And maybe the answer is we'd have to
12 build it and see if people come.

13 MR. GRAHAM: And I think they might. And John
14 and I were talking briefly earlier, and one of the things
15 that we were saying is that if you do something like
16 that, you might want to not call it Reg A.

17 MS. CROSS: Right. It's like that we got rid
18 of the SB forms.

19 MR. GRAHAM: Right, right.

20 MS. CROSS: So this would be, you know, a
21 smaller public offering, or --

22 MR. DENNIS: The other thing I would add, I
23 mean, the SEC has a brand, and it's, you know, it's a
24 pretty good brand. So when you go through the S-1
25 process, that's a stamp of approval.

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1 And I think we have to be careful. I mean, if
2 we want to allow in the securities markets a crowd
3 funding thing where it's, you know, if you invest a
4 hundred bucks, we don't really care, that's fine. But
5 that shouldn't have anywhere close to the SEC brand
6 attached to it. And I think we've got to be careful with
7 this Reg A stuff of, you know, you've got to make -- if
8 it's going to go through the SEC process, it needs to at
9 least have enough teeth to it so that the SEC brand, it
10 stays.

11 Because I think if we ever lose that brand in
12 the U.S. capital markets, that's a big detriment to our
13 markets here. And so, you know, I'm okay with -- I
14 certainly support expanding use of capital and access to
15 capital. But at some point in time, whether we use an
16 AIM market type thing or something that's completely
17 outside of the SEC brand, that's fine, but let's not
18 dilute the brand that we have here in the U.S. with the
19 work that the SEC does in capital protection.

20 MS. CROSS: So on that front, so the Reg A
21 process, if we built that larger and called it something
22 else and continued to have SEC review, might be an
23 alternative to, say, a smaller public offering choice.
24 But you would not go there on exemptions that didn't have
25 any kind of SEC review. You'd make sure that they were

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1 really outside the system.

2 MR. DENNIS: I just think that you've got to
3 protect -- I think when you look at the U.S. capital
4 markets, the SEC is part of the brand of the U.S. capital
5 markets, and it's a pretty good brand. With everything
6 we went through, it's still a pretty good brand, in my
7 opinion. And if we go down the road of the SEC approves,
8 because that's what you'll get, you know --

9 PARTICIPANT: You know it says on the cover
10 it's illegal to say that?

11 MR. DENNIS: Right.

12 MR. MAEDER: Nobody ever reads those covers.

13 MR. DENNIS: No one ever reads those covers,
14 right? So we're going to dilute that brand. And I think
15 if you dilute that brand, that hurts our capital markets
16 in total. So just be --

17 MR. MAEDER: Can I ask a question? What
18 problem are you trying to solve with this? Because it's
19 hard to walk down the street these days without running
20 into either a venture capitalist or an angel. I mean, if
21 you can't find an angel network near where you live, it's
22 because you don't know how to use a browser, in which
23 case I submit you probably shouldn't be starting a
24 company or taking money from other people.

25 I think access to capital at that level, at the

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1 very early stage, is not a problem at all in this
2 country. And it's a reasonable test of someone's ability
3 to actually attract customers, which is typically a lot
4 harder, that they first be able to attract \$50 to \$100,000
5 in angel money. Finding me is a lot easier than finding
6 your first customer.

7 MS. CROSS: What we hear is that there are
8 companies that struggle to find enough angel investors
9 and are not nearly to the level yet where they could
10 attract venture capital. So they're beyond their friends
11 and family, so they've tapped them out. They need, you
12 know, 100,000 more dollars to do something, and they
13 don't have -- those are the -- I think that's the
14 category that we've heard really need help.

15 That's not the Reg A thing. The Reg A thing is
16 just trying to make another -- trying to find other cost-
17 effective ways for people to raise money.

18 MR. MAEDER: I understand that. But there's a
19 possibility that there's some adverse selection at work
20 in who you're hearing from, right? You may be hearing
21 from people who really shouldn't get financed.

22 MR. NALLENGARA: And that's why we're glad --

23 MR. MAEDER: That's why you're asking us,
24 right.

25 MR. NALLENGARA: -- yeah -- you're all here.

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1 Because we hear --

2 MR. MAEDER: That's why I felt the need to make
3 that --

4 MR. NALLENGARA: No, no. It's good to hear
5 that. Because we have heard from a variety of quarters
6 the opposite of what you're saying, Paul, that without
7 things like this, there is no way for a subset of the
8 private companies to grow. And if you look at the, you
9 know, crowd funding, it's Reg A, but, you know, reduced
10 to a much smaller level. Some people will say that
11 companies of that size shouldn't be raising that much --
12 shouldn't be raising equity capital from that many
13 different people. They should be focusing on their own
14 savings, their friends, their family, and limit the
15 numbers. But, you know, crowd funding is talking
16 potentially thousands of --

17 MR. MAEDER: Right.

18 MR. NALLENGARA: -- thousands of individual
19 shareholders in a company that small? People question
20 whether that's the right approach to be taken.

21 MR. MAEDER: Yeah. Most of them will lose
22 their money. I'd be willing to bet that if you and I --
23 if you and I went home tonight with half a bottle of
24 Scotch, we could, by 11:00 p.m., come up with a business
25 plan good enough for me to take you to Boston and you to

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1 find five angels, two of which would put money into it.
2 I mean, there may be that perception out there,
3 but I'm -- it's not -- because I look at 20 angel-funded
4 deals a week, and I reject, on average, 20 of them as
5 viable businesses.

6 MR. YADLEY: Paul, I think there are some
7 regional differences there, just -- in Cambridge or Palo
8 Alto or Austin or -- I mean, I live in central Florida,
9 and a few years back, a number of securities lawyers in
10 our community tried to create an angel network. And we
11 were going to -- we just had a little cocktail reception
12 up at the University Club after work. We could get all
13 of our clients to come, and very few of us could get our
14 angels to come, because they just aren't group oriented
15 maybe the way they are in some other parts of the
16 country. We have some very good local private equity
17 firms, and we expose really early stage companies to
18 them, and maybe they know an angel.

19 But I think what you're hearing at hearings is
20 true for a large number of companies around the country,
21 and we'll get into the general solicitation in a minute.
22 But I think that's a more promising avenue than a lot of
23 angels. I mean, we don't have people that are seeing 20
24 a week, which adds up to a lot over a year. And then
25 it's just like that.

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1 I'm not sure about crowd funding, though,
2 because I do have -- I'm sympathetic to being able to try
3 and find people. But it just seems that, at least to the
4 extent I've read about it, there's very little disclosure
5 that is considered necessary for that. And again, I
6 think disclosure is the basis of all this regulation.

7 So while if you can only lose \$100 or \$500,
8 it's not the end of the world for anybody. It gives
9 people a real opportunity to do what you just said, is
10 just, well, it looks pretty good. And what the heck,
11 it's only \$100. And I think if the SEC -- to piggyback
12 again on what Leroy said, if the SEC really was behind
13 something that -- where people lost collectively \$50
14 million, the Commission would have mud all over its face.

15 MR. GREENE: Can I, Paul, challenge the
16 assumption not only just on the geographic piece? So
17 just to start with some numbers, if you look at the
18 number of new business starts in the country, we've gone
19 from an average of over 600,000 per year to under half
20 million. McKinsey estimates that that drop in starts,
21 you know, translates into 1.8 million jobs less created
22 each year.

23 In addition, you've seen a marked increase in
24 the death rate of firms. Maybe some of that's bubble and
25 real estate related, et cetera. But just in terms of new

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1 business starts. When you talk to small and emerging
2 businesses, access to capital frequently gets cited. But
3 when you look at the dollars really across the board, if
4 you're looking at the capital that provides new business
5 starts, well, we all know venture's way down. That's
6 really less relevant at the startup phase.

7 But angel investing is down 30 to 40 percent
8 versus 2007 levels. Nobody's got perfect data on the
9 angels, but the best estimate is down 30 to 40 percent.
10 Traditional bootstrapping mechanisms like borrowing
11 against your credit card or against your home equity line
12 of credit, that's not available.

13 So what we're hearing over and over again from
14 early stage entrepreneurs is traditional sources of
15 capital have dried up. It's harder to start. And that's
16 exacerbated on a geographic basis, again, where it's not
17 -- maybe not in Cambridge and Palo Alto, but across the
18 country. So whether crowd sourcing is the right vehicle
19 or not, a look at alternatives at the early stage is
20 important.

21 Second point, as we have gotten out and -- so I
22 participated in the Access to Capital Summit at the
23 Treasury that the IPO Task Force came out of, that have
24 done another dozen of those events. The IPO issue is
25 kind of issue number one that we heard over and over

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1 again, but crowd funding actually was, you know, very
2 close behind that.

3 So even if it's not come across the radar
4 screen for lots of folks here, lots of people are raising
5 it. And it's not always just, ``Hey, I have a wacky
6 idea. Let me see if I can run,`` you know, ``fund it
7 from Ebay folks.`` But you see businesses who say, ``I
8 actually have a customer base. I would love to be able
9 to raise equity capital from my customer base.``

10 So there's a wide variety of ways that it can
11 be deployed. But a lot of smart, interesting people are
12 looking hard and seeing opportunities here, not just the
13 adverse selection issue.

14 MR. CHANG: I just felt that we are spending a
15 great deal of time to help the -- kind of a non-issue.
16 So a classical situation in running a company, so here's
17 a question. If you have two salesmen, one closes a
18 million dollars a year, the other one only closes 100,000
19 a year, who would you spend more time and resources to
20 help? And I think the answer is really to help the one
21 that is a star salesman, not the other one.

22 And so I think the statistic early on pointed
23 out that most of the job creation came from the 92
24 percent that's growing, not the startup companies. So
25 we're trying very hard to help the people that really

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1 probably cannot be helped, like I said with some of the
2 earlier discussion.

3 So for example, the FDA got tremendous -- it's
4 a very tough organization, and to build a brand that
5 really helps American companies sell drugs overseas.
6 Because if it's FDA approved, it's a stamp of approval.
7 So I think it's really not something that I think the SEC
8 want to water that down to address this kind of issue to
9 help people that really probably have no business
10 starting businesses.

11 MS. MCGOWAN: I'd like to just state something
12 about the biotech industry. We're venture-backed. We've
13 raised quite a bit of money. We're moving into -- we're
14 in our Phase 2B, so we're well along in our process. And
15 I think this possibility of Reg A is a possibility. I
16 don't know all the details, but at 50 million, it's a
17 possibility to continue our pipeline and continue the
18 drug development and potentially have, you know,
19 worthwhile drugs and innovation. And I think that it's
20 well worth looking into and that it's worth trying. I
21 think 5 million is too low, but 50 million would make it
22 worthwhile.

23 And a lot of organizations like our
24 organization, we have audited financials. We don't have
25 quarterly reviews, but we have annual reports. They're

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1 done by, you know, a major audit firm. And so we have a
2 lot of the structure in place. So it's not just as if
3 we're going out and looking for money. We have the
4 structures and the processes in place in order to
5 validate any report. You know, it should be minimal
6 reporting is not to have -- to be too expensive or to
7 devote too much of our time away from the drug
8 development. But I think it's still worth looking into.

9 MS. GREENE: I would just comment on the crowd
10 funding thing. And I haven't thought a lot about it;
11 it's a fairly new concept to me. But sitting here
12 talking, I'm not sure with the age of the Internet how
13 the SEC could regulate or administer what's going on with
14 Internet solicitation. I don't think the staff could
15 ever be large enough to chase down everybody who's doing
16 something out there.

17 And when you're talking small amounts of --
18 small dollars invested by a huge amount of people, at
19 some point you have to put some of the risk being taken
20 on the person who's willing to take the risk. I mean,
21 you cannot protect everyone from the decisions that they
22 make.

23 And so if I want to invest \$100 in some up and
24 coming singer, you know, at some point there's going to
25 be a hundred senior citizens that did that, and they lost

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1 everything. And, you know, the haunts of Enron and
2 Sarbox, you know, the SEC cannot swoop in at that point
3 and then lock everybody down because a group of people
4 that didn't know any better jumped in with their \$100 or
5 their \$1,000 or their \$10,000.

6 But I just -- I don't see how in the world of
7 Internet somebody's going to come up with a way to get
8 around whatever it is the SEC comes up with in terms of
9 the limits, and I don't think you can have a large enough
10 staff to chase those people down. I mean, good or bad,
11 that's, you know, initiative. And if somebody wants to
12 put something, you know, stupid out there, you can't
13 protect every \$100 investor, however tens of millions
14 they're going to be. You can't -- you know, we're not
15 the -- the SEC, the government's not big enough to do
16 that.

17 So some of the onus for this investor
18 protection has to be on the person who's making the
19 decision. You can't -- SEC and Congress and government
20 cannot lock down everything to the point that, you know,
21 you protect us all from being stupid.

22 MS. JACOBS: And before -- just one quick
23 statement. Before coming here today, I knew there were
24 some issues that I wouldn't be immediately familiar with,
25 like crowd funding. So I sat with a group of investment

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1 bankers and VC folks in Atlanta, where I am from. And I
2 threw this subject out to them, and it was interesting
3 what came back. And I think to your point, this might
4 dovetail into it.

5 You know, they said, ``Why would the SEC
6 attempt to try to control or, you know, take the rap for
7 what is sort of the Wild, Wild West, known as the
8 Internet? And what would really help us in the business
9 is an auction house. Have somebody somewhere set up an
10 auction house with limited disclosure, i.e., guidelines
11 from you all, but wash your hands of it.'' And, well,
12 you might really like that.

13 But no. Because I agree with the comment about
14 the SEC's brand, but it was -- I thought that was an
15 interesting solution, is put out some limited disclosure
16 suggestions and urge somebody somewhere to set up an
17 auction house and let it go.

18 MR. ABSHURE: Now that my fellow observer
19 member has weighed in, there is one group that really does
20 want to be active in this area, and that's the states. So
21 I felt the necessity to speak up.

22 Reg A and crowd funding discussions always
23 raise the state regulators' least favorite subject, which
24 is preemption. And the argument that we hear more often
25 than not supporting preemption is issues of convenience

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1 and cost. And for us, we've never really seen studies or
2 the hard numbers telling us what those costs are. And
3 we'd also question whether convenience is really an
4 argument to support preemption, to turn over the federal,
5 state system of government and to deny states'
6 authorities to act within their own borders.

7 But more importantly, I think that it seems
8 like the interested persons assumed that the states can't
9 provide that efficient, effective system to balance the
10 needs of the investors with the needs of the issuers.
11 And I think that, maybe rightfully so, folks will assume
12 that the states, if not preempted, will try to fit new
13 ideas like a revitalized Reg A and a crowd funding
14 exemption into the existing state law. And I guess it's
15 our own fault for not letting people know that that's not
16 the case.

17 The states feel like we're the most appropriate
18 regulator in this area, because we understand the issues
19 faced by the small local businesses in our backyard.
20 We're going to -- we're the regulators that most
21 understand the economic factors faced by the small local
22 business. We have the most vested interest in seeing
23 that small local business succeed. And we also think
24 that we're most likely to be a more utilized resource for
25 both the small business issuer and the small business

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1 investor.

2 So I would just plead with the group to not
3 assume that preemption is the way to go just because you
4 fear that the states can't be proactive in this area in
5 developing it. You know, technically, they're both
6 exemptions, although one's kind of not an exemption. --
7 in developing an exemption program here that could really
8 provide a cost-effective basis for issuers and investors
9 in maintaining those protections.

10 MR. BOCHNOWSKI: As a former chairman, citizen
11 chairman of the Indiana Department of Financial
12 Institutions, I agree with everything Heath had just
13 said, because I think the states are fully capable.

14 But I'd like to go back to the question of
15 crowd funding and is it needed. I think it is geographic
16 in nature, in the Midwest, certainly. And I know that
17 lots of activity happens on both coasts, and it kind of
18 finds its way to the center eventually.

19 But this crowd funding may fit into the
20 community banker space in that we typically are the ones
21 who make the 50 or 100 or 250 or million-dollar loan.
22 And community bankers want to lend. We want to lend to
23 small business. But we also know that 50 percent of all
24 small businesses don't always make it.

25 So what we want to see is some capital and some

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1 equity. A lot of these entrepreneurs -- I sit on the
2 board of the Purdue University, basically, incubator
3 system, their venture capital -- or their venture
4 business system. And a lot of those companies, they do
5 have good management. But they can't find -- and maybe
6 they're going to fail. I don't know. But they can't
7 always find the angel investor who wants to take up their
8 cause. Maybe they need many investors, many angels, and
9 maybe that is the crowd funding concept.

10 I don't think we want to hold back their
11 ability to continue to press forward. Because if they
12 are tapped out, and before we go to the SBA -- because
13 the SBA's going to ask too, ''Is there a capital position
14 that the borrower has?'' -- they have to have the
15 capital. And we shouldn't preclude them from getting to
16 that point.

17 MR. LEZA: Having the opportunity to have
18 started in micro finance, and now the word is ''crowd
19 funding.'' You know, we did it within the State of
20 California, because as soon as we looked, that we could
21 go out to states with so many regulations and stuff like
22 this.

23 But there is a necessity, because there's a lot
24 of people out there that, you know, they would waste
25 their time coming to see a venture capitalist, because we

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1 would never consider. They don't have the management.
2 They don't have the high growth. They're into businesses
3 like Mom and Pops and stuff like this.

4 But I think there's an opportunity there. A
5 lot of people, you know, want to make small investments.
6 And if you look at it, depending what their resources are
7 or where the value is, they could go ahead and lose \$100,
8 \$1,000, but they would be happy with what they're doing.
9 And the people that are benefiting a lot of time are more
10 successful in the business, because all of a sudden,
11 they've got some capital to really work with it. And it
12 really improves the success of some of these smaller
13 businesses by actually getting some outside capital.

14 MR. SUNDLING: Yes. I had some comments in
15 particular and related to the banking environment. So in
16 my experience, banks are a non-player in the tech startup
17 world. And the reason is that, I mean, if you have farm
18 equipment or you're manufacturing -- manufacture
19 something, you've got assets to borrow against, you can.
20 But even with the most aggressive banks in Silicon Valley
21 where we started, debt instruments are just not
22 available.

23 But I think about this crowd sourcing thing, so
24 I've heard some really good pros and cons to it. And it
25 kind of strikes me that these folks may not always be --

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1 so there's a lot of dimensions to raising that seed
2 money. And if I understand it right, now, are we talking
3 about a limitation of 100,000 or of 1 million? Because I
4 thought I heard both.

5 MR. NALLENGARA: There's a -- the bill in
6 Congress is a million. There have been other -- others
7 have -- we have a rule-making petition that has it at
8 100,000. So currently, what Congress is considering is 1
9 million.

10 MR. SUNDLING: Okay. So --

11 MS. CROSS: So between 100,000 and a million.

12 MR. SUNDLING: Right. Because 100,000 has zero
13 value, right? In any startup you're doing, unless it's a
14 Subway franchise, you're not going to get anywhere with
15 \$100,000. So I would say it would have to be a minimum
16 of a million. But you probably also don't want to go too
17 far north of a million, because the purpose of this is to
18 get that five slides, two guys, and a dream something to
19 start with, right?

20 I don't necessarily agree that these are folks,
21 when I think about it, that can't raise money from
22 angels. It might also be those who, maybe they're not
23 familiar with the whole Sand Hill Shuffle and VCs and the
24 angel networks. But maybe they are. And they've seen
25 that the terms -- term sheets that come out of the angel

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1 networks these days are not something that they want to
2 deal with, right?

3 So this expedited process of getting your hands
4 on, you know, half a million, a million dollars to get a
5 business started, if it can be done in a way -- and I
6 guess that's wherein the trick lies is to somewhat
7 protect an investor. And I absolutely agree with the
8 comments of the SEC should get away from it, because
9 people will lose money. People lose money on great
10 investments, right? They're going to lose a lot of money
11 on this stuff, but a few will take hold.

12 But maybe one of the more important things is,
13 you know, the American entrepreneurship is when we talk
14 about all these big companies, right? Where do you think
15 Hewlett Packard started? And Larry Ellison was
16 visiting IBM one day and came up with, you know, the idea
17 for a relational database. All these things started as a
18 very modest idea and one or two people, and built these
19 great companies.

20 And I think that to whatever extent we can fuel
21 that by reducing regulations and opening up opportunities
22 for people to raise that first amount of money, right,
23 quit their day job, get that first prototype built, can't
24 be a bad thing for the overall U.S. economy over the long
25 term.

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1 MR. NALLENARA: That's the idea behind crowd
2 funding. It's not so much having a business ready to go
3 that people can understand and hold. It's funding that
4 idea or that next step for that small business, and
5 finding a source of capital that may not be available to
6 them if it wasn't for something like this, and tapping
7 into the power of the Internet.

8 Some of the concerns we have relate to investor
9 protection, some of the questions that Shannon raised.
10 And proponents for crowd funding have suggested that a
11 way to consider some of those issues is look at the web
12 site or the facilitator of the investments and see if
13 that -- see if you can bring the oversight there.
14 Because you can't -- it would be challenging for a small
15 business or small idea to have a -- have owner's
16 regulation on top of them, because, you know, they are
17 raising a million dollars or \$500,000.

18 So the idea would be if there is some -- if
19 there is a web site or web sites that develop that house
20 these potential ideas or these potential investments, you
21 bring oversight in the market by effectively regulating
22 those web sites. You require these web sites to do
23 background checks on the investments. You require these
24 entities that control the web sites to collect the cash.

25 Because if they're raising \$500,000 to build a

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1 new store, then they need to get the \$500,000 before they
2 take anybody's money. So there would be a way to -- you
3 know, you either get all of the money or you get none of
4 the money out of the capital raised.

5 So there are ways to -- there are ways that
6 people have suggested and, you know, Congress is
7 considering to bring some investor protections in there
8 in a way that doesn't sort of squash the life out of the
9 idea. Because if you -- you know, the concern is putting
10 too much regulation on the idea, on the person, will make
11 the venture impossible.

12 MR. DENNIS: Well, the other thing I'd just be
13 careful with, the more that the SEC puts in it for
14 regulations, the more their brand is associated with the
15 stuff.

16 MR. SQUILLER: Yeah, I couldn't agree with that
17 more. I think whenever you're looking at something
18 that's as shallow and wide as this, as comments had
19 previously been made, you're not going to be able to
20 regulate this. You don't want to regulate it. You just
21 basically want to authorize it.

22 And actually, this proposal by the ACA is
23 actually a fairly reasonable proposal for the simple
24 reason that it does limit the potential losses. But I
25 think that any kind of idea about the SEC trying to get

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1 more involved in setting up structures and regulating
2 this, I think that's a -- I think that's a mistake.

3 MR. DENNIS: Yeah, I agree. And the only thing
4 I would put in place -- and we probably already have it -
5 - is make sure that you have the laws in place or the
6 rules in place so that you can go punish the bad guys.
7 Because we'll have some bad guys in this that go out and
8 raise money, and they have no company, they have no plan.
9 They're just raising money. And make sure you can get
10 those guys to court and get them to jail, you know. But
11 beyond that, I'd be very careful about it.

12 MR. MAEDER: You folks might -- I assume that,
13 Dan, what you're asking, you may not have a choice,
14 right, if this bill gets passed. Congress may say,
15 ''Okay, go ahead and figure this out,'' right?

16 MS. CROSS: Well, certainly there's legislation
17 pending that would do that.

18 MR. MAEDER: Yeah.

19 MS. CROSS: I think that the -- you know, the
20 questions are certainly complicated. One question I had,
21 which isn't about crowd funding, but I think one of you
22 all mentioned the AIM market, which has gone through
23 difficult times, at least at some point, when it was --
24 when there was a not good impression from the AIM market.
25 I'm curious what you think led to that and then what

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1 pulls it out of that, and are there lessons from that
2 that would be useful for thinking about crowd funding?

3 MR. SUNDLING: So you're looking at me. I
4 guess that's my cue. Okay.

5 So I think -- and again, I'm no AIM expert, and
6 it has certainly gone through some iterations. Back in
7 probably the late '90s, I think it was a very fledgling
8 board to trade on. And the requirements to get there
9 were extremely low. And what was -- you know, the way it
10 was positioned back then was really a -- just a public --
11 an alternative to venture capital, right? So early stage
12 company looking for that B Round, or maybe even an A
13 Round. So if they've gotten maybe prototype products and
14 they were ready to raise a serious amount of money, maybe
15 3, 4 million pounds, they would go to the AIM.

16 And since then, it has matured quite a bit so
17 that -- don't hold me to the numbers. It would be
18 interesting to get that research overlaid with this graph
19 that was pointed out here in terms of the listings, so
20 the micro cap listings on U.S. exchanges.

21 My understanding is that grew 400 percent,
22 while you can see here that from 2000, while the U.S.
23 exchange basically went to zero on -- or, you know, there
24 was a little burp there, but effectively has been flat
25 for a decade, right?

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1 So it has gone up and down. My understanding
2 these days is you can't touch AIM unless you're looking
3 at a 5 million pound or larger raise. I don't know how
4 true that is. I heard that it's grown 400 percent, which
5 was the number I heard three years ago, and that over
6 half of the companies listed on AIM were U.S. companies.
7 So that was a kind of shocking number to me as well.
8 London is a very international city, but literally, 50
9 percent of all the listings were U.S. companies that
10 decided they don't want to go public here. They'd rather
11 do it there.

12 You know, the regulation process, I thought,
13 was very nice, right? So you have one annual report, one
14 annual financial report to provide. You get this thing
15 called a nominated advisor, or a NOMAD, that, right, kind
16 of sticks -- to some extent sticks their neck out and
17 vouches for the company.

18 It was kind of a market controlling thing is
19 that these are attorneys that have gone through a special
20 process and have become NOMADs, and their name is
21 associated with your business and they sit on your board,
22 which is also really interesting. So you know at least
23 that this company has a -- you know, somebody whose
24 reputation and livelihood is likely hinging on that board
25 doing the right thing and the management team doing the

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1 right thing, and you pay them a fee.

2 So again, I can't comment on why it's gone up
3 or down. I actually don't know exactly where it is
4 today. The last time I checked on it was about two years
5 ago, but they had an absolute rocket ship of a ride.
6 Most of that, or a good part of it, were either U.S.
7 companies or other companies -- Singapore, Hong Kong, et
8 cetera -- that would have otherwise come to the U.S. but
9 decided not to.

10 MS. HANLEY: So we do have some data on firms
11 that leave the U.S. and go public abroad, and they're not
12 quite as large as you might think. So the U.S. -- so
13 this dichotomy of the size of the issuer is not firms
14 leaving the U.S. to go public elsewhere. So we're not
15 seeing it, at least in the data.

16 We are losing some companies. So U.S.
17 companies in the latter half, between 2002 to 2007,
18 comprised about 15 percent of all of the LSE listings,
19 IPO listings, and so it became quite big. But that's
20 about 50 issues, not enough to make the AIM.

21 So I don't think that this issue of the small
22 companies is because they're leaving the U.S. to go in
23 many other markets. We're not seeing this huge exodus of
24 U.S. companies leaving. There are some that do. And if
25 the group is interested, we can provide those statistics

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1 for you.

2 MR. SUNDLING: Yeah. I think those statistics
3 would be really interesting for a number of different
4 reasons. But, you know, the other -- I guess the other
5 dimension to it is yeah, some companies have left to go
6 list on other boards. I would say that the AIM was
7 probably, at least at one time, less about liquidity and
8 more about just raising that next round.

9 But I think the -- probably the bigger issue is
10 just this everybody's turned off on IPOs, almost
11 worldwide, a trend that started here in the U.S. that's
12 propagated. And, you know, when I listen to all the
13 discussions here, we've got broker-dealers and investors
14 and bankers and CEOs of small companies and everywhere
15 else, is you just see this growing chasm between, you
16 know, where the investors want to put their money and how
17 these companies are raising money. And that once common
18 ground that existed of micro cap IPOs is just not there
19 anymore, right?

20 And this is a very dramatic scale here. I
21 mean, it takes a minute to absorb all this. But we
22 destroyed the market. I mean, it's gone. And it was a
23 radical change in legislation that caused that. And to
24 think that there's going to be anything other than a
25 radical change to fix it, I think that's just not

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1 realistic.

2 MS. CROSS: And to weigh in on the sort of
3 radical change in the legislation, what had actually -- I
4 think people are -- there's a consensus that it's not one
5 thing. It's not the regulations. It's a combination of
6 decimalization, the change in the model for research, the
7 -- which results in the elimination of smaller investment
8 banks. It's on and on and on.

9 And so the question is, which of those things,
10 if you were to try to move the levers, which ones are
11 ones that are -- that should be moved? Which ones are
12 ones that are important improvements that, while they may
13 harm micro cap IPOs, have enough other benefits to them
14 that you need them? For example, I don't think very many
15 people would want to roll back decimalization. You just
16 don't hear that as something that people think should
17 happen.

18 The question of the separation of investment
19 banking from research, if you just go back in time to
20 what happened in the late '90s, it was pretty awful, and
21 it really damaged investor confidence about research.
22 And I don't know that that was a good model to continue.
23 So you end up with the research settlement. People
24 referring to the Spitzer rules. Is there something
25 within those rules that needs to be modified, as opposed

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1 to saying, well, we don't want to have any rules about
2 restrictions between research and investment banking,
3 because it was pretty -- I don't know that a lot of
4 people were proud of what happened at that time. So I
5 don't know that we want to go there.

6 So I think each one of these -- that's the
7 reason this is such an important group to get together,
8 because you can think of each of these things and which
9 ones are levers you can adjust some, keep investor
10 confidence up, and perhaps open up more avenues for
11 people to raise money.

12 That's one of the reasons I think these other
13 somewhat arguably wacky ideas for letting people raise
14 money might make sense. I mean, there might be companies
15 for whom a new and improved Reg A, called something else,
16 is a way for them to get some more money, that gets them
17 to the next stage. Same thing with crowd funding.

18 So I think that's the purpose of, I think, this
19 conversation, if that helps you sort of think through
20 this.

21 MR. DENNIS: Well, and I think going back to
22 one of the points Milton, I think, made, you know, is
23 there a way that you could capture very defined and
24 easily attainable information?

25 I think of revenue, you know. That's pretty

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1 easy to get. And do that -- you know, maybe a company
2 pays a small fee to a web site, and, you know, all the
3 revenues by SIC code or some kind of classification are
4 then laid out so that you can -- maybe that's their
5 research, you know. And then some very -- you know, has
6 that become the research for a small company, as opposed
7 to Goldman Sachs just isn't going to provide the research
8 anymore.

9 MR. MAEDER: I think you're exactly right.
10 There are four or five different things that contributed
11 to this, and some of which we can't or wouldn't change,
12 like you said, decimalization. If you're on the Good
13 Ship Nemo, and you see yourself going towards the, you
14 know, the Empire State Building, which lever do you grab?
15 You grab every lever you can. And there are some we can
16 grab, some we can't. And clearly, I don't think
17 decimalization is one. I agree with you.

18 On the Spitzer thing, the thing that I never
19 really understood was it did get pretty bad. But if you
20 think about the fact that Lehman or Goldman was --
21 Goldman was publishing research on a company Goldman was
22 taking public, let me think. How objective will that --
23 I mean, the term ``research'' maybe was the wrong word.
24 It wasn't like academic research. It was advertising.
25 And I think everybody who was on the street knew it was

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1 advertising.

2 Most buyers of IPO issues, because by
3 definition they were sophisticated investors or
4 accredited investors -- sophisticated, I guess -- knew it
5 was advertising. There were, towards the end of it,
6 during the really obscene period, there were some
7 grandmothers whose pension funds, you know, got put into
8 some of these crazy stocks. Because a broker sent them
9 the research report and said, ``Mrs. McGillicuddy, look.
10 This is research.'' And she might have believed it. But
11 the solution to that was just a great big stamp on every
12 research report that said ``Advertisement.''

13 When I see an ad from Ford Motor Company, I
14 don't really believe them when they say they're the best
15 vehicles in the world, or when Toyota does.

16 And so it was really a context thing. And I
17 think 99 percent of people who are reading those highly-
18 biased research reports knew they were just that. So I
19 think that was a bit of an overreaction with good
20 sentiment, but bad collateral damage.

21 MS. CROSS: And I think one thing that might be
22 worthwhile for a later meeting, if you all are
23 interested, is to have the folks from our Trading and
24 Markets group talk -- come in and talk a bit about where
25 the research settlement is now, and what the FINRA rules

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1 are, and, you know, areas of possible discussion. Since
2 there does seem to be in every one of these
3 conversations, it comes back to research. And whether
4 that research is -- we just admit it's a prospectus and
5 get it, you know, filed under some version of free-
6 writing prospectuses, or what you think of it.

7 The IPO on ramp -- the Task Force Report
8 suggests that the underwriter be able to write research
9 that's during the offering for an IPO that they put out
10 in advance of the IPO, but not even file it under the
11 rules. And that's going pretty far. We haven't -- you
12 know, I'm not speaking for the Commission. But that's
13 something that, you know, they think is important to
14 letting this company's story get out there in a readable
15 way.

16 So that's an example of somebody who's trying
17 to think of another way to look at the research. And I
18 think if you all are interested, we could get some help
19 for a subsequent meeting on this issue.

20 MR. NALLENARA: From the IPO Task Force, if
21 you're -- if everyone looks at it the way you do, which
22 is it's --

23 MR. MAEDER: Right.

24 MR. NALLENARA: -- it's sales material. Then
25 the question is if you're going to let the -- as the IPO

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1 Task Force suggests, that's going to help a small company
2 IPO by allowing the underwriting at all.

3 MR. MAEDER: Allowing them to tell that story.
4 I don't mean to imply that there's no value in
5 advertising. There's huge value in advertising. Explain
6 your product, right? When Ford puts out an ad and says,
7 ''We have, you know, a 250 horse engine with -- you know,
8 that gets this mileage,'' or whatever, there's a lot of
9 value in that.

10 There was a lot of value in the research report
11 that explained what a router was and why the Internet
12 needs routers. And that was the research report that
13 Cisco went public on. So what's -- the part that was
14 silly was the buy/hold/sell recommendation, and the part
15 that was silly was some of the more promotional stuff.

16 But these companies, particularly technology
17 companies, absolutely have no prayer of going public if
18 somebody isn't explaining what they do and where they fit
19 into the work. Because this stuff is too complicated.
20 This is not -- you know, it's not a Veg-O-matic. These
21 are not products that are understandable without a fair
22 amount of explanation.

23 So the didactic portion of those reports was
24 vital, and that has one -- the loss of that portion has
25 done a great deal to damage the IPO market.

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1 MS. CROSS: And you don't think prospectus
2 disclosure can make up for that, even if it's plain
3 English?

4 MR. MAEDER: Oh, I think it could help a lot if
5 it was in English and if it was digestible, and it didn't
6 -- yeah, it didn't devolve into -- if it was in English,
7 yeah.

8 MR. YADLEY: Go on, say it. Legalese. But
9 that's part of it. Another thing that has happened,
10 remember that back 15 years ago, the research was all
11 from these big houses that were able to put the research
12 together. We're talking about community banks.

13 The bank information, financial information, is
14 on the FDIC web site's quarterly. Most of the smaller
15 regional investment banking firms that specialize in
16 banks put out reports, and they compile this data. And
17 so the investor actually can get information pretty
18 easily about which banks are doing better compared to
19 their peers.

20 And I would think that would happen now that we
21 have, you know, better financial tagged information since
22 June, that there would be companies that would start
23 doing their own analysis and would be out there.

24 But back on the AIM market. In the over-the-
25 counter market, the top tier, Pink Sheets developed

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1 something sort of like that. And wasn't your firm --
2 aren't you sort of the equivalent of a NOMAD on the Pink
3 Sheets, the QTX market?

4 MR. BORER: You're thinking of OTC Markets --

5 MR. YADLEY: Yeah.

6 MR. BORER: -- which is a different company.

7 MR. YADLEY: No, no. I --

8 MR. BORER: We're working with the Bulletin
9 Board.

10 MR. YADLEY: Okay. But aren't you one of the
11 firms -- because you can be a brokerage firm or a law
12 firm.

13 MR. BORER: Oh, right. We can be a PAL or a
14 DAD.

15 MR. YADLEY: PAL, right. And we looked at that
16 and thought about doing that and decided we weren't doing
17 enough volume to take the risk. But I think there were
18 some very good legitimate firms -- I think one was yours
19 -- that were sort of doing that. And I'm wondering what
20 kind of data Trading and Markets has on how companies are
21 being traded there.

22 MR. GRAHAM: You know, on that note, since you
23 mentioned Trading and Markets again, I think it would be
24 a great idea to have Trading and Markets come in and give
25 us some insight on what's happening with the research

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1 settlement. I also think it might be a good idea if we
2 took a 10-minute break.

3 (A brief recess was taken.)

4 MR. GRAHAM: Okay, why don't we try to get
5 started. Okay. The next topic that we want to tackle is
6 general solicitation. But before we do that, I want to
7 go back to we were talking a little bit about the
8 research and the absence of research coverage, and to the
9 extent that that's -- that has become -- that is an issue
10 with respect to a lot of companies that just are not
11 followed.

12 And I know that, you know, Chris wanted to make
13 a point about that.

14 MS. JACOBS: Sorry. Because I know Shannon
15 brought it up. And those of us in the room that have
16 public companies, throughout the morning, I've heard that
17 every one of us is suffering because of the lack of
18 coverage.

19 But I also totally agree with the fact that
20 something had to be done because it was egregious, even
21 while everybody knew that was the dirty little secret
22 about research. As little companies, unless we needed
23 money, we were totally ignored, and now -- so we were
24 ignored before the issue went public. And I think it's
25 exacerbated now.

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1 And I've actually gone to some VC folks and
2 I've talked to some folks on Wall Street and even,
3 believe it, the NYSE, saying, ``You know, could somebody
4 please just get the equivalent of Underwriters
5 Laboratory? I would gladly pay a fee to have our company
6 covered.'' And I don't want to pay for the writing, but
7 I want to pay for accurate reporting and accurate
8 representation.

9 And it would be the coolest service if we
10 somehow had an independent group, and let us pay for the
11 thrill of seeing that our financials are correctly
12 portrayed, and that our companies and what we're doing
13 are well-reported. So you kind of negotiate.

14 Like even today, we have one analyst covering
15 us. And I believe it's a micro cap group out of New
16 York, Sidoti. And the person calls us and asks us
17 pointed questions, some we can answer, some we can't,
18 because we all know about Reg FD.

19 But we negotiate. He gives us the question and
20 then listens to our answer and puts out the research, and
21 we didn't write it, if that makes sense. It's all -- it
22 seems proper. Now, I'm not paying Sidoti, but I would
23 gladly love to have something available to us, the
24 equivalent of Underwriters Laboratory.

25 So that's it. I just noticed that we all said

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1 it throughout the day, and I just -- go ahead and finish
2 it up.

3 MS. CROSS: And that's interesting. You know,
4 after the research settlement, there was a requirement
5 that the firms fund research to be provided
6 independently. And, you know, that didn't take, I don't
7 think, on a long-term basis. It took while it was
8 required.

9 But what you're talking about is more like a
10 utility, a public utility that -- whose job it would be
11 to rate -- to rate companies in some way. But not rating
12 agency, since we know how well that goes.

13 But it's an interesting idea, and I think one
14 we should schedule time with Trading and Markets to talk
15 to us all about the research issues, because I think
16 they're -- and maybe get somebody -- some FINRA folks to
17 come too, would be -- because they have a lot of rules in
18 this area as well. Yeah.

19 MR. CHACE: If I could just make a comment on
20 research. I wouldn't overstate the -- from the
21 institutional side, I wouldn't overstate the ability of
22 research coverage to be a panacea or to solve this
23 problem. I don't -- and I don't think the availability
24 of low-quality one-page research solves anything at all
25 on the institutional side either.

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1 I think quite a few companies -- when you get
2 down to the really tiny companies, there isn't much
3 coverage. But I think Yahoo Finance, for example, has
4 most companies' financials up there. It's not hard to
5 get access to information, I don't think. And I
6 personally wouldn't put much value on the availability of
7 a report as something to solve this problem.

8 MR. MAEDER: No, what was happening when there
9 was a real research industry was the best analysts were,
10 you know, Mary Meeker at Morgan Stanley, Rick Sherlund,
11 in the software business anyway, at Goldman. They were
12 earning 4 or \$5 million a year, and they were living and
13 dying by their research. And they were -- you know,
14 they'd win big awards, which resulted in big bonuses at
15 the end of the year if their research was accurate, and
16 made a lot of money for the bank's clients. And they'd
17 get fired if their research turned out to be incorrect
18 and inaccurate.

19 So the stakes were high and the quality of the
20 research was high. It went nuts like everything else did
21 in '98 and '99.

22 But having relatively low-quality, low-grade
23 stuff probably doesn't do a lot. I totally agree.

24 If you do pull some of those folks in, it would
25 be really valuable to bring in one or two, if they're

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1 still alive after all these years, analysts from that
2 time period, or people that ran banks, people like Mike
3 McCaffrey who ran Robertson Stephens, understood the
4 business model of research intimately, or a person like
5 Paul Denninger, who's on this IPO Task Force, who
6 understands how the economics work, what really paid for
7 all that coverage and how it worked.

8 MR. CHACE: And it's interesting you mentioned
9 Sidoti, because Sidoti actually, I think, has built a
10 moderately successful micro cap coverage list without
11 having a primary banking business. So it's all
12 secondary, all trading. And they cover small companies.
13 And they do a pretty good job, in my opinion. And it's
14 sort of depth and some -- or breadth and some depth. But
15 there is a model out there that does work profitably.

16 MR. MAEDER: And where a lot of the analysts
17 went -- they didn't turn into mushrooms -- they went to
18 the buy sides, they went to hedge funds.

19 MR. CHACE: Went over to the dark side. But
20 their hedge funds are obviously doing very high, as you
21 know, high-velocity trades. They take positions and stay
22 in them for 30, 40, 50 milliseconds. And so they're only
23 going to -- they're only going to figure out what's going
24 on with very, very high float, high volume companies, not
25 like Tandy. More like, you know, General Electric.

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1 MR. GRAHAM: Okay. Let's go to general
2 solicitation.

3 MS. CROSS: So I'm going to tee up this issue
4 for the group. This is going to feel like a law school
5 exam, and I'll try to make it not too technical.

6 So the exemption that's used the most often
7 that you heard about from Craig this morning is the
8 private offering exemption, which, under the Securities
9 Act, what it exempts is a transaction by an issuer not
10 involving any public offering. It's been there since
11 1933.

12 The safe harbor for that is Rule 506 under Reg
13 D, which also exempts these transactions. It does it by
14 defining specific kinds of investors who can buy, the
15 accredited investors, plus you can have up to 35 non-
16 accredited investors who are sophisticated.

17 And then the -- you're not allowed to -- you're
18 not required to have specific disclosure unless you have
19 non-accredited investors invest. So if you have all
20 accredited investors, you can choose your disclosure,
21 subject to the anti-fraud rules.

22 And then the securities you buy in a Reg D
23 offering are restricted, which means they can't be sold
24 publicly for at least a year for non-public companies, or
25 six months for -- I'm sorry. At least a year for non-

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1 public companies. For a public company, six months.

2 That's the basics. But then the biggest
3 requirement of all, frankly, is that you can't have any
4 form of general solicitation or advertising in these
5 offerings. So if you are doing a private offering and
6 you're selling your securities to qualified institutional
7 buyers, all accredited investors, you can't have, for
8 example, an open access web page that advertises your
9 offering. You have to go to people that you either --
10 that you have a preexisting relationship with, that you
11 find through non-public means, or that you have a broker
12 who has a preexisting relationship with.

13 So it's a closed -- the idea is that it's --
14 you can only go to people that you find privately, in
15 essence.

16 The -- this issue of -- is that necessary? Is
17 it necessary when you can only sell to accredited
18 investors, as defined in the rule? Why do we need to
19 regulate how you find those people if you can only sell
20 to people who are qualified is the issue that is raised
21 in this conversation.

22 This question has been debated now for 20
23 years. When I worked on the SEC staff in the '90s, this
24 was something we talked about a lot, because there was a
25 lot of concern that this exemption was unduly restricted

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1 by this limitation. And it has over the years become a
2 more and more difficult conversation with the -- I sound
3 like an old person here -- with the advent of the
4 Internet, where you could find people if you were allowed
5 to put your offering up on a web site, but you can't
6 under our rules.

7 It's also difficult in the context of a
8 continuous offering, such as a hedge fund offering, where
9 if you want to put your -- under our interpretations, you
10 can only have someone invest if you -- at the beginning
11 of your offering they were already known to you. And for
12 a hedge fund which has a continuous offering, that is
13 particularly difficult, because they're not having these
14 discrete, separate offerings. So it's difficult to add
15 investors as you go along.

16 The reasons for the restrictions on general
17 solicitation, there's probably two main ones. One is
18 just reading the words in the statute. ``Transaction by
19 an issuer not involving any public offering.'' What does
20 that mean? The interpretations of the SEC, going back
21 many, many, many years, are that it's inconsistent with a
22 non-public offering to have general advertising and
23 general solicitation.

24 The other concern is that if you allow general
25 solicitation, those who we call fraudsters, those who

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1 would want to rip people off could cast their net more
2 widely, and through the wider net would be able to bring
3 people in who -- bring more people in to defraud them.
4 So these are people who probably aren't going to obey the
5 law anyway. But if you -- if you let them go more broad,
6 they can hurt more people.

7 And the other side of it is is it necessary
8 when you do restrict who can purchase to say you can't
9 find them through a general solicitation?

10 So this debate has become more heated lately.
11 There's a bill in Congress on the House side that passed
12 the Financial Services Committee that would remove the
13 restriction on general solicitation in private offerings,
14 and so this issue would go away.

15 The SEC staff has thought about it itself over
16 the years. And even if you don't think you can read the
17 exemption as permitting the restriction -- permitting
18 general solicitation, in 1996, the Commission was given
19 general exemptive authority. And so the Commission could
20 craft its own exemption that allowed public offerings
21 with general solicitation, and limited them to qualified
22 purchasers, as defined in exemption that would be
23 crafted. There isn't currently a rule like that under
24 our -- under our regulations. I know Heath can probably
25 speak to this.

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1 But the -- NASAA has been engaged in the
2 conversation as well and has talked about the model
3 accredited investor exemption as another possible path
4 forward. So this is an issue that is getting debated a
5 lot.

6 Another interesting fact is that there was a
7 challenge on First Amendment grounds saying that the
8 restriction violated free speech. And that went all the
9 way to the Massachusetts Supreme Judicial Court. And
10 just recently, the Court ruled that it is constitutional,
11 at least the Massachusetts Supreme Court thinks that it's
12 constitutional under both federal and state law.

13 But that may well go to the Supreme Court. I
14 don't know if they're planning on appealing further. Oh,
15 they are planning on appealing further. So this issue
16 may get -- may get decided by the Supreme Court. It may
17 end up with a First Amendment challenge deciding that the
18 restriction is too significant for the -- what it's
19 trying to protect, because that's the analysis. I'm not
20 a constitutional lawyer. But basically, you'd have to
21 weigh -- you'd have to see whether this is an undue --
22 unduly narrow or onerous restriction for what we are
23 trying to protect against if only those who are qualified
24 can purchase anyway.

25 So the question for the group is, you know, the

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1 -- should there continue to be restrictions on how you
2 find people in your private offerings, or should you be
3 able to look more broadly? Limited online advertising?
4 Maximum online advertising? Info -- no. Infomercials,
5 no, I'm not suggesting that. You can see it in the
6 middle of the night.

7 One thing I would note that we have struggled
8 with on the staff -- and Gerry can certainly attest to
9 this -- is regularly, entrepreneurs who don't understand
10 this restriction will put something online to offer their
11 securities, and they're only going to sell to the people
12 that are qualified. But they don't realize that the
13 minute you put it up there, you're toast. Because there
14 is no exemption. Once you've put it up online in an
15 unrestricted web site, you're done. You've then
16 generally solicited. Your offering is illegal.

17 So it is difficult for us to explain to
18 entrepreneurs that no, even though you were only going to
19 sell to qualified purchasers, if you put it up on your
20 web site, it's over with.

21 So this is -- it is a technical legal issue,
22 but it's a different -- it's a challenging one, and hard
23 for us to explain to those who don't know why we would
24 care about how you found people if they are otherwise
25 qualified. So discuss.

0203

1 MR. YADLEY: You're absolutely right. I think
2 this is one of those issues that the time has come to
3 figure a way around the legal restrictions. And you can
4 certainly do it. Ralston Purina, one of the seminal
5 cases, you know, the Supreme Court said it's not about
6 the numbers of people that makes it a public offering or
7 a private offering, it's, you know, who's being
8 protected, who's supposed to have the benefit of the
9 information. And that was on the slide.

10 It is also difficult because what's happening,
11 just from a lawyer's viewpoint -- and maybe you had a
12 similar experience, maybe you didn't, at Wilmer -- people
13 come into the office all the time, and they don't
14 understand this. And worse, they don't like it, so they
15 go to another lawyer. And, you know, we can't regulate the
16 legal profession. Good luck there.

17 The fact of the matter is, there's a lot of no
18 harm, no foul out there, and a lot of people flying below
19 the radar. And people are abusing it. And it's created
20 a great disrespect for the securities laws. There's no
21 good way to enforce it. And is it really needed if, in
22 fact, you regulate purchasers, which is what Reg D did.

23 And I think, you know, proposed Rule 507, which
24 was really the only significant piece that wasn't adopted
25 from the 2006, April 2006 Small Business Advisory

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1 Committee Report, was a start with super-accredited
2 investors. But I really think this is something that its
3 time has come, and there should be a way around it.

4 PARTICIPANT: Somebody make a motion.

5 PARTICIPANT: I'll jump in.

6 MR. DENNIS: I agree with you. I mean, I have
7 a hard time reconciling between if a person is
8 accredited, then by definition they're supposed to be
9 knowledgeable and smart enough to be able to make
10 investments and look at information. I'm not sure I
11 understand why the restriction on how I get to that
12 person is that much of a difference. You know, the --
13 and I think it's going to happen anyway. You know, the
14 Internet's going to be out there.

15 MR. YADLEY: It's not just the Internet. And I
16 think we could really have a debate and say, ``You know
17 what? We're back to the same crowd funding discussion.``
18 You're going to get some really slick advertising and
19 people who just aren't being careful, and, you know, we
20 should look out for some people.

21 But a real difficult thing is you explain the
22 securities laws to the issuer. The issuer says, ``No.
23 I'm only going to approach the people with whom I have a
24 preexisting relationship.`` And I remind them, ``Well,
25 the SEC -- it has to be more than just you know them,

0205

1 should be, a preexisting business relationship or some
2 other relationship which evidences the trust that would
3 be needed to have access to the information.'' And
4 that's fine.

5 But they come back two weeks later with three
6 other folks: their roommate, their brother-in-law, the
7 guys they play golf with who tells his spouse, who
8 happens to be in a little investment club. The issuer
9 doesn't know these people. And now what do you do?
10 Because you've got to tell him, ''Okay, I know you've
11 paid me a retainer, you've gone out and hired a real
12 accounting firm like I told you to, and we've done all
13 this work, and now I can't help you.''

14 You can't -- again, it's just one of those
15 things, the friend of a friend. And you can give them
16 the speech, but they're just not listening, and you can't
17 enforce it.

18 MR. MAEDER: Does being friended on Facebook
19 count as a preexisting relationship?

20 MR. LAPORTE: No, but LinkedIn does. We
21 actually got that question from a caller, if being a
22 friend on Facebook is a sufficient preexisting
23 relationship.

24 MR. MAEDER: Well, as an engineer, I'm
25 inherently against any regulation that favors people with

0206

1 active social lives.

2 MR. NALLENGARA: Is there -- if you do permit -
3 - if a rule does permit a broad general advertising,
4 should we also look at how you determine or how you
5 establish that the person who actually invests is an
6 accredited investor? If you look at the -- if you have
7 to have a preexisting relationship with the person, the
8 goal behind that, in part, is to know that they meet the
9 requirements that they are an accredited investor.

10 Now, if you're broadly soliciting investors,
11 should you be -- should we dial up the rigor in which we
12 require companies to determine that the investors are
13 actually accredited investors?

14 MR. SUNDLING: So I have a couple of comments
15 on that. I think one -- I'm sure by now you can probably
16 guess what my opinion's going to be in terms of general
17 solicitation. But I never really -- and I kind of am
18 appreciating a little bit in terms of how that came to
19 be.

20 But I think the only real effect is that you
21 end up raising money through broker-dealer networks,
22 right? And so there's -- I would say they may have had a
23 very effective lobby on making things the way they are.
24 Because the only thing that's happening is you're
25 changing the marketing channel through which you're going

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1 to reach these accredited investors. And at the end of
2 the day, they have to be an accredited investor.

3 So while I would say that, you know, I'd be in
4 favor of general solicitation, I would also offer that
5 when you go to the point of generally soliciting any
6 security, that the disclosure -- maybe you give that one
7 up, but the disclosure requirement also goes up, right,
8 in terms of what you have to provide.

9 I think in general, any company raising any
10 money should provide at least an annual statement of
11 audited financials, and maybe a, you know, a chairman's
12 report or what-have-you about the general business, but,
13 you know, just enough so that these people can get some
14 basic protections on how this company is doing, because
15 that information is not otherwise compelled to be
16 publicly provided. So fair trade, maybe.

17 MR. GRAHAM: But why would they necessarily
18 need it in that context but not in the context where if
19 this is an accredited investor that you already had a
20 relationship with?

21 MR. SUNDLING: You know, I would say that maybe
22 it should be both. The only difference is that an
23 existing relationship, depending on the level of that
24 relationship, they may be investing in you, not the
25 company, right? So you as the CEO, where the

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1 relationship is maybe you talk to them on a regular
2 basis, so they feel like they're very in touch with the
3 business.

4 But when you start soliciting from the general
5 public, you're not going to have, ever, that
6 relationship, even on Facebook, or anywhere else. So
7 they've got to get some regular communication, I think,
8 from the company would be very helpful and address a lot
9 of these concerns.

10 MR. GRAHAM: I understand the point. But
11 essentially, it seems to me like that if you went down
12 that route, you would have the regulators, in effect,
13 saying, ``Trust this individual because you know them.
14 So it's okay if you go ahead -- it might be okay if you
15 go ahead and invest in them. Because again, you know
16 them. But this one that you don't know, we're going to
17 set up a series of regulations where, all things being
18 equal, it's just going to be more difficult to'' --

19 MR. SUNDLING: Yeah. And that is the paradox.
20 But I would say, you know, what I could see as being a
21 realistic model is that as soon as you general solicit a
22 stock and sell it to people that you don't necessarily
23 know, there should be -- and I'm not a big regulations
24 guy -- but there should be some basic required disclosure
25 on a regular basis that can -- you know, maybe it's a

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1 tier here. It's nowhere up in the Sarbanes world. It's
2 nowhere up in the -- you know, any of the things you have
3 to do as a truly publicly traded company. But it's some
4 level of information. And that can never go down so long
5 as those people are shareholders, right?

6 So now I'm putting my investor hat on. You
7 know, I'd like to -- and I'd be more comfortable with
8 investing in one of these opportunities where, you know,
9 you don't know a lot -- you like the model, you know. It
10 looks like an interesting deal. You get involved. But
11 you do need some kind of regular communication, and it
12 would be nice if the company were compelled to provide
13 that, but not --

14 MR. GRAHAM: But isn't that what you do as an
15 investor negotiating the investment?

16 MR. SUNDLING: Yeah. But in a general
17 solicitation, I don't think, you know, A, on the sell
18 side, the company can't be negotiating like in a PPM with
19 people coming in \$10,000 at a time. You're not going to
20 be negotiating disclosure terms with each one of them,
21 right?

22 So having more of a blanket and, you know,
23 template in terms of how things will be disclosed, with a
24 minimum and a fairly low threshold as here's our minimum,
25 right? We're selling stock open -- you know, we're

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1 marketing it to the general public. So at a minimum,
2 we'll provide the following documentation on a regular
3 basis, and right in a free, true market sense. Normally,
4 that would just be a feature of your stock --

5 MR. GRAHAM: Right.

6 MR. SUNDLING: -- which is what you probably
7 would expect I would normally say. Although if the trade
8 --

9 MR. GRAHAM: That's what you would kind of
10 expect in order to attract the investment in the first
11 place.

12 MR. SUNDLING: Yeah, yeah, right. But, you
13 know, I think in reading some of this case study in here,
14 a very good point is the going dark. So you might even
15 provide that information at first, and then take it away
16 later if you're not legally compelled to provide it,
17 which I think as an investor, nobody would like, right?

18 MR. GRAHAM: Right. It would have to be part
19 of the purchase agreement.

20 MR. DENNIS: Yeah. It seems to me like -- I
21 want to go back -- I mean, what you said, I think,
22 earlier was that, you know, let's not go down. And so if
23 you cut a deal with -- if you do a general solicitation,
24 and your deal that you cut to get that is that you're
25 going to provide audited financial statements on an

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1 annual basis, and you're going to provide quarterly sales
2 numbers, and you're going to provide a board report of
3 some kind, you know, then that's your deal. And you
4 shouldn't be able to go down from that without the
5 shareholders agreeing that you're going to go down from
6 that.

7 If your deal is that, you know, we're going to
8 make a \$10,000 investment, and we're going to give you
9 nothing, well, I suppose that's your deal too. And, you
10 know, if somebody wants to invest in that kind of company
11 -- you know, at some point we've got to let the
12 shareholders or the investor take responsibility for
13 their own actions. And, you know, I guess I would be
14 okay with that kind of model, as long as that was
15 disclosed up front.

16 What I wouldn't be okay with is I agree to
17 provide all this information, and then take it away after
18 I get your money. And that's --

19 MR. YADLEY: There's a whole spectrum here
20 which are now -- and I think those are all good points.
21 I think where the Commission staff sort of left it with
22 the rule proposal was we really were talking about a
23 small offering in terms of the number of people, really a
24 506 offering, which today can be in an unlimited amount
25 of dollars to an unlimited number of accredited

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1 investors. So we sort of have that world, and there are
2 none of these restrictions such as we just talked about.

3 So that may be a good idea, but that's not the
4 world we live in today. And under most states' laws, you
5 only have to provide an annual financial statement. In
6 Nevada, you don't even have to do that, necessarily.

7 So that would be some other changes that we
8 probably ought to talk about. But at least what I'm
9 thinking about is a really garden variety private
10 placement. And we could put limits on it. You could put
11 a dollar limit. You could put a numbers limit on it.
12 But the whole point here is that there are sophisticated
13 investors out there who can fend for themselves, who meet
14 whatever accreditation test we want. And the only
15 problem is that this company doesn't know them.

16 Now, if they're in Boston, maybe they know you
17 and they don't need it, or in other places like that.
18 But this does certainly open it up to a broader range of
19 people. But again, at least as a first step, I think we
20 could talk about making this available, as we started to
21 with 507, in a more garden variety 506 offering.

22 At some point, we're now down to crowd funding,
23 I mean, if there are no restrictions. And at that point,
24 we're subject to sort of the same issues of backing into
25 the SEC regulating something that it can't possibly

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1 enforce, and therefore, you know, every good deed -- no
2 good deed goes unpunished, and that's where you may be.

3 MR. LEZA: Every accredited investor that I've
4 ever dealt with always wants financial statements, always
5 wants this. Okay. So how you get them I don't think is
6 really, you know, a problem here, whether you know them
7 or you don't know them.

8 The only people I know that will put in
9 \$100,000, you know, and not ask any questions either
10 turns out to be a family, somebody that you know very
11 well, or somebody like this, because they're just doing
12 it on you. Everybody else that we've dealt in the VC
13 business that is an accredited investor requires certain
14 things. And when you go out there, you always have, you
15 know, ''We don't want anybody else that's not going to
16 put in 100,000 or more,'' or this and this and this.

17 So if you need some extra people and you want
18 to solicit it, and he ends up being an accredited investor, I
19 don't see where the problem is.

20 MS. CROSS: I'm going to call on Paul. Do you
21 have a perspective from the VC world?

22 MR. MAEDER: Well, first of all, I think what's
23 been said is a lot of common sense. Once you cut a deal,
24 the deal ought to stay, as Charlie said. The way to get
25 out of the deal and stop providing that information is to

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1 give the person their money back, with a coupon, right?

2 So the going dark thing is a little shocking to
3 me. I wasn't aware of it. That seems odd.

4 The formerly known, I understand, is an attempt
5 to create a reputation-based hurdle. It seems
6 inappropriate these days for the reasons that you just
7 mentioned. If anybody's going to invest in you without
8 some degree of disclosure, is a family member, and for
9 better or worse, they already know your reputation.

10 So I would simplify dramatically. The -- all
11 of these conversations have one over-arching
12 characteristic, which is you're trying to prevent
13 people's greed and gullibility from overcoming their
14 rational curiosity, or their rational tendency to
15 interrogate reasonably when they make an investment, what
16 we call in our business due diligence, but what everyone
17 should do.

18 And the sophisticated or the accredited
19 investor test attempts to do two things. Number one,
20 make sure that people have enough money to lose; but
21 number two, presumably, if they're an accredited
22 investor, if their net worth is above a certain
23 threshold, they understand the unwritten rule of all
24 business, which is that everything's negotiable, and no
25 question is inappropriate, and so they'll start asking

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1 questions. You just don't want greedy, gullible people
2 getting hurt.

3 And so to the extent that you chum the water a
4 little bit by providing some information and making it
5 clear to people that they're in a position to ask for
6 more information if their money's being solicited, you
7 obviate a lot of these perils.

8 Our business is driven by due diligence. There
9 are two reasons that people invest in venture capital.
10 Number one, because they're presuming that we do very
11 sophisticated due diligence, that we understand the
12 businesses before we invest in them, and we understand
13 the industries, because we invest in no other industries.
14 We specialize by vertical. And secondly, that we add a
15 lot of value post-investment.

16 Angels and these sorts of small investors
17 should be presumed to do the first. They probably won't
18 do the second, but they should be presumed to do the
19 first. And anything we can do to encourage them to do
20 the first, including a very simple statement that says,
21 ``You should, before you invest, ask questions. You may
22 not get them answered, but the fact that they were not
23 answered may discourage you from making the investment,``
24 that would solve, I think, a lot of these problems.

25 I absolutely would get rid of this previously-

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1 known condition, because it obviously is rife with
2 opportunity for confusion and people ignoring, and as you
3 said, fundamentally, loss of respect for the rules.
4 Ambiguous rules do not encourage compliance.

5 MR. SUNDLING: I think one of the other maybe
6 key elements that's lost also in this discussion is,
7 under the current structure, there's probably, you know,
8 a hundred, a thousand great opportunities that willing
9 investors miss out on, right? So not everybody raising
10 money is trying to scam somebody, right? There's a lot
11 of good businesses that have a PPM out there that goes to
12 a very tiny number of the actual investors that could be
13 putting money to work in these companies, maybe even
14 oversubscribing what they're looking for. But they'll
15 never hear about it, right?

16 So, you know, not everybody's -- Paul probably
17 gets 300 PPMs a week, or whatever the number is, because
18 he's known in the industry. There are probably millions
19 of investors out in the United States today that would be
20 getting involved in these deals, but they will never see
21 them.

22 MR. MAEDER: What's extraordinary is it's --
23 pick when you say the start of modern venture capital
24 was. Was it '82 or '84? Eighty-two with the IBM PC.
25 Around 30 years? To my knowledge, there's never been a

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1 fraud in the history of venture capital. There just
2 hasn't. Now, partly because the industry's peopled with
3 engineers who are, you know -- they're, you know,
4 sometimes not sophisticated enough to be fraudulent. I
5 don't know. And I think there have been very few frauds
6 in angel funding of tech companies. It's just a
7 remarkable record.

8 And so when we have all these conversations
9 about crowd funding and so forth, my biggest concern is
10 not so much for the protection of people that should
11 really protect themselves, but that we don't open
12 Pandora's Box, and all of a sudden negatively affect not
13 just the brand at the SEC, but the brand of small
14 companies getting funded. Because it is an enormously
15 important thing in this country.

16 MR. ABSHURE: Let me respond to one comment you
17 made there. For the states, the biggest enforcement
18 issue that we have across the board is 506 offerings.
19 Almost uniformly every state, that's the biggest problem
20 we have.

21 And looking at this specific issue, I tell
22 people all the time there's really two fundamental tenets
23 of securities laws. If you're selling securities, give
24 them the material information they need to make the
25 decision, and don't lie to them. Now, that sounds

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1 simple, but really, that's it.

2 And typically, that information is provided
3 through a registration. And we all understand that
4 sometimes, registration is not needed. It's the
5 exemptive process. And, you know, Ralston Purina said
6 it's this class of people that already have access to the
7 type of information that a registration will provide.
8 Well, you don't have to register the offering to them.

9 And I think the states feel like Reg D,
10 through, well, one, the accredited investor concept, but
11 also through the advertising, we're getting away from
12 that, and we're getting too far abroad.

13 Now, I'm not saying that we can't craft a
14 proper exemption that balances the issuer's need to have
15 some sort of advertising with also some protection for
16 investors to make sure they are informed. But I'm
17 worried that 4(2) and the safe harbor under 4(2) is legally
18 the place we ought to be doing it.

19 MR. DENNIS: I think you bring up an
20 interesting point I thought of as you were talking there.
21 You know, what are the other -- you know, we seem to have
22 a generally unanimous -- or at least people have spoken
23 about getting rid of this -- some portion of this
24 restriction. What are the unintended consequences if we
25 do that? I mean, what happens to the venture capital

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1 industry? What happens to, you said, the funding of
2 small businesses? What are some other -- maybe we can
3 just brainstorm for a second of what would be some
4 potential unintended consequences if we just took this
5 rule off. And have we thought through those?

6 MR. YADLEY: Well, there would be an
7 enforcement issue. I mean, that's clear. And that's
8 after the fact. Even if you strengthen the SEC and the
9 states' enforcement efforts, you know, the horse is gone.
10 So that's why I think, you know, some step-by-step in how
11 this works and in the discussion, we shouldn't mix sort
12 of the de minimus crowd funding sort of issues with
13 really sophisticated investors who are going to be able
14 to bargain.

15 And, you know, the Commission's general
16 exemptive authority is probably the place to start so
17 that we can have the whole cloth and have a discussion
18 and bring in what are the unintended consequences.

19 MR. ABSHURE: I think one will be a
20 deterioration in the market. I think you're going to see
21 a flood right now. Even though the prohibition on
22 general solicitation and advertising does present a
23 burden, and also ensures that the people that are active
24 in the 506 market, the 506 issuers and the other
25 professionals that are kind of in that market, are --

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1 know what they're doing and the right one's there.

2 And I think that if you do see the rules change
3 where you can have advertising and general solicitation
4 in the market, you're going to see a flood, and it's
5 going to be harder to detect the good ones from the bad
6 ones. And it might have a -- we might end up shooting
7 ourselves in the foot.

8 MR. BORER: I don't think I remember anything
9 in the definition of accredited investor that talked
10 about either prudence or wisdom. That's sort of an
11 arbitrary thing. And I've certainly, in my own career,
12 made some bad investments and gotten lucky on a few as
13 well.

14 I tend to look at this issue from the
15 perspective of the broker-dealer. I know this could also
16 apply just for direct issuance by an issuer. But just
17 because somebody's accredited and perhaps eligible to buy
18 these things don't make them suitable to buy something.

19 And oftentimes when we go to market, we'll deal
20 only with QIBs, in some cases we'll deal with sub-QIBs,
21 but institutional investors, as opposed to just
22 accredited individuals. And then we'll get down to the
23 point where we're dealing with, you know, accredited
24 investors in certain cases. And it's a subjective
25 decision based upon our assessment as a broker as, you

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1 know, to what they're qualified for and what the best
2 approach is with respect to the investee level of
3 sophistication and depth for any given, you know, deal.

4 With respect to the issue of the general
5 solicitation -- and put aside First Amendment and
6 commercial-free speech, which I could have a good
7 argument about also, but that's for the courts to decide
8 -- I don't see any benefit to the market in general from
9 limiting the general solicitation if the rules are
10 followed with respect to the actual placement and the
11 qualification of the investors.

12 I do see that by limiting the prospective
13 audience for any given deal through not being able to let
14 the word get out that there is an opportunity, it does
15 reduce the group of eligible qualified, appropriate, and
16 willing investors in any given transaction. And the one
17 thing that I think is always good is to have a deeper
18 market of appropriately qualified and capable investors
19 by just arbitrarily limiting it.

20 And I see a Crestor ad on television at night.
21 I'm not going to go to the doctor and say, ''Hey, I saw
22 that. It looks really good. I don't need it, but will
23 you write me a prescription?'' He'd be violating
24 whatever the ethical or legal rules are. And it's the
25 same thing with many, many types of these things.

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1 Now, I'm not saying we should have, you know,
2 infomercials. ``Come get this investment. And buy now,
3 you get two. You've got 60 seconds,'' et cetera. But
4 there are appropriate means along the spectrum that might
5 be very, very helpful in deepening the market of, you
6 know, wealthy entrepreneurs, retired people, and all
7 these things.

8 And I think we, at least in my mind, we're
9 getting a little bit ahead of it if we say that, well, if
10 people aren't going to do their due diligence and be, you
11 know, appropriately circumspect in what they're doing,
12 you know, you shouldn't be able to advertise. Those two
13 things, to me, I think, are very linked. Because the
14 issuers and their advisors still have to follow the
15 federal securities laws, you know, on disclosure and
16 fraud, et cetera.

17 MR. MAEDER: The only adverse effect I could
18 see is undermining the monopoly or oligopoly that Silicon
19 Valley, New York, and Boston currently have on these
20 kinds of offerings. In other words, I think it would be
21 good. It would solve some of the regional problems you
22 were talking about.

23 Because the reason this market is so vibrant in
24 Boston and Silicon Valley, and now in New York, is
25 because there are lots of people who have already done

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1 it, and they have friends, and they tell each other about
2 it. All of a sudden, culturally, the word gets out that
3 you too can start a company. You too can raise some
4 capital and get going, and here's how you do it.

5 And there is a whole -- I hate to use the word,
6 but there's a whole milieu, a whole ecosystem of people
7 that teach each other how to do this. And to the extent
8 that that could spread to the rest of the country, that
9 would only be good.

10 MR. YADLEY: Somewhat related to this, and a
11 topic that has been discussed at SEC forums and in the
12 Small Business Advisory Committee are private placement
13 brokers. One of the things that has hurt small companies
14 that are trying to raise \$500,000 or less is there
15 haven't been brokers that would really be willing to help
16 them raise that small amount of money, because there's a
17 lot of professional time that the broker has to spend,
18 and it still has to do due diligence and make the
19 suitability judgments and everything else.

20 So there have been some of these same people
21 that probably invest in angel groups and so on who would
22 be happy to. They sort of Dutch uncle these little
23 companies and would invest some of their own money, and
24 they have two or three friends who would also be
25 interested in investing. And often these guys don't want

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1 to get paid unless the deal works out, but if they take
2 incentive-based compensation, they're acting as a broker.

3 So the ABA had a task force that studied the
4 issue of intermediaries who might be licensed for the
5 very limited purpose of helping small companies raise
6 small amounts of capital. That, especially if general
7 solicitation remains, is an issue that I think it's worth
8 our group focusing on a little as another alternative way
9 to help small companies raise capital.

10 MS. CROSS: So I think when we have our -- if
11 the group is interested, we can have our TM colleagues
12 talk about the business brokers issue, or the finders
13 issue, when we also have them talk about the research
14 issues. I think that it has been -- we know that's a
15 recurring theme forum after forum after forum. And we
16 have not -- it's not been easy to find the right path to
17 address that concern, because there are also unscrupulous
18 brokers who would love to go down that path. And so the
19 staff has had significant concerns.

20 I know that's been a frustration to the small
21 business community and something that we recognize. It
22 would be lovely if we could find the right solution.
23 It's easy for me to say, because it's not my division.

24 But I think it will be helpful to hear from our
25 colleagues in Trading and Markets on that point as well.

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1 I think it's a fair point. And we assume it's going to
2 continue to be a forum recommendation until we can come
3 up with something.

4 MR. GRAHAM: Any more comments on general
5 solicitation?

6 (No response.)

7 MR. GRAHAM: Okay. Well, thank you. We've got
8 about 35 minutes remaining, and I guess what I'd like to
9 do is two things. And one, we've talked about a number
10 of issues, obviously. And, you know, first of all, there
11 may be some things that are at the top of your mind that
12 we haven't discussed. And I think part of the exercise
13 that we're undertaking today is kind of defining the
14 agenda for us going forward.

15 And so I guess the first thing I'd like to do
16 is just, you know, take a couple of minutes and -- to see
17 if there's any other issues that any of you would like to
18 mention that you think are of particular significance in
19 terms of addressing the primary issues that we are set up
20 to address.

21 MR. WALSH: I have a question for the staff. I
22 think Charlie sort of hinted a few times there seems to
23 be so many big issues here. And I think if we -- to
24 paraphrase Paul's idea, if we had half a bottle of Scotch
25 between us, we could write the whole thing by the end of

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1 -- by 11:00 tonight.

2 But I guess the question for the staff is, you
3 know, we have a lot of smart people on this committee,
4 and we come with the recommendations. I mean, how do we
5 know when these are going to be implemented? What is the
6 -- it seems like it's all the legislative issues where,
7 you know, they're more concerned about the box-checkers
8 in Sarbanes-Oxley to make sure that a WorldCom and Enron
9 doesn't happen again. Because of that, they get so down
10 into the granular, you know, thousands of businesses
11 don't get created over the next 10 years.

12 I mean, is there anywhere that there's a staff
13 of the legislature of Congress that actually will be
14 involved in this?

15 MS. CROSS: Well, obviously --

16 MR. WALSH: My concern is we have all these --
17 you know, we meet three or four times here in the next
18 year or so, and we have all these grand ideas, and they
19 just die on the vine, to put it frankly.

20 MS. CROSS: That's not what we want to happen
21 at all. I think --

22 MR. WALSH: Well, I'm not worried about you.
23 I'm worried about the big Capitol building down the road
24 here.

25 MS. CROSS: Well, there's -- the questions --

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1 each of these questions that we talked about today we
2 were thinking about without regard to legislation. And
3 so these are big issues, obviously, as you said. They
4 are not something where you flip a switch. They would be
5 things that we would have to study carefully.

6 Our Commission is five people who vote. The
7 chairman decides the agenda, and then we would come
8 forward. She has asked us to develop recommendations
9 about 12(g), so -- what gets you reporting, so the staff
10 is in the middle of that study already.

11 The next step on general solicitation was we're
12 preparing what's known as a concept release where we put
13 it out for comment from the public. Should we do this?
14 Should we lift the restriction? And then ideas around
15 scalability were just recently raised.

16 So those would be future rulemakings. But what
17 I would say is that we can do these things without regard
18 to what Congress does. So there -- and there is a lot of
19 uncertainty around legislation. We told you about the
20 bill so that you wouldn't be surprised to go out and hear
21 about them later, that the things you talked about today,
22 there also happens to be legislation about. But we've
23 been thinking in terms of preparing staff recommendations
24 for Commission action and wanting your input in
25 connection with preparing those recommendations.

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1 They will take time. I mean, they're each big.
2 I mean, they're big topics, but they're topics that I
3 think -- we think need pretty quick attention.

4 MR. GRAHAM: So really, Tim, I think that
5 that's -- you know, maybe the most important thing here
6 is making sure that this committee shows appropriate
7 follow-through. And to the extent that we do come up
8 with regulations, and of course we will, and it seems
9 like nothing is happening with the SEC with respect to
10 those regulations, or those recommendations, then we talk
11 to our colleagues to my left.

12 MR. DENNIS: Yeah. And I would just add, I
13 mean, I can just give you my experience on our prior
14 committee that I relayed before. It does take a while.
15 So, you know, as businesspeople, a lot of times we have
16 an idea, we all agree on the idea, and we say let's go do
17 it tomorrow, and that doesn't work as smoothly in the
18 government side of things.

19 But I would say that the majority of our
20 recommendations of the previous committee, I think,
21 eventually were implemented in some way or form, which is
22 very satisfying. It's just not a short-term
23 gratification. So that's been our prior -- my prior
24 experience, and I think it was very positive.

25 I wanted to add, you know, Stephen, one of the

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1 things we talked about -- we've talked about a lot of
2 different companies here. And we kind of had the same
3 experience in our previous committee. You know, you get
4 so broad. So maybe we need to spend some time the next
5 time we get together, what's our target here?

6 So we've talked about companies that are going
7 to use crowd funding to do a startup institution, to, you
8 know, billion-dollar companies. You know, where's the --
9 you know, do we need to break down into two or three
10 different groups of small and emerging companies?

11 Because what we define for help on emerging companies may
12 be different than what we want to do for \$100 million
13 companies, or \$50 million companies.

14 MR. GRAHAM: Yeah. And I don't necessarily
15 disagree with that. I mean, you know, clearly, the thing
16 is we're talking about the issues that we've been going
17 over today are going to impact different companies
18 differently, depending on how they stand.

19 Obviously, when you're dealing with something
20 like crowd funding, you're dealing with things that are
21 at a much smaller scale than if you're talking about
22 making sure that you've properly calibrated the
23 regulations that apply to a small public company.

24 And this -- we need to think about this and kind of
25 come to some conclusion as to where we're going.

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1 But I think that's one of the -- one of the
2 good things about our charter is that we're not, again,
3 heading towards some comprehensive final document. We're
4 looking at a number of issues that are important. And as
5 we're able to kind of tackle those issues and come up
6 with recommendations, then we provide those
7 recommendations as we go.

8 So if -- I'm not saying this is the case,
9 necessarily, but let's just say that we can develop some
10 issues relating to crowd funding relatively quickly.
11 Again, that's dealing with the -- you know, with the
12 subset, you know, basically, the -- probably the small
13 entrepreneur kind of looking for seed capital. If we can
14 come up with recommendations for that, you know, after we
15 break with a half a bottle of Scotch and before midnight,
16 then let's come up with that recommendation and present
17 it tomorrow.

18 So I think that what we need to do is to kind
19 of digest what we have gone over today and begin to draw
20 things into a bit sharper focus, and, you know, begin to
21 prioritize, and then, you know, have a conversation. And
22 I'd like to begin that conversation, if we have time
23 today, begin the conversation as to what the solutions
24 might be.

25 You know, as we have talked today, we've talked

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1 about, you know, off and on, you know, potential
2 solutions. But I think that -- I think that we've got to
3 get to the point where we start kind of tossing out the
4 big ideas to address some of these issues that we talked
5 about, and then kind of -- you know, ultimately distill
6 those down to recommendations that might be meaningful.

7 MR. MAEDER: I would say a vehement yes to what
8 you just said.

9 Medici invented double-entry bookkeeping. It
10 is a truly amazing thing that the same income statement
11 and balance sheet format works equally well for a pizza
12 parlor, or one of my little tech startups, as it does for
13 General Electric.

14 The problem with that is it creates a
15 perception among some that there are other things those
16 businesses have in common. My companies have nothing in
17 common with General Electric with respect to how they
18 do product development, R&D, marketing, sales, general
19 management, how they finance themselves, nothing to do
20 with each other. But because accounting carries over all
21 of them, people presume other regulatory regimes should.

22 So I would say you're absolutely right. Any
23 recommendation -- any recommendations that we come up
24 with --and this is the great failing of the last 10 years
25 of regulation in this area -- should be tailored to the

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1 scale of the company. There should be some degree of
2 proportionality with everything we recommend. Because as
3 we've seen -- now the results are in from the experiment
4 -- you can have devastating effects on small companies
5 when you apply big company rules to them.

6 MR. SQUILLER: What are the ideas here on time
7 frames for getting these things into crisper focus, and
8 recommendations?

9 MR. GRAHAM: Good question, Dan. That's one of
10 the things that we've been tossing around. You know, for
11 example, you know, when are we going to have an
12 opportunity to get together again as a committee? I
13 would like to be able to do something in fairly short
14 order. We have the holidays coming, and then we have the
15 year end, you know, stuff that so many of you are faced
16 with. And, you know, that might push us into sometime in
17 January, maybe early February, before we can have another
18 meeting.

19 I'd like to be able to give that some thought.
20 You know, certainly what -- just kind of thinking out
21 loud. You asked the question of -- what I'm thinking is
22 that it probably would be good if, you know, following
23 this meeting if Chris and I got together with the staff,
24 kind of debriefed a little bit as to, you know, what has
25 transpired today, and come up with a document and then

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1 circulate it to the committee so that we can begin to get
2 people's kind of buy-in in terms of kind of what we're
3 considering, what it is -- if not moving in the same
4 direction, at least begin to build some consensus as to
5 what we think the issues are, so that we can then get
6 together -- maybe we end up getting together by
7 conference call. It's something that -- we talked about
8 that briefly over lunch.

9 But it's not the greatest thing as we're trying
10 to get to know each other and kind of build a
11 relationship of the -- yeah, the relationships among the
12 committee. But maybe that's what we're going to have to
13 do, and, you know, begin to, you know, talk through some
14 of these things and then come up with the
15 recommendations.

16 I would like to be in a position to begin to
17 formulate and present real recommendations, you know, by
18 the first part of the year. I think we need to
19 understand from you folks as to kind of what your time
20 frame is as well.

21 But certainly as issues come up before actual
22 recommendations come out of this committee, that you
23 would like to kind of run by the committee, that's
24 another reason why we might -- or another potential
25 impetus behind, you know, scheduling a meeting that might

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1 be by conference call, as opposed to getting together.

2 MS. JACOBS: And Stephen, I've got one
3 addition. Because we have heard today that there's
4 pending legislation, there's an opportunity to sort of
5 call us off that subject if indeed the legislation's
6 going to go through so we can certainly get on and be of
7 great utility to you all because legislation is passed
8 and our opinions and our advice is moot at that point.
9 So --

10 MR. SQUILLER: I would think I'd actually go
11 the other way. If there's an opportunity to influence
12 that legislation, then we should prioritize those topics
13 that could possibly do that. I think we'd need guidance
14 from the staff.

15 MS. CROSS: If I could explain where we are on
16 legislation -- so the Commission isn't taking a position, or
17 hasn't on the various bills that are pending. You know,
18 they've come in through the House side, and they are
19 going to be, at least the Reg A bill, the crowd funding
20 bill, and the two 12(g) bills and the general
21 solicitation bill, are up for a vote in the House this
22 week. I don't know what the status is in the Senate.

23 From our standpoint, we're just doing our work.
24 We're working on things without regard to whether there
25 will be legislation, because there's an awful lot of

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1 uncertainty around legislation.

2 I think we'll need to get back to Steve and
3 Chris to talk about the priorities, but I will say that,
4 for example, we are deep in the weeds on our study of
5 12(g). You can take -- I think you could take more time
6 in giving us your thoughts on that, because we're not to
7 the action item point. We're to the point now of seeking
8 information.

9 If you have information to give us about the
10 kinds of companies that are not public yet or how
11 companies are impacted by the 12(g) limits, that would be
12 useful to know. That's an information-gathering phase.
13 We're not to a recommendations phase for quite some time.
14 So that one, I think, is one where you could go later to
15 us, and it wouldn't delay us.

16 The questions around various kinds of
17 exemptions to facilitate smaller companies raising money
18 may become more acute sooner if we were to try to take
19 some steps to provide -- if you all had recommendations
20 in that area. Because then that's something that we
21 would have your input in going to the Commission and
22 talking about whether these are things that we should
23 work on.

24 MR. CHANG: Meredith, you asked for that many
25 times, so I actually have two ideas I meant to speak up.

1 In the early days, a company can go to an
2 established company to say, ``I'm raising venture money.
3 And if I meet certain goals, you acquire me for certain
4 amount of money.'' And then the startup company will go
5 to venture capitalists to raise money.

6 And that was a rule by FASB that that's an
7 issue of control. That means that makes the established
8 company have control over the startup company, and
9 therefore has to consolidate the earnings. And that has
10 been a deterrent for all these pre-arranged acquisitions,
11 which was a way of raising venture funds.

12 And then the other point I want to make is
13 that, relating to perhaps IRS, is that, for example,
14 Uniphase of JDSU got funding from a couple of us by an
15 R&D partnership, where they can allocate all the losses
16 to the investors, which again, it's a tremendous
17 incentive for investors to invest.

18 And so those are two things I would like you to
19 consider at some point in time, even though it doesn't
20 seem like directly related to the SEC. Thank you.

21 MS. CROSS: So anyway, I think that we will --
22 we'll talk with you all about what might be the earlier
23 priorities, compared to later priorities, if that would
24 be helpful. Seems like that might be.

25 MR. GRAHAM: It would be.

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1 MS. CROSS: Okay. And I think we -- so we
2 should talk about that.

3 MR. GRAHAM: Okay.

4 MR. CHACE: One other item I might add, which I
5 think fits into the pulling a straw off the camel's back,
6 not necessarily a fix-it-all. But is -- and this is
7 back on the IPO. Is this just the process of communication
8 around IPOs, which, from my perspective, the IPO process
9 is a screwy one. It's not designed to make rational,
10 thoughtful decisions. It's kind of a horserace with a
11 quick decision at the end with a lot of uncertainty in
12 terms of the outcome for you as the investor in terms of
13 how much stock you'll get and how much effort to put into
14 it.

15 I don't pretend to know the regulatory aspects
16 of communication. I just know from the end user
17 experience there are a lot of quirks to it that seem like
18 they could be smoothed out, with, I think, the goal for there to be
19 more communication, rather than less, over the course of
20 the IPO, which I think might sort of bridge this gap of
21 seller-buyer mismatch that I think we're seeing.

22 MS. CROSS: And I appreciate that. We didn't
23 talk about that today, but that's on our -- we have a
24 work stream already that we're working on that -- some of
25 the issues are touched on in the IPO Task Force Report,

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1 which is looking at the offering reforms that we did in
2 2005 and 2006 that freed up communications for larger
3 companies, and seeing if we can provide more of those to
4 -- in connection with other offerings. And also look --
5 I also think looking at the various exemptions for
6 communications that we put in Reg M&A, which also
7 allows companies to communicate with their shareholders
8 when they've announced an M&A transaction before they
9 have filed.

10 Those are each things that we think could be
11 useful for the IPO market, to think about, you know,
12 facilitating communications with employees, facilitating
13 better back-and-forth with potential investors. The
14 quiet period rules get a lot of criticism, and we think
15 that they're worth re-looking at, as long as -- the
16 concern that you have with offerings is you want people
17 focusing on the disclosure in the prospectus, because
18 that's where the balanced disclosure is, that's where the
19 disclosure that's been vetted is.

20 So you don't want a bunch of marketing
21 materials taking away from that. But you also don't want
22 to completely cut off all other communications. So that's
23 the balance, but that will be part of what we'll be
24 looking for your guidance on as well.

25 MR. GRAHAM: Any other issues?

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1 MS. SCHAPIRO: I would like to just make a
2 comment if I could. I wanted you all to know I had
3 blocked the whole day to be with you today. And I got
4 pulled out this morning, and I actually wanted to explain
5 why.

6 You may have read about MF Global, which is a
7 very, very large futures broker and securities firm.
8 This morning, my first foray out of here, was that the
9 parent company had filed for bankruptcy. We worked on
10 this all weekend, the regulatory community, to try to
11 work with this firm to avoid any market disruption. And
12 shortly after that, its UK affiliate went into something
13 called administration in the UK, which is their new
14 regime post-financial crisis for managing a firm that is
15 in what they call in an event of default.

16 And just in the last few minutes, SIPC sued the
17 U.S. Broker-Dealer and Futures Commission Merchant in a
18 SIPC proceeding. So that's what I've been doing all day,
19 and I apologize for not being here with you. I will
20 catch up with the staff and I will listen to the
21 audiotape so I'll have a good sense of what you were able
22 to cover.

23 But I didn't want you to think that I wasn't
24 here because I don't value that you all have given up
25 your time and talent for us today. And it just was one

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1 of those things when you just don't know and just can't
2 control your schedule.

3 But so I wanted you to know it all revolves
4 around the efforts we had to make with respect to the
5 bankruptcy of this very big firm.

6 PARTICIPANT: How big --

7 MS. SCHAPIRO: No. No, but it's a large firm.
8 I don't know if it'll be in the tenth, eleventh, twelfth
9 largest bankruptcy range. So it had -- it had been
10 experiencing issues all during the course of last week.
11 It had been downgraded. Very large sovereign debt
12 positions, which is what sort of started us on this path.
13 So don't hold me to the 10, 11, 12 number, but it's
14 large.

15 PARTICIPANT: She was doing her day job.

16 MR. GRAHAM: Yes, exactly. While we've managed
17 to somehow avoid our day jobs, you were here at the
18 office. That's kind of difficult to do.

19 Any other comments?

20 (No response.)

21 MR. GRAHAM: Well, thank you again for coming.
22 I think this has been a productive day. I think this is
23 kind of a good first start. I think it's up to all of
24 us, you know, perhaps in some ways, primarily, to Chris
25 and I, to make sure that we build from the momentum that

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1 I think that we have started today.

2 But I am encouraged by the discussion. I
3 enjoyed meeting all of you. And I'm confident that by
4 the time we're finished with our work that we can
5 actually, you know, do some good.

6 So I will -- unless anyone is opposed to it,
7 I'll entertain a motion to adjourn.

8 PARTICIPANT: So moved.

9 PARTICIPANT: Seconded.

10 MR. GRAHAM: Anyone in favor?

11 (Chorus of ayes.)

12 MR. GRAHAM: Anyone opposed?

13 (No response.)

14 MR. GRAHAM: Okay, thank you.

15 (Whereupon, at 4:50 p.m., the Advisory
16 Committee meeting was concluded.)

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