U.S. SECURITIES AND EXCHANGE COMMISSION

MEETING OF THE SEC ADVISORY COMMITTEE ON SMALL AND EMERGING COMPANIES

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U.S. Securities and Exchange Commission

100 F Street, N.E., Washington, D.C

PARTICIPANTS:

Mary Jo White, Chair
Commissioner Luis Aguilar
Commissioner Daniel Gallagher
Commissioner Kara Stein

Luis Aguilar
Charles Baltic
John Borer
Dan Chace
David Certner
Julie Davis
Daniel Gallagher
Stephen Graham
Shannon Greene
Sebastian Gomez
Rachita Gullapalli
Sara Hanks
John Hemphill
Keith Higgins
Marianne Hudson
Christine Jacobs
Richard Leza
Sonia Luna

PARTICIPANTS (cont.):

Catherine Mott
D.J. Paul
Timothy Reese
Javier Saade
Michael Seaman
Kara Stein
Timothy Walsh
Mary Jo White
Gregory Yadley

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MR. GRAHAM: So why don't we get started. I think it's about 9:30. I assume we have a quorum.

MR. GOMEZ: We do.

MR. GRAHAM: Well, I'm Stephen Graham. I'm a partner at the law firm of Fenwick and West. I am one of your co-chairs, and to my left is my able co-chair.

MS. JACOBS: Thank you. Oh, Christine Jacobs. I was the longest-seated female CEO of a public company for 20 years. My company was just purchased. I also serve as a member of the Compensation and Governance Committee of McKesson, another New York Stock Exchange Company. Thank you.

MR. GRAHAM: Thank you, Chris.

Chair White, other commissioners, staff, those in the audience, I extend a welcome to today's meeting of the SEC's Advisory Committee on Small and Emerging Companies. I, of course, extend a welcome to the members. It's nice to see a number of familiar faces, and I'd like to offer a special welcome to those who are here for the first time as members of this committee.

It -- this is not the best time for running off to Washington and having meetings. And we recognize that, and we appreciate your willingness to take this time. It's a particularly busy time of year we all know, but I think the work of this committee is also important. And we felt it was a good idea to at least get started in 2014 so we can hit 2015 running.

The -- it's -- the --

ELECTRONIC VOICE: Welcome to Unified Conferencing.

MR. GRAHAM: Okay. So we're not going to start all over. (Laughter.) But I just want to say that I do look forward to working with you as a team to ensure that this committee accomplishes something meaningful.

(Interruption to proceedings.)

MR. GRAHAM: That's nice. (Laughter.) That was good. I think we all agree that contributing to the facilitation, the formation of capital for small businesses is important work. Finally, I want to make sure that I do thank the SEC staff. They're extraordinarily helpful. They do an incredible job. I always appreciate their incredible level of dedication as well as their professionalism.

A couple of administrative items. Once we start having discussion, please, before you start talking, wait to be recognized, and when you're not talking, please make sure your mics are turned off. And I also would ask you that you put your cell phones on silent.

One thing I forgot to mention as far as members are concerned is that one member that some of you may have expected to see but you will not see is Heath Abshure. He resigned recently, and so therefore he will not be serving with us. Heath was one of our observer members. He was representing NASAA. Heath was with us from the beginning. He was an able contributor. We enjoyed working with him, we will miss him, and we wish him well.

We have a full agenda for today as we dive into the timely topic of accredited investor definition. And as we will discuss in more detail later, we will want this committee to formulate recommendations on the issue. And to help frame our discussion, we have arranged for presentations from AARP as well as the Angel Capital Association.

But first, we're honored to kick things off this morning with remarks from Chair White as well as Commissioners Aguilar, Gallagher, and Stein. Commissioner Piwowar wanted to be here, but his schedule did not permit it, so he sends his regrets. And so with that, I'm going to turn it over to Chris.

MS. JACOBS: Thank you. And I would like to echo Stephen's welcome to new members and those returning members. But first I'd like to introduce Chair White.

Chair White was appointed in March of 2013 by President Obama to serve as the 31st chair of the SEC. She arrived at the SEC with decades of experience as a federal prosecutor -- excuse me -- and securities lawyer. Prior to serving as the chair of the SEC, Chair White was the U.S. Attorney for the Southern District of New York, the only woman to hold that position in the 200 year-plus history of the office and the chair of the litigation department at Debevoise & Plimpton in New York.

Chair White.

CHAIR WHITE: Thank you very much for that very kind introduction, and thank you, all of you, for being here today. Welcome to the meeting. I want to also extend a special welcome to the new members of the committee as well as those members who are returning. Each of you really do bring to this committee a wealth of knowledge, expertise, and insights about the needs of small businesses and the impact that our rules at the SEC can and do have on this very important part of our economy.

I know you have extraordinarily busy schedules and multiple demands on your time, so I do want to express my deep appreciation for your willingness to serve and especially to be here at this time of year, which I know is an -- even more difficult, although

Stephen assures me that was part of your doing, that you did it to yourself, too. But in any event, thank you. Your thoughts, ideas, and recommendations will help the Commission's thinking on many of the important issues affecting small businesses.

I also want to thank Stephen Graham and Chris Jacobs for agreeing to lead this committee again as its co-chairs. They really do a tremendous job. I'd also, as Stephen did, like to take a moment to recognize the invaluable contributions of Heath Abshure, who yesterday I think announced that he will be moving on from his current position as Arkansas securities commissioner and as the NASAA representative for this committee.

He's been a dedicated and energetic advocate for investors throughout this distinguished career starting as an SEC attorney and then as the Arkansas securities commissioner and president of NASAA. He's always been a friend of this agency, and we'll all miss having him on this committee as well.

Lastly, I would like also thank the staff, Keith Higgins and the staff of the Division of Corporation and Finance for their hard work in supporting the activities of your committee and helping to organize this meeting. I'll try to be brief in my remarks. You certainly don't need any of us to tell you that small businesses play a crucial role in the growth of our nation's economy and the creation of new jobs. Small businesses are a vital, but often under represented segment of the American economy.

This committee plays a critical role in ensuring that the views of small business owners, investors, and other stakeholders in the business community are clearly heard by the Commission. I want to take just a few moments to provide you, actually, with a very brief update on a few of the initiatives that have been of interest to this committee starting with the JOBS Act rule makings.

We're working hard to finalize the JOBS Act rule makings. Last summer, as you know, we adopted the final rules that eliminated general solicitation, the general solicitation prohibition in Rule 506 offerings designed to help small business solicit new investors more easily. We also have a pending and related rule proposal. We know many of you are eager for us to finalize the rule makings for Regulation A-Plus, as we call it, and crowd funding. We are, too. We've received lots of thoughtful and varying comments on both proposals. Completion of these rule makings remains an important priority, and the staff is working very hard on the recommendations for final rules.

Tick size, tick size is another important issue that the committee has considered, and the Commission has considered earlier this year. Again, I think as most of you know, if not all of you, the Commission directed the exchanges and FINRA to develop and file a plan for a pilot program that would widen the quoting and trading increments for certain smaller cap stocks.

In November, the Commission published a notice soliciting comment on the plan. The comment period will run until December 22nd, which I guess is next Monday. We appreciate the feedback we've gotten already and welcome more. I'm hopeful that a pilot program will yield data that will better inform our thinking about ways to build more robust markets for smaller public companies.

Next, our disclosure effectiveness review, staff and the Division of Corporation Finance is currently conducting a comprehensive review of the disclosure requirements for public companies. The goal is to find ways to improve the disclosure regime for both the benefit of companies and investors. This includes looking at whether additional scaling of disclosure requirements for smaller companies would be appropriate.

I look forward to reviewing the staff's recommendations on how to update the requirements to

facilitate timely material disclosure by companies and shareholders' access to that information.

Accredited investor, which is obviously the focus of your meeting today, is a very important topic for us as well. As you know, the Dodd-Frank Act requires the Commission to undertake a review of the accredited investor definition in its entirety as it relates to natural persons. And the Commission staff, including the staff from the Division of Corporation Finance as well as the Division of Economic and Risk Analysis is conducting a comprehensive review of this definition.

The goal of the review is to assess whether we are properly identifying the population of investors who should be able to purchase securities in offerings without the protections afforded by the registration requirements of the Securities Act. A critical part of the staff's review is soliciting and considering input from the public and other interests parties. And again, there are varying views on this topic.

We recently received recommendations regarding the definition from the SEC's Investor Advisory Committee. Those recommendations are very helpful, and we'll be very interested to hear this committee's insights at today's meeting.

A word just about outreach. Public outreach to

small businesses really is essential to our efforts to inform ourselves. Just last month we held our 33rd Government Business Forum here at the SEC headquarters in Washington. This forum brought together really from across the country small business executives, their advisors, investors, and government officials to discuss and really think creatively about how our rules might be improved to help small businesses. I look forward to reviewing the recommendations from the forum participants once they have been finalized as well.

We also recently launched a new initiative with the U.S. Small Business Administration to host public events across the country, to inform small business owners and entrepreneurs about the options for capital raising. SEC staff members including from our Office of Small Business Policy work -- are working very closely with the SBA staff to highlight the ways that small businesses can raise funds and to answer questions from small business owners really in the field.

We already have had two of these very well attended events with more in the works to come. So let me stop here and thank you again for your service on this committee. I look forward to receiving the report from your meeting today and continuing our dialogue to help small businesses in America. Thank you.

MS. JACOBS: Thank you. And I think I can speak for the committee in appreciating the update. So thank you very much.

Next I would like to introduce -- Keith, is Commissioner Aguilar on? Are we --

COMMISSIONER AGUILAR: I am. Hopefully you can see me.

MS. JACOBS: We can.

COMMISSIONER AGUILAR: I'm behind you, I think.

MS. JACOBS: Behind us and down the row a little bit, but good morning. Thank you. Commissioner Aguilar has been a commissioner of the SEC since 2008. Prior to serving as a commissioner, he was in private practice specializing in securities and corporate law, international transactions, investment companies, and investment advisors. Welcome.

COMMISSIONER AGUILAR: Thank you. And thank you for that introduction, and good morning to everyone. I wanted start by welcoming the members of the Advisory Committee on Small and Emerging Companies to today's meeting. Like my colleagues, I very much appreciate your efforts, and I look forward to today's discussion. And of course, I also want to thank the staff of the Division of Corporations Finance Office of Small Business Policy for organizing this meeting.

Since its formation in 2011, this committee has provided the Commission with advice related to privately held small businesses and the smaller publicly traded companies. It is well known that these businesses have an outside impact on the growth of our country's economy and job creation for all Americans. And as you know, today's meeting will focus on the definition of accredited investor, a definition that is critical to the Commission's Regulation D exemption from the registration requirements of the Securities Act of 1933. Regulation D may be the Commission's most widely used exempted offerings, and it is regularly used by small businesses to raised needed funds in the capital markets.

As many of you know, and as Chair White alluded to, roughly one month ago today this topic was a subject of a lively discussion at the Commission's Forum of Small Business Capital Formation. And at the November 20th forum, I spoke about the urgency and importance of improving upon the accredited investor definition. The accredited investor definition is critical for the protection of investors. At its essence, the definition attempts to identify those individuals who are expected to be able to defend for themselves and protect their interests.

The current accredited investor definition

attempts to do that for individuals by focusing on whether an individual has either an annual income of at least $200,000 per year or $300,000 with their spouse or a net worth of at least $1 million. Generally speaking, securities offerings made to accredited investors under Rule 506 are exempted from the registration and disclosure requirements of the federal securities laws, and the securities purchase cannot be freely resold. Because of the importance of the accredited investor definition, Congress has mandated that the Commission undertake a periodic review of the definition as applied to natural persons to determine whether it should be modified for the protection of investors.

And notwithstanding the congressional mandate, there are those that think that the Commission should not review the income and net worth test contained in the accredited investor definition. The view is that we should not examine a definition that identified eligible purchasers to be millionaires and other affluent persons and that these individuals simply did not need to be protected. While that may make for a nice sound bite, it simply fails to convey who is really impacted.

Accredited investors are not only individuals like Bill Gates or Warren Buffett, but rather constitute a large pool that includes a large swath of Americans.

For example, the following individuals would be eligible accredited investors: first, a single working parent of three children with an annual salary of $205,000 and likely with a home mortgage to pay; second, a recent widow who inherited $1 million, but is not otherwise earning any separate income; and third, a senior retiree who has accumulated over $1 million in his or her retirement account during their working life and needs that money for the retirement years.

While these individuals qualify as accredited investors under the income and net worth test, there is nothing in definition that helps to identify whether these individuals have the financial sophistication and/or investment experience to be able to assess whether any particular investment is appropriate for them. Many observers believe that the definition's failure to consider an investor's actual financial sophistication is a serious flaw.

As the SEC's own Division of Economics and BRICs analysis has reported, many investors whose financial worth gives them accredited investor status have limited investing experience. In addition, other studies have shown that accumulated finances will -- is not necessarily correlated with intelligence. One financial professional has found that -- and I quote --

"There are often people whose net worth puts them in the accredited category. They may be smart and successful in their fields, but most are confused about the basics of investing and managing money."

I am supportive of the Commission's efforts to review the appropriate conditions for determining whether someone is or is not an accredited investors. Beyond the fact that Congress has mandated a review of the definition, it is an appropriate task to be undertaken by the agency responsible for regulating the capital markets. Investors who are considered accredited under these rules are carved out from the basic investor protections that the securities laws mandate, which regard to registered securities offerings. These protections, provided in part to mandatory filings and required disclosures, simply do not exist with those deemed to be accredited investors. As a result, the simple working parent with three children, the widow with the inheritance, and the retiree all deserve the Commission's attention to make sure that they are not made more vulnerable by an accredited investor definition that may fail to distinguish between individuals who can protect their own interests and those who cannot.

For these reasons, it is entirely appropriate for the Commission to review whether the accredited

investor definition is accomplishing its intended goals. Moreover, as the Commission's Investor Advisory Committee has pointed out, the current accredited investor definition may also be under inclusive. Potential investors who most people would consider to be financially sophisticated, such as a chartered financial analyst or a graduate professor of corporate finance may not have the income or the accumulated net worth to be eligible to be accredited investors, but they may actually be in a better position to protect their own interests.

This is why the AIC has recommended changes to the accredited investor definition that take into account other ways of measuring financial sophistication. These recommendations include assessing individual special life work experience or their investment experiencing or their licensing or other professional credentials.

Ultimately, it is important that we get this definition right. There is no doubt that the definition for accredited investors under Rule 506 of Regulation D will remain critical to the success of capital formation. In the long run, the continued success of Rule 506 will depend on whether the accredited investor definition appropriately identifies individuals who do not need the protection of the Commission's securities, registration,

and disclosure requirements and those who do. For those reasons, I am pleased that this committee would today focus the entire day on the definition of accredited investors, and I very much look forward to your discussions and recommendations. Thank you. I join Chair White in being grateful that such busy people have taken their time to be with us today and to share their intellectual thoughts and their experience. I wish you a very productive day, and thank you for having me here this morning.

MS. JACOBS: Thank you, Commissioner. We appreciate those comments, and we'll do our best today.

Next I would like to introduce Commissioner Daniel Gallagher. Commissioner Gallagher has been a commissioner of the SEC since 2011. Prior to serving as a commissioner, he was a securities lawyer both here at the SEC where he served as deputy director of the Division of Trading and Markets and in private practice.

Commissioner.

COMMISSIONER GALLAGHER: Well, thanks so much, Chris, for that introduction. To borrow the opening words of my alma mater's fight song, "It's been so long since last we met." At a critical time of importance for small business capital formation with our implementation of the JOBS Act, it's unfortunate that the last meeting of this

body or, to be precise, its predecessor, was in September 2013, and I applaud Chair White for getting this on the calendar in 2014. I will be glad to see more regular meetings in 2015. This group's work is very important, and we do well to solicit, receive, an heed its advice.

Of course, today's meeting, as has been discussed, is set to discuss that old chestnut, the accredited investor definition. And after shocking the attendees of the Small Business Forum last month with my views on this topic, it should come as no surprise to those of you who follow me, that these views haven't changed in the last few weeks. I still do not believe we need to be spending our time protecting millionaires. I respect the views of Commissioner Aguilar, and I understand why accredited folks like him want more attention.

But the rest of us would like to focus on things like Reg A and public offerings that we are allowed to participate in. We have Reg A-Plus to finish, we have venture exchanges to create. We have crowd funding to fix. We have disclosures to scale, and the list goes on and on. So by way of priority, this at least to me, is near the bottom somewhere right above the pay ratio disclosure.

Nonetheless, there was one critique of my position that I did and do take to heart. Am I refusing to consider a potential expansion of the pool of accredited investors to learned professionals and others who have the education or skills such that they, too, might be able to fend for themselves in the markets. Refusing is a strong word, and let's just say I'm extraordinarily skeptical.

I worry about getting the government more deeply involved in defining who is sophisticated and who is not. Net asset and income tests are a very hands-off, unobtrusive, and value-neutral way for the government to define who is accredited. Having the SEC place its imprimatur on certain forms of education or training and not others is a dangerous path. Do we accept FINRA or CFA exams? Do we administer our own program? I have a better test, real world experience.

If a learned professional has investment aptitude, then what prevents him or her from prudently building an investment portfolio in the public market sufficient to pass our asset test as a ticket into the private markets. This operates both as proof of knowledge and skill in investing and also as a buffer against risk of loss in the private markets.

Moreover, I am simply incredulous that an expansion of the categories of persons deemed accredited

can be achieved without compromising on the asset and income test. It is much more likely that there would need to be a bargain which would be somewhat more Faustian in nature. This seemed to me to be the clear import of the SEC's Investor Advisory Committee recommendation from earlier this year.

For example, the asset test could be raised to an inflation-adjusted $2.5 million, but I'm more concerned about the effect of cutting those individuals out of the market than I am eager to try some new combination of rules that might loop some different subset of people in. Just on its face, like scooting a successful business person with 1.5 million in assets in order to include a first-year lawyer with $150,000 in student loan debt doesn't seem to be a trade-off that makes sense.

Or, as some have suggested, we could tier the asset test and tie it to investment limitations. So an individual with barely over a million in assets could only invest 10 percent of their wealth. As wealth increased, so would the percentage in age. While such an approach made limited sense in the context of crowd funding or small investments across a number of companies is at the heart of that approach to capital raising. Importing that approach to private investments in general

goes back to my first concern about the proper role of government. Here it would put the government squarely in the position of dictating portfolio theory to millionaires. It's the nanny state at its worst.

So if we could change the definition of accredited investor by a means that does not result in a more intrusive role for government or involve any cutback in the number of accredited investors or quantity of investable assets today, I'd be open to having that debate. But so far, I have seen no indication that that would be the case, and so I believe we should spend our limited bandwidth focusing on more critical matters. In sum, what we have by way of the accredited investor definition today is good enough. It's not perfect, but it's also not broken. So I hope you have a good discussion today, but I also hope we can turn to more productive issues in the future. Thanks very much.

MS. JACOBS: Thank you, Commissioner. And now I would like to ask Commissioner Kara Stein to make some comments. Commissioner Stein has been a commissioner of the SEC since August 2013. Prior to serving as a commissioner, Ms. Stein served as staff director for the Securities Subcommittee of the Senate Banking Committee where she worked on many financial service issues, including the legislation that became Dodd-Frank and the

JOBS Act.

Commissioner Stein.

COMMISSIONER STEIN: Thank you, Chris. I want to thank everyone here for your pro bono work and for agreeing to be with us today and engage in this discussion and I hope many others during the course of the committee's tenure. I'm -- certainly share your focus on an interesting capital formation, and I'm particularly interested in helping to provide more and better options for smaller businesses and for those who invest in them. Smart rules, smart policies around capital formation will lead to both jobs and investment opportunities across the country, and I think we all know that, and that's why you're here.

I've said this before, and I'll say it again. Over the years we've created a jumble of overlapping and sometimes inconsistent options for both private and public capital raising. The system has become increasingly complex and at times even irrational. This potentially inhibits efficient capital formation in some areas, while needlessly exposing investors to undue risks in others. We can and we should rationalize this jumble. It will benefit both entrepreneurs and investors.

Excuse me. I have a cold. I'm very focused on working through these issues, and as part of that effort, I, like my fellow commissioners, want to see the Commission move quickly towards finalizing three very important rules related to capital formation: ground funding, the new Reg A-Plus, and investor protections under 506 -- Rule 506. I'm glad to see this committee tackling the very important issue of the definition of accredited investor. I think it's an important topic because it gets to the heart of how we think about investor protection, and I think part of the conversation is should we rethink that or not, especially in the space of what divides public from private capital raising, because to some degree, that's the been the way we've decided which way you capital raise and who you can raise from.

In effect, should we be trying to protect people who need protection, and who are they, and how do we identify them? One of the things the Investor Advisory Committee was talking to us about was sophistication, which a couple of my colleagues have talked about today. And it comes in all shapes and sizes. And another way we've talked about is through income or net worth, either high or low. We did, I think, receive very thoughtful recommendation on the definition of accredited investor from our investor advisory committee. So if it's not in your packet, I'd

recommend it to you to think through and comment on.

But I'm very much looking forward to your ideas, your analysis and recommendations today as well and whether we should be thinking about this. I think that's fair as well. Congress has asked us to think about it. That doesn't mean we need to do anything about it, but it means we need to think about it, and I think it's becoming increasingly important as more of them -- more and more capital raising is done in the private space. I think that's part of the reason people want us to have that discussion.

I say this in many contexts, but I really believe we get to better public policy choices when we hear from a variety of participants from different viewpoints in the market. So I'm, again, very appreciative that you're here today, that you're offering us your guidance and wisdom, and I look forward to meeting each of you individually, and hopefully being people I can reach out to to sort of think through things as we go through the process. So thank you for your time. Hopefully, we'll result in better rules and better policy because we're taking into account your views.

MS. JACOBS: Thank you, Commissioner Stein. We appreciate the comments from all of the commissioners today and showing your interest in our work as we start

today.

Next, I would like to introduce Keith Higgins. Keith is the director of the SEC's Division of Corporate Finance. Keith with introduce the rest of the staff joining us today.

MR. HIGGINS: Thanks, Chris. Good morning, everyone. I'd like to add my welcome to all of you, and thank you for taking the time during this season to come and attend this meeting and share your views with us today. We have a very full agenda, so I'll keep my remarks brief.

Before we begin, I should start with the standard SEC disclaimer that the things that you'll hear today from the SEC, the SEC staff represent their views alone and don't represent the views of the Commission, any of the commissioners, and any of our other colleagues on the staff.

So with that dispensed, let me -- since this is the first meeting of this renewed committee, I thought it would be a good idea to go back to basics, and I pulled out the committee charter and took a look at it. The committee charter, as charters tend to do, provides what the objective of the committee is, and that's to provide the Commission with advice on its rules, regulations and policies to advance the mission of the Commission,

protecting investors, maintaining fair, orderly, and efficient markets and facilitating capital formation in three specific areas: capital raising, securities trading, and public reporting of smaller private companies or emerging private companies and smaller public companies.

So the Commission is very fortunate to have such a diverse and accomplished group of representatives of that community to participate on this committee. The committee provides a mechanism through which the Commission can get thoughtful recommendations and advice from those who are most directly affected by the rules and regulations and help us set interests and priorities for those important constituencies.

As you commence your work in the new term, I'd ask that each of you, as we do, at the Commission and the staff, keep in mind in formulating the recommendations that the effect of the recommendations on both capital formation and investor protection, marrying capital formation and investor protection, and finding the right balance between those -- and we've heard a little bit about it already this morning -- is really the key to successful markets and a healthy economy. Before we start,

I'd like to also thank -- be a little

self-congratulatory, but really to give a shout-out to the Office of Small Business policy here at the Commission. It's really the SEC's office that's the main point of contact for small companies. It always has in mind the interests and priorities of that constituency. At the same time, it works to facilitate capital formation and consider investor protection at the same time.

The office answers countless questions from companies and their advisors about capital raising, how to raise money through exempt or a small registered offering. It plays a key role in the Commission's rule makings, many of which were mentioned today, and acts as the liaison with the state securities regulators and the Small Business Administration, and really day to day does a great job of reaching out and working with and advocating for the needs of smaller companies.

In addition to these efforts, the office supports the work of this committee and, as Chris and Steve have noted, and it also organizes such events as the Government Small Business Forum on small business capital formation that continuously -- where we solicit the views and recommendations from that community.

So I'm joined today by two members of that office. Sebastian Gomez to my right is the chief, been

chief of the office for about a year now. And Julie Davis, who is special counsel in the Office of Small Business Policies. So thank you two, and others -- there are other members of the office in the audience, and I'd like to thank them for their work.

So with that, I'd like to turn it back to Steve and Chris and kick off the more formal part of today's meeting.

MS. JACOBS: Thank you, Keith. Next we would like to take a short period of time, and we thought it would be helpful to go around the room, starting with you, Charles, for introductions so that we get to know each other as quickly as possible and get to know one another a little bit better and a little bit about your relevant experience, because I think that's what's so important right now for our work is that we have boots on the ground experience for the topics today.

While you all have more experience that's going to be able to fit into the time allotted, in order to keep these introductions into a 15-minute window, but we would like to ask you to introduce yourselves.

MR. GRAHAM: That's not 15 minutes apiece.

(Laughter.)

MS. JACOBS: Isn't he a jokester?

MR. GRAHAM: Okay.

MR. BALTIC: Thank you. Good morning, Chair White, Commissioners, and Committee Co-Chairs Graham and Jacobs. Thank you. I'm a new member of the committee. My name is Charles Baltic. I'm co-head of healthcare investment banking at Needham & Company focused on the emerging growth companies in both healthcare and technology. I've been involved in the investment banking investment banking industry for approximately 20 years, and prior to that practiced corporate and securities law. I also sit on the boards of a public emerging growth company, a private company, and two nonprofit organizations involved in fostering life sciences and research? Thank you. I look forward to my service on the committee.

MS. JACOBS: Thank you.

John.

MR. BORER: Good morning. This is my second tour of duty here. I am the head of investment banking at the benchmark company in New York, which is a boutique investment bank, educated as a lawyer, never practiced, was in commercial banking and leverage finance for 13 years and then have been in investment banking for 23 years since, and have also served on the boards of small public companies, private companies, and taking companies public, not only our own company when I was CEO at one

time, but involved in the IPO practice and raising capital principally is our business.

MR. CHACE: Hi. Thanks. Dan Chace, along with John, my second time here. I'm a portfolio manager at Wasatch Advisors which is an investment manager in Salt Lake City focused on public markets. I manage our microcap fund which is focused on the smallest public companies that are out there, typically between 80 million to 600 and above. I hope to be able to contribute in terms of prospective on those types of issues. Thanks.

MS. HANKS: I'm Sara Hanks. I'm a CEO of Crowdcheck. We do due diligence on companies raising funds in the new online investment market. I have 30 years of experience in corporate and securities matters, mostly on huge IPOs, and what we're doing now is focusing very much on the tiny little companies, seed-stage companies who are encountering securities regulations for the first time.

MR. HEMPHILL: Hi. My name is John Hemphill. I'm a partner in Sheppard Mullins New York office. Unlike my predecessors here, I'm still a lawyer and have been for my entire career, and I've been working with small and emerging growth companies for over 20 years, and that ranges from two kids in a dorm room all the way to smaller public companies, sometimes larger public companies. And I've also been working with Reg D since October 1982 when I worked on the offering for Cablevision of Boston representing Drexel Burnham. And that offering was interesting not only because it was early on with Reg D, but it was also the company ended up having over 500 investors, so it also had to register as a public company. Not -- it really didn't like that very much either. So in any case, I'm glad to be here. Thank you very much for inviting me onto the committee.

MR. LEZA: Hi. I'm Richard Leza. I spent the first 12 years of my career and started six start-up companies. Then I went over to the venture capitalists, and I spent 15 years in the venture capitalist business. I sit on five boards, one public, two private, two -- one educational and one non-profit, and I'm now the chairman of Exar Corporation in Freemont, California.

MS. LUNA: Hi. My name is Sonia Luna. I'm the owner and founder of Aviva Spectrum. We're a boutique compliance consulting firm based in sunny Los Angeles, California. And our bread and butter is coming from smaller reporting companies that need to comply with SOX 404 or other operational compliance issues.

MS. MOTT: I'm Catherine Mott. I'm the founder of Bluetree Allied Angels and the Bluetree Venture Fund

in Pittsburgh, Pennsylvania. Bluetree Allied Angels was formed in October 2003 when there were about 90 professionally managed angel groups in the country. Today there's over 400. Bluetree Allied Angels has invested in 46 regional companies, roughly $30 million, so -- and have created thousands of jobs in the Pittsburgh region.

MR. PAUL: Good morning. My name is D.J. Paul. I'm the chief strategy officer for Propeller, which is a real estate and alternative investment craft funding and Reg D platform based in New York. I'm also the co-chair of CIFRA which is a craft funding advocacy organization. My first exposure to this was probably when I passed my Series 7 and Series 63 in 1991 as a would-be mortgage-backed securities salesman, which I did for several years.

And my first exposure to Reg D was when I left that to become an entrepreneur and actually had to go do a raise at 27 in 1994 and that was my first introduction to the rather arcane and complicated universe that we're going to be discussing in part today. I'd like to thank all those involved for inviting me to participate, and I'm looking forward to lending my shoulder to this.

MR. REESE: Good morning. And thank you for having me. I'm here because I do want to make a

difference to this issue. I built my success as an entrepreneur over 21 years. I've exited both publicly and privately through six ventures, all using Reg D as a beginning to get my ventures off the ground.

And my second part of my life is I've been an angel investor since 2002 and have both formally and not formally participated in angel funding, crowd funding, and through the development of a national minority angel network model focused on minorities, women, and veterans. Thank you.

MR. WALSH: Good morning. Tim Walsh, my second stint here on the advisory commission. I've been in the investment world for about 30 years. The first 15 was out of Chicago. I was in the options, derivatives, and currency markets. And the last 15 years I've had a sort of -- as my wife would say a too varied of a career, but it's encompassed from being a trustee of a pension -- a public pension fund in Indiana to most recently being the CIO of the State of New Jersey $75 billion pension fund.

I'm currently the president of Gaw Capital. It's a commercial real estate investment firm outside of Los Angeles. I recently resigned from a public board. I've been on very many private boards, and I'm currently on two advisory boards as well. And I've been an investor in small businesses. I've formed a few a few

years ago, and I've made money on some of them, and I've lost money on some of them.

And listening to the varied -- Commissioners Aguilar to Gallagher, I'm not sure what the answer is on accredited investor. I did hear an interesting line yesterday with an investment manager in New Jersey, said that, "I'm sick and tired of billions being spent to protect millionaires from billionaires." So that's maybe paraphrasing Commissioner Gallagher's line. Thank you.

COMMISSIONER GALLAGHER: I think you just weighed in on my side. I just want that reflected on the -- (laughter).

MR. WALSH: I feel -- Commissioner Aguilar's side is well, so I'm not sure there's an easy answer.

MR. YADLEY: I'm Greg Yadley back for my second stint on the committee. I'm a private -- in private law practice in Tampa, Florida with Schumaker, Loop & and Kendrick, medium-size firm. As I was running this morning by 500 North Capitol Street, I remembered back to 40 years ago about this time when I received my first job offer at the Commission, and my first boss was Justin Klein, who I know Commissioner Gallagher knows, and I have felt ever since that time that the Commission is a great agency who does an excellent job of doing its best to protect investors.

At the same time, I also learned that rules need to work in the real world and being practical is very important. I also found that most people are honest and that you need to write rules that work for most people, and you need to spend certainly enforcement and regulatory efforts for the bad guys. But if you write all the rules for the bad guys, our economy will come to a halt.

I left the Commission and was assistant general counsel at Freddie Mac, which I was proud to say. I'm not so sure anymore after what's happened. But I spent my time in private practice working on everything from soup-to-nuts starting companies, helping them get funded, raising money privately, publicly, counseling boards, helping companies reorganize through the bankruptcy process.

And like Tim, I've invested successfully and lost money and the times that I've been unhappy have been times when I felt that there were conflicts of interest where people made money on the side and where there was lack of disclosure. So where I lost money because the deals didn't work, that was my decision and my personal loss. So I'm probably mostly on Commissioner Gallagher's side, but a little bit with you, Commissioner Aguilar, too. Thank you very much for having me on the committee.

MR. SAADE: Good morning. My name is Javier Saade, and I hold an observer seat in this committee, so thank you for inviting me, and I look forward to observing. I'm the associate administrator of the Small Business Administration, and we are very excited to be working with a lot of the folks at the SEC educating folks on the new options that we're going to be talking about here and that dance that has been discussed before as to the excitement of capital formation with the prudence you need to do to implement the rules so that that balance is critical.

I run a couple of programs that are relevant to this. One is called the SBIC program which is a 290 alternative investment funds, managing about $23 billion, all of them doing private investments from early-stage venture capital all the way to structure lending. Another program I run is called the SBIR program. It's essentially the largest seed fund in the world. It takes a slice of the federal R&D budget, which this year President Obama requested 135 billion from Congress. We're still figuring out the budget.

But in general terms, it's basically $2 and a half billion that is made as grants to companies that are pre-commercial. So before any venture capitalist in their right mind would write a check to a company, the

government is there to de-risk some of that technology. Many of those people are very excited about Title 3, because the world of venture capital has changed, and I hear a lot about crowd funding in Title 3 over and over again. A lot of the companies that are funded through these programs are very interested in what this committee is doing and the Commission.

Before I was appointed by the White House to this role about a year ago, I've done a lot of different things. I'm kind of ADD. I started my career as an engineer at a pharmaceutical company, Abbott Labs. Then I did some consulting at two firms, Booz Allen Hamilton and McKinsey & Company. That's kind of the first half of my career was kind of big company advising. The second half of my career has been investing. I have worked two venture capital firms, one private equity firm, and one hedge fund, and I've started three companies, two spectacular failures. And I've invested in many around the world.

One thing that I would like to say that I know the commissioners know is that a lot of the work that's done by the SEC is looked at by your counterparts all around the world. I used to do deals in emerging markets, and a lot of the stuff that comes out of here and the stuff that the SEC does is -- actually indeed

informs a lot of the commissions, the CBM in Brazil and so and so forth. So I'm very thrilled to observe this -- in this area also. Thank you for having me.

MS. JACOBS: Thank you. And we are slightly ahead of schedule, which I appreciate, but not as much as your backgrounds and experience. This is going to be a great day. We are going to -- I promise you commissioners and Chair White, we will get it up and get it down today. So thank you for staying on time and being brief, and at the same time giving us a sense of your experiences. With that now, I'm going to turn this over to Stephen who is going to bring the issue forward for today.

MR. GRAHAM: Thank you, Chris, and thank you all. I mean it is clear that you represent a broad spectrum of the small business community. It is clear that you have an awful lot to offer, and we all look forward to receiving your input.

Everyone today understands how critical it is for small business to be able to raise capital. And the overall majority of capital raising by small and emerging companies is done using the safe harbors under Regulation D, especially for rule 506(b) and the new provisions under rule 506(c) of which the accredited investor definition is of course a central component.

The concept behind accredited investor is intended to encompass those individuals -- entities with financial sophistication and ability to sustain the risk of loss and fend for themselves and gain access to information. And under the current definition, as we all know, but just to tee it up, I'll repeat it, and that is that natural persons are accredited investors if their income level exceeds $200,000 per year or $300,000 with their wife or a million dollars net worth excluding their primary residence.

For investors, qualifying as an accredited investor has significant consequences because it allows them to participate in investment opportunities that are generally not available to non-accredited investors such as offerings by private funds or seed investment in early stage companies.

The flip side is that investors who participate in unregistered offerings can be subject to increased investment risk. They generally do not receive information comparable to that in a registration statement, and the SEC staff does not review whatever information is provided to them.

For companies and other market participants, the size of the accredited investor pool is of significant interest, and given the critical importance

of the exempt offering market to the economy, that interest is not confined to the small business community.

The current definition was adopted by the SEC as has been mentioned in 1982. Many feel it is in need of updating, and the topic is particularly timely now because the Dodd-Frank Act directed the SEC to undertake a review of the definition as it relates to natural persons, and the SEC staff is currently conducting that review. The results will help to inform the Commission's considerations of possible changes to the definition.

We have with us today as staff from the SEC's Division of Corporation Finance and the Division of Economic and Risk Analysis who are working in that study. They'll give us an overview of what the review encompasses and some of the data that they're using. It's important for us to remember, though, that the study isn't done until the Commission releases it, and these professional staff members can't front-run the commissioners.

In other words, they won't be able to tell us the timing or what the conclusions will be or even what they think the conclusions might be, but they can give us an overview of the topics they're looking at as well as the data that will be integral to their recommendations.

One of -- one final note. In October of this

year, our colleagues from the SEC's Investor Advisory Committee put forward a set of recommendations regarding the accredited investor definition. Chair White has asked for our committee -- for its recommendations on this topic as well. So by the end of today, I suspect that we'll be in a position to at least have a sense of this committee and be on our way to developing and formulating recommendations.

Now we'd like to turn it over to the SEC staff. First, from the Division of Corporation Finance, which as most of you know is the division in charge of disclosure operations and rule writing under the 33 Act. As Michael Seaman -- Michael is a special counsel and part of the team working on the study. Also, we have Rachita Gullapalli, a financial economist from the Division of Economic and Risk Analysis, which is the division in charge of data and economic analysis. So with that, I would like to turn it over to Michael and Rachita.

MR. SEAMAN: Thank you. I'm going to speak very briefly this morning about some of the work that's going on at the Commission with respect to the accredited investor definition, and then I will turn it over to Rachita to share some interesting information about the numbers the Division of Economic and Risk Analysis has found.

As everyone knows, the Dodd-Frank Act requires the Commission to conduct a review of the accredited investor definition every four years as the definition applies to natural persons to determine whether the requirements of the definition should be adjusted or modified for the protection of investors in the public interest and in light of the economy.

Chair White has asked the staff to conduct a study of the definition as part of this first required review. That study is ongoing now and involves staff members from a number of divisions and offices throughout the Commission. In connection with this study, the staff is considering the many recommendations received over the years regarding the definition and is considering whether and if so how the definition should be modified.

More specifically the staff is considering whether the income and net worth thresholds should be adjusted or left where they are. The staff is also considering the manner in which those metrics are calculated. For example, are there components of the net worth threshold such as retirement assets that should be not included in the calculation? The staff is also considering whether there are alternative financial measures such as investment assets that could be used as an alternative method of qualifying as an accredited investor.

The staff is also considering whether there are alternative nonfinancial attributes, the means by which the certain individuals could be qualified as accredited investors based on attributes that they have such as education, business experience, professional certifications, and investing experience.

Finally, in order to provide a more complete review, the staff is also considering the definition as applied to entities. We look forward very much to the recommendations that this committee will provide. Thank you.

MS. GULLAPALLI: Thank you. I'm -- yes, thanks. So I'm going to be providing some perspective on how the pool of accredited investors, as it pertains to natural persons, changes under different recommendations. So very quickly, and then as Michael just explained and as its told in the room. The accredited investor is basically an SEC-defined investor category as to who companies can sell to in their offerings under Rule 505 and Rule 506 of Regulation D. And this definition was established in 1982, and the Dodd-Frank Act requires us to do a comprehensive review.

So I'm just going to step back for the next few slides and provide some context about the Regulation D

market and why we consider this category of accredited investors to be so important. Now the chart here shows capital raisings in billions of dollars in the way -- with capital markets. As you can see, Regulation D, the amount of capital raised has averaged about a trillion dollars in the past three or four years, and Rule 144(a), which is another private capital market, but it's primarily brown securities, which are sold to qualified institution buyers that also has an extremely high rate of capital formation.

But if you want to compare Regulation D like the public markets, like in 2013, a little over a trillion dollars was reported to be raised in the Regulation D market. Whereas public equity and debt raisings amounted to about $1.3 trillion during the same year. So clearly Regulation D market is a very -- extremely important capital market in terms of financing issuers.

It has to be also noted that on those 99 percent of capital raisings in Regulation D market are made under Rule 506 offerings, which is the primary market for accredited investors. And last year a new marker -- a new exemption, Rule 506(c) came into existence, and in that market, offerings are to be sold only to accredited investors.

So not only is it a very important market for capital formation; it's especially important for small business capital formation. So if you broadly divide the market into pooled investment funds and non-fund issuers -- and non-fund issuers are like operating companies and financial companies -- we saw that during the period September 2013 to September 2014, more than 70 percent of the offerings in Rule 506 market were by non-fund issuers.

And even in terms of numbers, if you see, they were like more than 15,000 new offerings that were initiated by non-fund issuers. And if you look at the age profile of non-fund issuers in Rule 506 market, almost two-thirds are like less than two of age since incorporation. And firms that are over five years of age are less than a quarter of all non-fund issuers in the Rule 506 market.

And even if you look at pooled investment fund issuers, they are like primarily venture capital funds, private equity funds, hedge funds, and all these issuers have proven to be an important source of financing for early stage, small, and immature firms. So clearly this market has proven to be a very important source of financing for small and emerging companies.

So here I'm going to provide some information

about investors in the Regulation D market. So all this information that I'm presenting here today is basically based on Form D filings of issuers. So we find that based on the initial Form Ds that are filed by issuers for the new offerings, there are about -- they report about 250,000 to 300,000 investors. And of course, this includes double-counting since we don't know the identity of investors, and we also do not know whether these investors are entities or natural persons, so we don't know the breakup.

But I have provided some information on the average number of investors and offering by industry type. And as you can see, it ranges between 9 in operating companies to about 38 in banking issuers. So for Rule 506(b) also allows up to 35 non-accredited investors, but less than 15 percent of offerings in any industry category, you have non-accredited investors in their -- participating in their offerings.

And if you look at the last column, you can see that the total number of non-accredited investors are really small in comparison with the total investors. So clearly accredited investors are like by far the main participants in the Rule 506 market. So given this context and background, and also the fact that this is a private market and there is like less information, in this environment the broad characteristics that probably underlie the definition of accredited investors can be broadly -- to see like do these investors have the sophistication to understand the risk-reward tradeoff in any opportunity and also do they have the ability to withstand losses.

So in 1982 when the definition was established, the Commission relied in income and net worth as a proxy for these two characteristics. So as has already been mentioned, like the standard that was established, was having individual income of at least 200,000, joined income of at least 300,000, or net worth of $1 million, excluding primary residence and any indebtedness associated with it.

So a natural question is: How many people in the U.S. would qualify to be accredited investors? So to understand that, we relied on the survey of consumer finances. It's a triennial survey conducted by the Federal Reserve Board, and it has detailed information on income and financial assets of U.S. households. And the sampling and weighting is done in such a way that it's representative of all households in the U.S., which amount to about 122.5 million in 2013.

So the last column basically shows how many households would qualify under each of these categories.

So under the individual income threshold of 200,000, a little over eight million households would qualify, under the joint income, a little over four million households, and for the net worth of 1 million, more than 9.2 million households would qualify under that standard, and if you see like any under any of those standards, it would be about 12.4 million households, which represents a little over 10 percent of U.S. population in terms of households.

So for perspective, I've also provided how many households would have qualified in 1982 when the definition was established. So again, we relied on the 1983 survey of consumer finances to get that information. And as you can see -- this is the third column. As you can see, it was about 1.5 million households that would have qualified at that time under the definition established, which is a little less than 2 percent of U.S. population in terms of households.

So as the Dodd-Frank Act requires us to review the definition, there have been a lot of recommendations by various entities as to how we can refine the definition. So in the next few slides, we have like tried to see how the pool changes if we look at various recommendations. So one of the recommendation, which has also been proposed earlier has been to adjust these

thresholds by inflation. So the table here shows what would happen to the thresholds if we look at them in current dollars.

So individual income would increase by almost 2.5 times. So from 200,000, it would be close to 500,000 in today's dollars. Joint income would amount to 628,000, and net worth in today's dollars, 1 million would be equivalent to about $2.5 million. So to see how the pool is affected by these recommendations, the chart here basically shows the different recommendations, how the pool changes. So the lighter part of the bar shows how many million households qualify under the income standard, and the darker part of the bar shows how many qualify under the net worth standard. And the slimmer gray bar provides information on the pool of accredited investors that is either under income or net worth standard.

So the first two you have already seen. Like in 1983 about 1.5 million households qualified, and today like under the current standard it's about 12.4 million households that qualify. The third bar shows what would happen to the pool of accredited investors if we just adjusted inflation. So clearly the pool for both like income-based threshold and net worth-based threshold shrinks considerably. And it shrinks to about 4.4

million households.

So another recommendation that has been in the public domain is to adjust the net worth standard by retirement assets. So retirement assets being a source of stable income for people in their golden years, they should not really be used for investment and riskier activities. So if we look at net worth excluding retirement assets, the pool shrinks even more, and the pool of accredited investors would be about 3.8 million households.

So lastly, it has been argued that income and net worth is a good proxy for ability to withstand losses, but not so good a proxy for sophistication, and that there are better and more direct measures of sophistication. And some of these that have only been floated are like education or some professional certification, professional experience or even investment experience.

So in 2007 there was a proposal to adjust the accredited investor definition by also including a minimum investment experience standard for at least 750,000 in assets. So I've included that to see how the pool of accredited investors changes. So the new shaded line on top basically represents the number -- the millions of U.S. households that would qualify under the minimum investment standard, which is about 8.9 million households. And that would, again, increase the pool of accredited investors to about 9.1 million households.

MR. WALSH: Can you explain that 750,000 minimum? I don't understand that.

MS. GULLAPALLI: So it's basically investments and financial assets or other assets totaling at least 750,000. So --

MR. WALSH: I still don't understand --

MS. GULLAPALLI: So households invest in various assets. It could be stocks, bonds, mutual funds, could be real estate, and so on. So the survey provides us information on where individual households invest. So based on that, we can see how many households have investments of at least 750,000.

PARTICIPANT: Does that also exclusive of equity-related investments -- primary residence, or --

MS. GULLAPALLI: Yes, it excludes investment and --

PARTICIPANT: Nothing to do with sophistication, it's just if they've been able to invest 750,000 that they --

MS. GULLAPALLI: Right. The idea is that if you have experience in investing in various assets, it provides you some understanding of risk-reward tradeoffs

of investing in various assets.

PARTICIPANT: (Off-mic.)

MS. GULLAPALLI: Yes, it was a proposal in 2007.

MR. GOMEZ: If you could, when you speak, if you could turn on the mic. That way our court reporter could get it.

MS. GULLAPALLI: Yeah. This is the last slide I have. Basically all this was just to provide a perspective as to how the pool changes based on various recommendations. And as we tried to balance issuers' interest in terms of capital formation with investor protection in terms of their suitability to invest in a less informed environment. Thanks.

MR. GRAHAM: Sure. We have time for that. Will you take some questions?

MS. GULLAPALLI: Sure.

MS. HANKS: Okay. So I've got a couple of questions on methodology there. When you do the inflation adjusting, do you also have numbers for the impact of taking out the principal residence under Dodd-Frank? Because I think to get a true apples-to-apples comparison, you'd need to start with inflation adjusting and then inflation adjusting on a medium house value to take out the impact of the

Dodd-Frank impact. Because we don't have an apples-to-apples comparison that way, because if you can't include the house, then we should be assigning a value to the house and then taking that out on an inflation adjusted basis from '82 to whenever.

And then the second question on methodology is when you say retirement assets, we're just talking about things that fall within IRA or Roth or whatever? Because it's just -- when you talk about stable -- you can put a whole load of really weird stuff into an IRA. You can put Bitcoin into --

(Interruption to proceedings.)

MS. GULLAPALLI: So all the calculations that I've shown here excludes --

(Interruption to proceedings.)

MS. HANKS: It's censorship.

MR. GRAHAM: I don't mind that -- I don't mind music. I do mind that music. (Laughter.)

MS. GULLAPALLI: So yeah -- so all the calculations that I've shown excludes the value of primary residence from the beginning to --

MS. HANKS: From the beginning to -- thank you.

MS. GULLAPALLI: So the issue is that in the 1983 survey of consumer finances, that information is not as well populated. So the numbers could be slightly

higher, the net worth numbers than what they could be.

MS. HANKS: Okay. So -- but -- so the methodology is good. It's just --

MS. GULLAPALLI: But everything from there on --

MS. HANKS: -- the basis from --

MS. GULLAPALLI: Exactly, yeah. It excludes that. And with respect to retirement accounts, yes, it is primarily IRA or Roth accounts and so on. They identified specifically these are retirement assets in the questionnaire. So yeah, we're able to exclude those.

MR. GRAHAM: D.J.

MR. PAUL: So my question is -- and this has been something that's been ongoing as some of this data has been released is that we are looking at the entire pool of eligible investors.

MS. GULLAPALLI: Right.

MR. PAUL: As opposed to -- and so you quite definitely showed how it would be lessened if some of these suggestions were implemented. But is there data available that looks at what the actual pool of not likely -- of actual investors are? Are we looking at a lot of people that are at 220,000 in individual income or a million two of net worth?

Or is it perhaps more likely -- is there any data to show that maybe most of the individual investors in Reg-D actually have net worths well in excess of the current limit or individual income well in excess of 200,000 so that by adjusting the numbers, it might not have as much of a practical effect or that the market is actually adjusting for it already? Is there anything on that aspect of it?

MS. GULLAPALLI: Yeah, unfortunately, we do not know the actual number of investors in private markets. I mean even from Form D, like we get very little information, and we do not have any closing amendments for an offering, so we do not know like the totality of the investors. And there's no information on the breakdown of entities and individual investors, so we don't know that.

But we can make some informed guesses as to how many people are likely to invest in private markets, which would be considerably smaller than the actual pool. Like one way how can do, and we have presented this in like rule making for general solicitation, the Title 2 rule making earlier, was like if you look at direct equity investment as a gateway to perhaps investing in private markets, then we did provide some data based on some brokerage accounts, retail brokerage accounts that the number of households that would invest in direct

equity is much smaller.

Like if you look at 100,000 as the minimum amount invested in retail equity, it's less than 3.3 million households. So the actual numbers are likely to be much smaller than the pools that I've shown here.

MS. LUNA: So this is Sonia with Aviva Spectrum. I had a question. On your aged pie that you had, you had five years and you had the -- did you take a look at some of the dollar amounts that they were trying to raise by age group?

MS. GULLAPALLI: I do not have a direct answer for that. No, we haven't done that specifically by age group how much they're raising, but non-fund issuers tend to raise much smaller amounts than fund issuers.

MS. LUNA: Yes. Okay. And then I had another question. So there were -- you took apart the investment experience of 750K and you showed a delta that got us to 9.14. So -- or the cap was 9.4, so there was a delta of 8 million households that would be in addition. Did you take a look at other items such as the education certificate work experience? Did you also do an analysis in terms of households that would be able to meet that threshold to create that delta as well?

MS. GULLAPALLI: So the data that I presented here is based on survey of consumer finances. Data on

like work experience and education, it's not available --

MS. LUNA: On that.

MS. GULLAPALLI: -- on a very fine level in this survey.

MS. LUNA: So of the three, you only took a look at the investment experience? That is all?

MS. GULLAPALLI: Right. That was the easiest with this survey, yes.

MS. LUNA: Okay.

MR. GRAHAM: I think Tim has a question.

MS. REESE: Yes, thank you. Thank you. I don't think I said my name the first time. I'm Tim Reese. I just have a question. Can you help me in terms of the assumptions around the 750 just so I have a clarification of where do you cut off someone's personal finances and then it becomes investment finances for this calculation?

MS. GULLAPALLI: So the definition I meant can vary based on how we look at it. So I just made a few assumptions and looked at financial assets, including real estate, but excluding primary residence. So that's what we looked at.

MR. REESE: So just clarification is saying that if you looked at a household and to include them in this new number, the first thing is that the buildup,

that they don't have to have 200,000 of income, they don't have to have a joint income of 300,000, and they don't have to have a million dollars outside of the main property, they're included in this 750?

MS. GULLAPALLI: Right. Yes.

MR. REESE: And then so in the second portion of the buildup from an assumption basis, so you throw everyone in, and then you look at -- and I'm asking the question. It will sound like I'm -- but I just need to understand the assumptions -- is then you build up and you say who in America in these 125 or 122 million households owns property or some other alternative investment that could qualify them to be an investor. Is that correct?

MS. GULLAPALLI: Yes, right. So we just look at do they have assets worth 750,000, at least --

MR. REESE: Or a combination. Not a single asset, it could --

MS. GULLAPALLI: Right.

MR. REESE: -- be multiple assets. Okay. But they can't be -- so -- but the whole criteria is they're not associated with your home. So it could be a building, it could be real estate, it could be a fleet of cars or something like that?

MS. GULLAPALLI: Right. I have assumed real estate to be included other than primary residence. But of course, based on recommendations, yeah.

MR. REESE: Sure. Okay. Thank you.

MR. YADLEY: Can I ask a follow-up to that on the same calculation? Family businesses, would they be included or excluded for the 750?

MS. GULLAPALLI: So in my calculation, I've included business interest, yeah.

MR. GRAHAM: Okay. I think Chris has a question.

MS. JACOBS: One quick question. When you were running comparisons of the percent of households 1982 forward or 1983 forward, did you do any kind of normalization for population growth so that it could appear apples to apples rather than population '82 versus today?

MS. GULLAPALLI: Yeah, so the --

MS. JACOBS: Total population.

MS. GULLAPALLI: -- population that I looked at that time is, yeah, a lot smaller. It was like I think about less than 100 million households in 1983. So 1.5 million households could be apples and oranges, but if you look at percentage of U.S. households, it is like relative to what it was at that time, the total.

MS. LUNA: So this is Sonia. I have another

question about the study. So this is an aggregate review of households. Have you thought to maybe consider looking at where those households are physically located? For example, if we start making recommendations and we find out really the people who meet these threshold are all in metropolitan cities, then what we're really saying is everybody in non-metropolitan cities have to create a network outside and go to New York, LA to find the money for those accredited investors with a new definition. Did you take a look at kind of geographic location of changes?

MS. GULLAPALLI: Yeah, we are considering those as well, yes.

MR. GRAHAM: Okay. I want to take a -- I want to offer you a short break. Let's take five minutes before we have our presenters. So actually about seven minutes. We will reconvene promptly at 11:00.

(A brief recess was taken.)

MR. GRAHAM: We'd like to reconvene. And Chris, I'll just hand it to you.

MS. JACOBS: Thank you. We have since had one of our prior members, Shannon Greene, join us.

Shannon, in five, ten seconds, would you give your background to the committee?

MS. GREENE: Ten seconds. I'm Shannon Greene,

chief financial officer of Tandy Leather Factory, headquartered in Fort Worth, Texas. We are a very small public company, run retail stores in 41 states and five countries.

MS. JACOBS: Thank you. And welcome. You missed all the other great comments. We'll fill you in at lunch.

Now we have two speakers slated to address the committee. We're going to begin with David Certner. We are pleased to have with us today David, legislative counsel and legislative policy director at AARP. AARP is a nonprofit, nonpartisan membership organization that helps people 50 and over improve the quality of their lives. With 40 million members, AARP advocates for policies that enhance and protect the economic security of individuals. David has been with AARP since 1982. He has served as chairman of the ERISA advisory council of the Department of Labor and has been appointed three times as a delegate to the National Summit on Retirement Savings.

David, thank you in advance for joining us today. We look forward to your comments. And when David's finished with his presentation, we will invite you to ask questions, comment, dialogue, and Stephen and I will then be watching the clock for us. So we -- if

you have questions, comments, we'll invite you to make them.

David.

MR. CERTNER: Thank you. As mentioned, my name is David Certner, and I'm the legislative counsel and legislative policy director for AARP, and I appreciate the opportunity to join you today to discuss the issue of accredited investor.

Let me just talk a minute about AARP's interest. One of AARP's central priorities is to assist Americans in accumulating and effectively managing adequate retirement assets. Essential to achieving that goal is helping individuals better manage their financial decisions as well as supporting efforts to protect individuals from investment fraud and abuse and erode savings and financial assets.

But at the outset, let me make clear that AARP agrees that facilitating assets to capital for new and small business is a worthy goal. Small business, including startups with high growth potential continue to have difficulty obtaining access to capital. We recognize this. And policy makers are certainly justified in exploring new, innovative ways to help them get access to capital.

However, it's imperative that we do so in a careful and deliberate fashion balancing the goals of capital formation with investor protection. AARP agrees that investors should have the opportunity to invest in small business, including emerging business so long as those investors adequately understand risk and have the financial ability to potentially absorb losses.

By definition, as you know, small and emerging businesses are risky investments. Indeed, statistics show that roughly 50 percent of small businesses fail from the first five years. Moreover, within this sector of small business investment, those startup businesses with no track records are particularly speculative and prone to failure. If efforts to promote access to investment capital for small business are to be successful, investors need to be confident that they're protected to the fullest extent possible from fraud and undisclosed risk. Such assurances encourage investment and in turn will increase the availability of investment capital.

In proposing its rules to implement the JOBS Act, the Commission itself acknowledged increased risk of fraud associated with lifting the ban of widespread marketing of securities that, by definition, are intended only for a specific segment of the investing public. Unregistered securities, such as private placements, have

emerged as one of the main vehicles for fraud involving older investors. Even before the general solicitation rules went into effect, the private placement market exhibited a significant amount of fraud.

Of the enforcement actions taken by state securities regulators in 2010 involving investors age 50 or older, cases involving unregistered securities outnumbered those related to ordinary stocks and bonds by a ratio of five to one according to the North American Securities Administrative Association. Ensuring that investor vulnerability in these offerings is mitigated to the greatest extent possible is therefore of tremendous interest to AARP.

Older investors with a lifetime of savings and investments are simply disproportionately represented among the victims of securities fraud. Indeed, under a recent estimate, at least one in five Americans over the age of 65 have been victimized by financial fraud. And I think you understand this, it's older Americans, particularly, who have accumulated assets over a lifetime, and quite frankly tend to sometimes be a more trusting population, are often the victims of fraudulent actors.

Now key to AARP's investor protection concerns with respect to the growing private securities market,

the size of which, as you know, rivals that of the public markets is this matter of who qualifies as an accredited investor and is thus able to "fend for themselves" without the protection of the 33 Securities Act. Now the 1953 Supreme Court ruling at the availability of the private offering exemption turns on whether the investor can "fend for themselves" have generally been interpreted as requiring the following four elements: one, the ability to hold these typically illiquid investments over the long term; two, the ability to withstand a total loss on investment; three, an understanding of the potential risks of the investment; and four, the ability to gain access to information needed to assess the investment.

Now these criteria seem to be generally appropriate in determining who can fend for themselves in the securities market. However, the current accredited investor definition, which intended to define a population of investors that meet the standard, uses financial thresholds based on both income or net worth as proxies for the tenets of accessed information, sophistication, and so forth. We believe this definition is ineffective at best.

For example, an individual with 200,000 in income but fewer or no financial assets cannot easily shoulder the risk associated with private offerings,

particularly if that individual was near retirement. Also an individual with a million or more in relatively liquid financial assets may not be able to withstand potential losses in private offerings if that million dollars is a retirement nest egg that has been accumulated over a lifetime of savings and must provide income throughout that individual's life.

At the same time, many individuals who satisfied the current accredited investor definition do not have the financial sophistication to assess the risks and merit of an offering based on the limited disclosures available in private offerings. Lacking this sophistication, such individuals are unlikely to be able to negotiate access to even more comprehensive information.

If the current definition of an accredited investor, as we believe, fails to effectively define a class of individuals capable of fending for themselves, then the question is: How can the definition be adjusted to better meet its goals taking into account the reality of today's investment marketplace. So let me talk about some possible approaches.

One obvious update, as we heard this morning and perhaps the simplest, is simply to adjust the existing thresholds. When the current thresholds were set in 1982, an income of 200,000 or millionaire status covered a relatively limited number of very well off people and did not affect that many retail investors. As you know, that dollar amount hasn't changed in the three decades since while inflation has brought more and more individuals within this definition, effectively extending its reach deeper into the population of those with smaller real incomes.

Indeed measures of percentage of the pool of individual tax payers, the number of individuals whose income is 200,000 or above is now 20 times larger as we saw this morning, at the time -- since the Regulation D. So raising the thresholds to account for inflation would increase these thresholds as we saw this morning in the charts by roughly two and a half times.

Now while it may make sense to update the financial thresholds, we don't believe that that approach alone necessarily will resolve the shortcomings in the definition. First of all, we don't really know with any certainty whether the Commission got that threshold right in the first place. And second, many individuals who meet the net worth threshold will do so based on a retirement nest egg that they will have to rely on to last through their remaining years.

For example, while approximately 7 percent of

all households have a net worth of 1 million or more, a household headed by 65 or older meet that threshold as do approximately 12 percent of households headed by someone between the ages of 50 and 64. While some of these retirees and near retirees may be able to absorb the potential losses associated with private offerings, others who may meet the threshold would see their retirement security put at risk as a result of losses.

Finally, the investing population has changed significantly since the 1980s with a larger percentage of financially unsophisticated middle-income individuals turning to the capital market to save for retirement than they did 30 years ago and the complexity of financial products, including those sold to private offerings, has also grown in the intervening years. And I think this is really a critical point here if you're thinking about some of these older individuals.

In 1982 when these definitions were first set, we essentially didn't have individual account plans like 401(k) plans and IRAs, which were basically just being put into the tax code. And I don't think anyone would have foreseen some of the changes that we have seen over the last three decades and how people accumulate assets for retirement moving away from the traditional to find benefit plan with basically annuity for life to now

individual account arrangements where individuals have to save for themselves through their 401(k) plans with that money very often being rolled over to IRAs.

Many of you may know that actually the amount of money in IRAs now exceeds the amount of money in 401(k) plans. The amount of 401(k) plans exceeds the moneys in traditional defined benefit plans. So we have moved almost entirely towards an individual account arrangement where, quite frankly, if you have accumulated a million dollars for retirement -- and we're going back to say a typical 4 percent rule I'd say, which is maybe throwing off for someone who has a million dollars, $40,000 a year -- this is not your high income person. This is a person who's done the right thing with their retirement savings their whole life and can be firmly established as a middle class person.

And we don't think that these are folks who are necessarily the ones meant to be under this definition in the first place. So we've just seen a dramatic change, I think, in the marketplace.

If the Commission sticks with the financial thresholds test, therefore, we recommend that we look at limiting investments and privative offerings to a percentage of assets or income and that strong consideration be given to eliminating the retirement

accounts, the net worth calculation altogether. We recognize that moving beyond the simple net income net worth test may add complexity to the definition and will make the definition's implementation more difficult. However, we believe that given the potential harm to investors, these options are well worth consideration.

As the Investor Advisory Committee, on which an AARP representative does sit, noted in its discussion, the risks associated with investing in private offerings are greatly affected by how heavily the individual invests in the offerings, so that obviously an individual with 200,000 in income who invests $5,000 is unlikely to suffer irreversible harm. But the same cannot be said if you were investing 50,000 or $100,000.

The difference in risk isn't reflected in the net worth definition either. So someone with a net worth of $999,000 can't invest a dime, but someone with a net worth of $1,000 more, a million dollars can risk it all. To us this doesn't make sense, doesn't seem logical. We believe it would make sense to allow some investments in private securities once a person reaches an initial threshold based on a percentage of income or assets with restrictions being reduced or eliminated as income or assets arise.

Another problem with this definition, of course, is that it treats the 1 million net worth the same for a 35 year-old and a 65 year-old. This, too, seems illogical. It's quite apparent that a 35 year-old who has accumulated that much money likely has more opportunities not only to make up money and make up losses that the person in retirement certainly does not. And so I do want to -- and this was even I think confirmed by some of the data that we saw this morning for the first time about retirement income assets and how much that has increased the number of potential people who can be in this marketplace. So we would strongly recommend excluding retirement income assets from this definition.

As I said earlier, I don't think anyone would have foreseen back in 1982 how these plans would have basically exploded in growth and become the main form of retirement income. Of course, even there, we know there might be challenges associated with that. People certainly could, for example, be encouraged to remove money from an IRA in order to make an investment as an accredited investor. So we would believe we would need some protections against that as well even if we were to eliminate retirement income assets from the definition.

We also encourage the Commission to consider allowing individuals to invest in private offerings upon

the recommendations of a fiduciary advisor with no direct -- who had no direct or indirect financial stake in the offering. A fiduciary advisor would have to consider key questions related to the appropriateness of the investment, including questions like: Can you withstand potential losses? Can you deal with illiquidity? Is the investment appropriate given your financial goals and risk tolerance? And what portion of your portfolio should be invested in such assets?

Finally, we agree it's worth exploring this issue also raised this morning about whether there's some way to qualify individuals as accredited investors based on their financial sophistication or knowledge and experience. Individuals who have earned certain professional credentials or have relevant professional experience may be candidates to qualify without regard to the strict income or net worth test.

We understand this will be a question about line drawing how to define this, but another approach might be to enable individuals who qualify based on their investment experience, and the question is: What form and level of investment experience qualifies? We understand that, but we believe that these are certainly questions that are worth pursuing.

In concluding, we believe that updating and

strengthening the accredited investor standard to ensure it fairly reflects the financial sophistication is a key way in which the Commission can counter the adverse effect on investor protection and efficient markets that are limiting the 506 general solicitation that an advertising ban may cause.

And as the Commission conducts its review of the accredited investor definition, we encourage you to fully explore whether the definition truly achieves the goal of identifying those investors who do not need the 33 Act protections in order to make informed decisions and make sure that their interests are protected.

We strongly encourage you to consider some of the outlines, approaches -- various approaches I've outlined as together they will better financially -- protect the financial vulnerable investors without necessarily constraining the ability of capital in the private offering market. So I thank you and happy to take any questions.

MR. GRAHAM: Thank you, David.

D.J.

MR. PAUL: Hi. Thank you for that. So just so I'm clear, the AARP is advocating for excluding retirement savings from the computation of net worth.

MR. CERTNER: That's correct.

MR. PAUL: Would AARP also support excluding the ability to invest retirement income in private placements, or is that a bridge too far?

MR. CERTNER: I'm not sure what your question -- I mean obviously -- I mean most -- you're not going to -- most people are not going to have accumulated hundreds of millions of dollars in these retirement plans. They all obviously have limits of how much can go in in the first place, but we certainly -- I mean middle-income people are encouraged to shoot for a million dollars as a goal in order to provide a 40 or 50 or $60,000 a year annuity.

So remember -- I mean I understand we have -- most of the people in this panel have come from a securities perspective. I come from a retirement income, protect older Americans perspective. We obviously have -- we have government purposes in both. We have, as you well know, a strong regulatory and tax favored sphere of retirement income assets. So it is a governmental objective to encourage people to contribute to plans.

We give them tax favored benefits, and this is all designed to ensure that people get a nice stream of retirement income. So we think that's almost a separate regime. We would very much like to see those retirement income assets pulled out of that completely. Now I think you -- I'm not sure if you were asking whether maybe we could tap some of those assets if that was your question.

MR. PAUL: If the concern is that a retirement income is inappropriate to -- or rather retirement assets shouldn't be at risk because of this so-called riskier pool that are Reg D offerings, why not exclude retirement savings from being able to be allocated towards this in the first place?

MR. CERTNER: I think that certainly one idea to contemplate -- I mean quite frankly if people have $100 million and want to also use some money in their retirement plan, I don't know if it's that big a deal, but I think the blanket rule you're suggesting probably makes sense.

MS. LUNA: This is Sonia with Aviva Spectrum. Aren't -- what checks and balances are not in place with a retirement account that should be there? For example, I thought that when someone does retire, right, and let's say they've accumulated a million dollars. Are you telling us that they could pull out 100 percent of that money without any penalties whatsoever? I mean usually there's a check and balance. You can't take out 100 percent of your million dollars once you reach a certain age. There's got to be some tax penalty, isn't there?

MR. CERTNER: Not really. I mean once you're

59 and a half, you can take your money out without any tax penalties. You of course would have to pay income taxes on any money you take out.

MS. LUNA: Then there is a tax penalty. If you take 100 percent of your --

MR. CERTNER: It's not necessarily a penalty; it's a -- you have to pay income on that money whenever you take it out.

MS. LUNA: Right.

MR. CERTNER: The sooner you take it out, the sooner you pay taxes on it. I'm not sure I would consider it a -- that's not a penalty. If you take it out prior to 59 and a half, there is a tax penalty of an additional 10 percent for taking that money out.

MS. LUNA: Okay.

MR. CERTNER: Of course, you could also be investing some of this money through your individual retirement accounts, for example, in some of these offerings, too, I think.

MS. LUNA: Right. And did your organization take a look at -- so on the financial fraud analysis that you were providing us earlier, did you take a look at how much of that was attributable to this type of offerings versus let's say other types of financial fraud that are not related to these offerings?

MR. CERTNER: I appreciate that question, and I was actually curious to hear some of the questions earlier at the panel because we don't have access to that detailed level information about which of the -- which types of securities we're talking about. And one of the numbers I cited was not aimed at this, but for seniors in general, so even those who aren't meeting this threshold.

We know that that population is a very frequent target of fraud because of who they are, how much they've accumulated of their lifetime if they've done the right things. They've obviously accumulated more than 35 year old would have in most circumstances, and also quite frankly you're dealing with issues such as mental capacity sometimes with these folks as well. So there is a lot of other issues that go into play there that make this a target population for scams and fraudsters.

So Catherine.

MS. MOTT: Thank you. Actually my question was a follow-up to that. I really was trying -- I wanted to try to understand this study with the fraud cases, like would you be able to identify like how many of them came from -- the percentage that came from brokers versus from the issuer themselves, like the entrepreneur who's pitching for money. For something like that, it would help me understand. Or how many of them were simply

fraud cases because they were excessive fees or something like that? If we could understand the study a bit more, I think I would -- because the five to one seems pretty high. I don't know. I'd like -- I'd just like to understand.

MR. CERTNER: Yeah, no that is a broader -- I'm trying to see if I can find the study here offhand -- but that's a broad issue not specific to this issue of accredited investor. But just making the larger point of how many seniors in this country are subject so financial fraud and scams of any type.

MS. MOTT: So we don't even know how many of them are just -- it was just inappropriate, it was high fees, Nigerian prince scams, or we don't know --

MR. CERTNER: This is the whole range of scams we're talking about. I can't tell you --

MS. MOTT: Is there some way you can get access to the details of that? I would very much like to see that.

MR. CERTNER: The report that I'm referring to is an Investor Protection Trust 2010 report that estimated at least one in five Americans over the age of 65, so 7.3 million seniors in particular, have been victimized by financial fraud, and we'd be happy to provide a copy of that report to the advisory council.

MR. REESE: Yeah, this is a --

MR. CERTNER: This -- again, I want to be clear that that was -- those are -- not all those people would be subject to this definition.

MR. GRAHAM: Can we get Tim and then go to Greg?

MR. REESE: Okay. Most of my colleagues are talking about the issue that's in my mind, is understanding what's -- I really recall that retail -- it's retail -- what are the retail, what are the brokers selling retail to seniors versus someone sitting in a room coming to hear a pitch by a private placement or going online to a portal and then being subject to fraud of that type of magnitude. I think that number is going to probably be important to understand that magnitude.

And then listening to the earlier presentation around -- by Rachita. The number that she showed for folks who were investing beyond their home, beyond just their home of 750,000 or so is roughly -- and so maybe these folks are below 750. Maybe they're below. Maybe they're falling into fraud at a smaller number, 10,000, 5,000. I don't know the number.

But what it showed to me if you take her numbers is that roughly 8 million -- there were 8 million households that fit the 750,000. That's 6.5 percent of

American households. So what I would be looking for is something that would show the magnitude so that we can get a better picture if it's now -- if it goes from 8 million by adding these folks who are following into these private non-retail offerings that they may produce up to 32 million or something, I think that would be important to understand that magnitude.

MR. CERTNER: And I think -- and this was the first we were seeing some of the numbers this morning, because I think the first time I think I saw numbers with -- if you pulled retirement accounts out what that would mean. And I think you saw a pretty significant reduction in the number of people.

And I think the point that I'm trying to emphasize is that we -- if you go back to 1982, the people who had a million dollars to invest was a much different story than today, that we now have what I would call middle-income people who have done the right thing through their individual retirement accounts. They've been putting in certainly -- not even hitting the 401(k) limits, but putting amounts and had matching contributions and diversified investments.

But even more than that now, I mean if you think about what's going on and even in the 401(k) universe now, if you're just contributing 10 percent or

15 percent of your salary, and it's going into a default target date fund where you're not even paying attention to this thing, and it's accumulating, getting matching contribution, individuals don't even have to manage their 401(k)s in many cases anymore. You just put them in a target date fund based on your life or balance fund, and you just let it go. These are not people who are sophisticated investors who may have accumulated a million dollars if they've done the right thing over the time who we think should really be under this kind of a definition.

And I think that's a huge number and a growing number of people, because the IRA and 401(k) market is just now hitting maturity. Right? It's been in place now for about 30 years. So going forward, I think we're going to see more and more people we hope -- we're all encouraging people to do the right thing and save more over time because we know how much is needed. But I think we're going to see more and more people who are not sophisticated investors who are not the targets, we think originally, of what an accredited investor is falling under these definitions if it's not updated.

MR. REESE: Thank you.

MR. YADLEY: Greg Yadley. When I was on the staff, we were always trying to protect the little, old

lady with tennis shoes. That was sort of what we talked about, and the wealthy widow that somebody mentioned earlier that had no financial sophistication but now all of the sudden has assets. And I think your presentation was excellent and raises a lot of good points. I think the financial fraud data will prove that much of that is, in fact, public market fraud and brokers who are calling people to make investments, certainly down in Florida, which a hotbed of fraud. That's a lot of what we see.

The percentage limitation certainly has some appeal. It's easy to understand. It's rational. But I'm troubled by what that could mean in the real world, and remember we are talking about offerings without general solicitation or up to 35 -- well, we're talking about 506(b), so there's no general solicitation. Okay.

At the very early stage of companies where the failure rate is great, most of the investors aren't solicited; they're well known to the issuer. In fact, they're friends and family. And guess what, those people are providing more than 10 or 15 percent of their net worth to their son or their daughter or their niece or their best friend.

The rationale for making those investments isn't necessarily made because of financial sophistication. And in fact, if you get the most sophisticated investors, no matter how good the idea is, the first thing that the better investors on this panel will tell you is you're investing in management, who they are, and what their accomplishments have been and what their talents are, and you're making a bet sure on the concept or the product, but also on those people.

So I think we should be very cautious in having the government set percentage limitations or take away from the calculation retirement assets and look at the effect that that would have on early stage companies and that would just be a blow if you can't go to the people that the issuers know the best for more than whatever the government says is the correct percentage of investments.

MR. CERTNER: I appreciate your comment and concern. I would just add that it's a very large percentage of the fraud that occurs with the elderly people, occurs through family members.

MR. GRAHAM: Let's go with Charles, then back to, Tim.

MR. BALTIC: Thank you, Mr. Certner for your presentation. Very thoughtful. I just wanted to ask as a matter of factual history if in the buildup to Dodd-Frank in 2010 and 2011, did the AARP weigh in in the legislative debate about the exclusion of retirement assets from the definition of accredited investor at that

time as we ultimately know primary residence value was excluded from the definition? And if you did weigh in, what was the consideration around that, and how was it disposed of?

MR. CERTNER: I don't believe that we weighed in at that issue at that time. I wish we probably had seen more of where we were headed and maybe had raised that earlier, but we have raised the issue about retirement assets in other contexts in trying to protect it, but not in this instance.

MR. GRAHAM: Tim.

MR. WALSH: Good morning. Why do you say that private investments are riskier than public investments? And how do you define risk?

MR. CERTNER: Well, I think this is -- I mean it's a good question, but if you're talking about the people I'm talking about, which is folks who really don't have the financial sophistication, then these are not even questions I think they could ask, more or less answer. So I appreciate your question to me.

I don't know if I can give you the right definitions for risk or talk about what's available in the marketplace, but for most of the people we're talking about who have grown up in a -- particularly in a retirement, income, and asset world, have really grown up

in more of a plain, vanilla, 401(k) plan. These are kinds of investments that are quite frankly beyond what they've even been exposed to, more or less really should have their money invested in.

So I appreciate your question, but I think the people we're talking about, these questions are well beyond their level of financial sophistication.

MR. WALSH: But I agree with -- you're saying -- your target audience, but as a general rule, we're not talking just retirees, but say private investments, that's incorrect. Depending how you want to -- if you look in at risk as volatility or a long-term risk adjustment return, you could probably -- two out of three private investments have done better than public investments. That's -- you can go to various different stats on that.

MR. CERTNER: Maybe I'm incorrect myself, but I was under the impression these investments were more illiquid.

MR. WALSH: As a general rule, you're incorrect. But where I think you are correct, and you did make a comment that I agree 100 percent on, is the ones that are sold through non-investment advisors and through broker-dealers, that's something I'm with you 100 percent. I mean 10 percent lows on these things with

usurious expenses, that's a different -- but to just carte blanche say that private investments are risky in my opinion is incorrect.

I invested in New Jersey and Indiana billions of dollars both in public and private, and the concept, as Greg was saying, it's really the management team you're backing. Great public ones you trust -- I mean there's a lot of poor public ones out there, too, as well as private, but that one is one that I think you're 100 percent correct on. I'd love you to spend your resources focusing on that because of the -- these -- there's many of these retail retirees and non-retirees get sold these private investments with 10 percent commissions going in and 2 to 300 basis points annuals in poor performance, too.

MR. CERTNER: I think you're just raising another issue we're talking to the Commission about right now in terms of making sure people are investing in the best interests of their clients.

MS. HANKS: Just to go back to the fraud issue, do you have any data on the correlation of fraud on seniors and whether or not they fall on one side or the other of the accredited definition? Because it seems to me that it's quite possible -- when you commit fraud on seniors, you're just taking advantage of their age and their inability to assess the situation as opposed to whether they are or are not accredited. I think a lot of fraudsters are not actually doing the calculation as to whether they're accredited or not. Any data on that?

MR. CERTNER: I don't know that I've seen any data on that, so I don't think there's any available that I'm aware of. And part of our concern, of course, here is that we think the number of people who are accumulating these sort of individual retirement accounts will be growing I the future and that we'll have more and more people who would meet the -- at least the million dollar test here, a million dollars, which is really a retirement account that we really think is not by definition of a sophisticated investor who can fend for themselves.

MS. HANKS: But it would seem like the bad guys are not going to sit down with a calculation of whether you're a one million or two million or whatever. They're just going to sit down and go you're old so I'm going to take advantage of you.

MR. CERTNER: Well, that's part of it, too. You would not believe how sophisticated some of these fraudsters are. It's just incredible how many scams -- we have a whole fraud watch network that we've been developing, and it's really just absolutely incredible to

us the kinds of things that we see and then you shut one scam down, another one grows up, and they're really incredible. They're very sophisticated.

MR. GRAHAM: D.J.

MR. PAUL: Yeah, just I think that we're talking about -- first of all, fraud, what's illegal is illegal, it's always going to be illegal, and someone who is inclined to commit such a fraud is not going to be dissuaded by raising a limitation, particularly in the 506(b) universe where it's a box check. So I'm not sure if this would -- I appreciate the goal, I agree with the goal, but I'm not sure whether or not playing with the definition, at least with respect to the dollar amount limitations, is going to have a real impact on someone who is dead set on committing fraud on -- elder fraud.

I don't think they're going, oh, okay, well now it's 2 million or whatever the number is, now I'm not going to make that phone call. So that's -- I'm not sure that this is going to achieve the end -- that this might achieve the end that -- your worthy end that you're trying to achieve.

MR. CERTNER: And let me be clear here. Fraud is obviously a problem and a big problem and one we're concerned about, but it's not just fraud. There are many things that are not fraudulent that are legal that are

just simply inappropriate. And that's really what we're talking about, thinking more than anything else, because some of the things that Mr. Walsh was referring to and some of the high fees or certainly lower returns and someone who -- taking advantage of people. Some of these things are not illegal. They're certainly inappropriate, perhaps immoral, but they're permitted, and you're taking advantage of basically investors who are not sophisticated and cannot absorb the losses if you want to go with these definitions.

MR. GRAHAM: Okay. Let's take one more question, and then we'll --

MR. LEZA: It's not a question, but a basic point. In Northern California, they did the analysis just to see on the 506 for accredited investors as what kind of fraud they were seeing. This was done about two years ago. And they basically from the data that they got, they found zero. So a lot of the scams are happening to the non-accredited investors. Okay?

MR. GRAHAM: Thank you, Richard.

Thank you, David.

MR. CERTNER: Thank you very much for your time.

MR. GRAHAM: We're going to move into our next speaker.

MS. JACOBS: Marianne Hudson. Good morning, and thank you for coming. We're pleased to have with us today Marianne Hudson, the executive director of the Angel Capital Association. The Angel Capital Association is a professional and trade organization supporting the success of angel investors in high-growth, early stage ventures. ACA's membership includes more than 160 groups and 20 affiliate organizations across North America. The member angel groups represent more than 7,000 accredited investors and are funding approximately 800 new companies per year and managing an ongoing portfolio of more than 5,000 companies. Prior to her current position, Marianne was the entrepreneurship director at the Kauffman Foundation, and prior to that she was VP of the Mid-America Manufacturing Technology Center.

Marianne, welcome. Thank you for coming today.

MS. HUDSON: Thanks so much for having me. I'm really thrilled to be here and really appreciate the work the Commission is doing. We've really enjoyed working with the staff in particular. I had the opportunity, I guess, to be at the most -- at the last meeting, so thank you for inviting me again from September. So I do come with a slide deck. I'll try to get through it quickly and look forward to the dialogue.

So just to maybe update you on the Angel

Capital Association, we have 12,000 member angels doing -- in about 208 angel groups and angel platforms. Our members are individual angels, those who belong to groups, and those who belong to accredited platforms, angel list, funders club, and organizations like that, and we're really here to help them be better angels and kind of be their voice so that they can be -- they can select the best opportunities, they can support the entrepreneurs that lead them to the best exits. And our members are in every state and actually a few Canadian provinces.

I'm going to just tell you up front we have three main recommendations as it relates to the accredited investor definition. The first one is to leave the thresholds -- the financial thresholds as they are. We think they work well, particularly in the angel field, and I'll have some data to talk about that, and we're not seeing fraud in our area. And we really believe that if you increased those financial thresholds for inflation, it would have a huge impact on the market, particularly for the startups that create the jobs in this country.

The second one is to consider adding sophistication criteria to grow the base of individuals who don't meet those thresholds, but to make sure that

you put things together that are somewhat simple to administer and that the market understands and to make sure that there's multiple criteria that are available so you don't hem certain people out of being sophisticated.

And the last one is to I guess really expand investor education that's available, make it free, and make it easier for more people to find it. So I'll come back to those in more detail in a little bit. But if we just think about the life of a company, they're getting money and growth throughout the time. So as they're coming up with ideas, they're working with their own money, the friends and family, which actually we understand to be something like $60 billion a year to support those organizations.

And then as they grow, they start getting capital from angels and angel groups, seed funds, and then once they really have a product ready to go, they might be getting venture capital and moving onto a lot of other institutional equity. Now hopefully, eventually you get -- start working with the investment bankers down the way there so that they're acquired or go public.

Maybe to put in context a little bit, too, I'm talking about an estimated market really of $25 billion which we think of as real important money and certain venture capital which is about the same size. I know

we're really talking about private offerings on the equity side. Private equity is probably pushing $350 million. And if you're looking at Reg D or private offerings, I know it's more than a trillion dollars. So yes, we are a small piece of that, but we think we're pretty important in there, because we are driving most of the startup funding that's available.

Estimates are last year that angels invested about $25 billion and about 71,000 deals. Actually there might be more -- fewer companies there. Majority of net new jobs really come from those startups, so companies are less than five years old, and most of those are getting their capital from angels if they have equity capital before they go to the VC round. And we believe that angels provide about 90 percent of the outside equity raised by startups. So after friends and family, angels are putting in that money. And then we're hoping that the companies that do well go onto VC money to expand.

We're taking our own money and making our own investment choices, and while data is still developing on angel investing, there's somewhere between 200,000 and 300,000 angels across the country pretty much everywhere. And we really think that these startups are important that I just talked about because they're creating the

most net new jobs in the country.

This is a chart from the Kauffman Foundation from a few years ago looking at 25-year timespan, really found that the blue is the job creation that came from startups, and the red is from job creation from everyone else. So really it's -- if you take out the startups, we're actually losing jobs even in some good economy years.

So we're focusing on the startups, and then we're combining with the venture capitalists to take the most successful startups and really expand where they're going, and so we're helping create those billion dollar companies that are creating jobs pretty much as we come out after the fifth year, and a lot of those companies are some of the brand names that you've heard about. So angel backing started groups like Facebook and companies you may not even kind of think about that much like Home Depot or Best Buy. But a lot of them are tech or life science based.

And just kind of quick thing to think about where startups get their funding, angels and venture capitalists are investing about the same amount of money per year in total, but we're seeing that angels are making smaller deals, so 71,000 a year as opposed to venture capital, which is about 4,000 a year. So they're really focusing on the expansion capital. And I think these slides will be available for you at some point.

Another thing to think about is that a trend in angel investing is the formation of angel groups where people typically in one community kind of pull together to look at investments together, learn from each other, and combine their capital and find a way to work with the companies together. In fact, I'll talk about that a little bit here.

So if we think about it, sophisticated angel investing is really hands-on work. So we're not just writing a check. We're providing ongoing support, mentoring, we're on their boards, we're helping them figure out getting customers, finding the right people and additional capital as they grow. And we're working hand in hand. We're part of the ecosystem of these communities. We're working with universities' economic development, accelerators and incubators and figuring out a way to support these companies throughout their life cycle.

But we're really focusing on having the best practices for active deal and risk assessment. So we're taking in deals, and we have strong processes to look at how these deals are going to work. Do they have the right entrepreneurs? Do they have great markets to grow?

And so that does mean that we're funding probably few than 5 percent of the opportunities that we're seeing and really understanding from our own experience how we can support those companies.

So we're really seeing almost no fraud in what we're doing based on the processes we have, the relationships that we have. In fact, it's kind of hard to prove a negative. I just really haven't seen fraud in our industry. I've taken a few calls in my job over the last ten years about fraud, and the couple times I can remember, it was entrepreneurs who are approached by people representing themselves as advisors and thinking something sounded funny in what they were hearing about fees and a couple times a similar situation on the investor side. So we're trying to be able to give them the best information that we can and follow your gut if you're calling me about that. But we're just not seeing the fraud.

We're also working on extensive due diligence. We have put together a lot of education on how to do that and really understanding the entrepreneurs doing background checks and understanding their capabilities. And then also putting together the terms of the deal, so the issuers aren't setting those. We are, and we're negotiating those together. We're making sure that we

have information rights, and typically if we're enough into the deal -- we're on the board or an observer, and we're just working directly between the investors and the issuers. We're really not working with intermediaries.

And finally, I mean I think that's a way that groups are working. We're seeing accredited platforms are working very well, too. They found super experienced angels who are doing a lot of that work and allowing some smart people to follow on with them with additional information. And we're finding kind of over time -- some studies from Harvard and MIT are finding that when we as angels get involved, the entrepreneurs are going to be a lot more successful.

So we do have -- I'm going to click through this very fast. We do have a couple stats just to kind of get you kind of a background on angel group investment. And it's called the HALO Report. It's now a three-year study that comes up quarterly that's a combination of the Angel Resource Institute, CB Insights, and Silicon Valley Bank. I'll just show you a little bit. So for -- we're just looking at 2013. It looks like the average-size angel group deal is about $600,000, or if we co-invest with a venture capitalist, it's just under a million dollars. And it's been that way for the last three years.

Where we invest -- this is a map from 2013 -- you can see that angel investing really is not just in the typical venture areas of California, New York, and Boston. It's really all over the country. That's both by deal and by dollar. That's one of the reasons I love being an angel investor.

When you look at the sectors that we're in, this is kind of a busy chart, so I'll make sure you have copies of this to look at, but the point is that internet, kind of IT, healthcare, which would be both -- internet, healthcare, and mobile are two-thirds to three-quarters of our investments for the last three years, and it's flipped a little bit with growth really coming in mobile. And so we're really looking for the kinds of companies that can scale and deliver some returns. And that was in terms of deals. This is in terms of dollars, and the numbers really go up. So last year, those three sectors that I mentioned were 80 percent of the deals in this data set that we have.

The other thing is we're really trying to make sure we have good data and best practices that we can learn from. This is a somewhat old study, but this is what we know about risks and returns for angels. So this data set had I think more than 600 investors who had done more than 3,000 deals, but about 1,300 of them had exited at this point, good and bad.

So we found in this dataset that 52 percent of the investments had lost some or all of their money. The businesses went out of business. And -- but they did that in three years or so, whereas over to the right, just under 8 percent of those deals had a 10X cash-on-cash return or more and provided the vast majority of the return.

We were able to kind of look at that as a portfolio in understanding the IRR, but I think the point we wanted to do was really understand the risk that was there, and the education we've pulled from that is if you as an angel investor could understand the risk that's there we're recommending that you make multiple investments and use certain processes that are there. And if we had more time, I could show you more of what we've learned, but we're really trying to build from data and understanding and hope to have a new study next year.

So that's just a little background on angel investing. So let me just get to a little bit about the impact of the definitions that we're thinking about. So if we think about the regulatory objectives that we've heard, I think we've heard a lot about that today. It's about investor protection, it's about capital formation and just good integrity in the market.

I think our goals are somewhat similar, but I'll kind of take them out a little bit more. So we want to make sure that knowledgeable investors that fund startups can keep doing that because we think it's important to job creation and the economy. And we want to make sure there aren't undue obstacles for that relationship so that we can keep funding those important companies. And we want to make sure there's good education and best practices to make sure that the number of sophisticated investors grows.

And if we look at 2010 Dodd-Frank, we think about that, I think we find that removing the primary residence that started the conversation in 2010 and came into effect in 2011 was a major shift. The data we've seen was that that cut back about 20 percent of eligible households that were there. I guess the other things I'd want to remind you is that the act asks the SEC to review it, and I think it sounds like we're doing some really good work there, but not necessarily to alter it. Take a look at that combination of investor protection, public interest, and the economic environment that we're participating in.

So I'm going to go back to those three recommendations and put a little bit of data behind it. So our first recommendation, again, is to leave the

thresholds alone. I think I've talked a little bit about that. We really do think the issue is it would have a major market impact and reduce the pool of capital for entrepreneurs that we think are incredible important for the economy.

So we actually took a look at our own data, our own membership. We did a survey about a year ago. We had 109 accredited investors who are writing checks. They're located in 41 states and a great range of ages. I believe the average age of investor here was 58, 58-plus, something like that. So we found if you raised them for inflation, which we understood to be 400,000 in income and 2 and a half million in net worth, we found that a lot of our members did continue to qualify, but that there would be 28 percent that would no long qualify. I happen to be one of those people. So I guess I have a personal interest in making sure that that doesn't happen. But we try really to have our data and really compare it, who met one or the other or both. So we do skew a little bit larger than the numbers that we saw this morning.

We also wanted to understand what the impact would be if it was raised on a geographic level. And so what we really found is that if you were in California, New York, or New England, that took out about 26 percent

of the investors, and if you were pretty much anywhere else in the rest of the country, that would affect 32 percent, so basically a quarter versus a third, which we think is a pretty big deal in important parts of the country.

Kind of as an aside, too, we also saw a skewing that the impact would be a little bit more on women and also younger people. So we found that there was an average age of about 48 for people who were qualifying by income, but not net worth. And they seem to have been impacted just a slight amount more, so something else to think about as I think a lot of younger people are starting to get involved in supporting startups.

We also thought we'd take a look at some of our members and what they did. So AngelList is one of our members, the largest accredited platform. They have created a term they call mere accredited, which I guess I'll say is just somebody who meets the -- who's at the lower end and would be basically wiped out if they had -- they have less than $2 million in net worth. So they found that they had about 46 percent of their members who qualify by net worth just at kind of $2 million or less, and I think that funded about 23 percent of their investments.

Our second recommendation is to think about adding sophistication criteria to expand the class. We really do think there are some smart people out there who are left out, or I suppose I put it this way, too. If there were some changes to the thresholds, perhaps this is a way to make sure you keep the class at the same size as it is. So we're talking about people who have -- who really understand the industry. So they've been on a board or an executive or financial responsibility -- P&L responsibility at a for-profit company. Or they've got relevant degree or training, so they've been in a -- they've had MBA finance training, or they have some certification, CPA, that kind of thing, previous investment as a Reg D offering, and membership in an established angel group, which has the strong processes I've talked about not just in investment, but how they make sure that their members are accredited.

And we think it's important to have a simple way to look at the sophistication. So have them certified via detailed questionnaire -- this is information we've provided to the SEC before -- just to validate the sophistication and just make it reasonable for administration. The other point would be once you've done one of these things from experience or education, you're accredited for life. No need to kind of continually do that.

This is not readable, but it is kind of a -- basically what we actually submitted to the SEC before as a potential certification form. So kind of somewhat similar to the past self-certification, check the box. But you could probably add with that easy checks, like these days it's easy to see things by LinkedIn and other publicly available databases. And we think -- maybe this is not only common sense, but common ground for thinking through sophistication.

Maybe this does work for a lot of people with different views on this issue. From the same database and the same research that I talked about about a year ago, this is our membership. We took a look at, well, how would we meet some of these requirements. So we really found if you take away past investment, I think it's 95 percent of our members would hit one of those criteria that I talked about. So they've been a board member of a for-profit entity more than 60 percent, or they hold a business degree, which is more than 50 percent, and certainly more about two-thirds have held a C-level position or a P&L position in a company. So I think those are common sense and easy things to work through.

AngelList looked at similar sophistication and really found that a lot of its members had a lot of past

experience from founding companies to being tech execs to founding companies. They're entrepreneurs, and they understand the class.

Our last recommendation is really to think even more about education. It was neat to hear this morning about the partnership between the SEC and SBA to do a lot of education, and I know there's a lot more out there. But if we could just think creatively about more ways to get education to the people where they are, easy and free, I think that brings more education. An example is the Kauffman Foundation's Investor IQ program, which is a free web-based program that really helps you understand where you stand sophistication-wise now, what your gaps are, and then provide you some education via reading and some really cool videos. And I'm sure that there's a lot of other things that could be done there. But we need to think more about how do we get that information to the right set of people.

I would also just comment that the 506(c) issue or verification does complicate things and has us thinking the way we are. So if you just think about the verification that's required there, you already have to kind of think about how you're going to verify whether somebody is an accredited investor. And so if I think about some of the other limitations that we've talked

about today, we start thinking, well, how are you going to verify that. And so that makes us want to be I think a little bit more simple in our recommendations, and it probably relates to just a few comments on the Investor Advisor Committee recommendations.

I think removing retirement assets from the net worth calculation is very problematic for us. There's a lot of sophisticated angels who invest in those -- through their accounts, and you'd be surprised of the people who do that, and many of them have been advised by their tax experts to make those investments through Roth IRAs or others. And remember, we've got a lot of them that are in the older categories. So I do think that would wipe out a lot of people, and it would already take out a lot of people who already make their investments through that.

Kind of two other things to say. The IAC did recommend finalizing the proposed rule about Regulation D and Form D providing 15-day advanced Form Ds, et cetera, and we think that that is unworkable in the startup arena. It might work in other areas, but we would not like to see that. And any other thing we would say is if the SEC did decide to make some big changes, we do think they should be phased in gradually so that there's not a huge disruption of the private market. So kind of think about that.

So thank you for your having me be here. I think we really believe in keeping the thresholds as they are. We like the idea of sophistication and education, and I'm here to take questions.

MR. GRAHAM: Thank you, Marianne. I'm sure we have some questions.

Sara.

MS. HANKS: A quick one. Do you have any data on ACA members who do hold their angel investments through retirement funds?

MS. HUDSON: Not very good. We have anecdotal information. Unfortunately we did not collect that in the study I had, but probably one we could do down the road.

MS. HANKS: Be nice to have.

MS. HUDSON: I agree.

MR. GRAHAM: Charles.

MR. BALTIC: Thank you, Ms. Hudson. Very comprehensive and informative presentation. I noted the data around the job creation from the companies that are fostered by angel investments and also the data around geographic diversity or dispersion of angel investing. I was wondering if you had a perspective on institutional VC capital in terms of geographic dispersion. My own

experience is that it's heavy concentrated on the coasts, much less evenly balanced than angel capital, and I'd like to know if you have a perspective on that and how that relates to balancing out economic development nationwide as opposed to in centers of financial --

MS. HUDSON: No, I mean I think I agree with you, and I think the data shows that the vast majority of venture capital is in Silicon Valley and Boston with some growth now happening in New York, certainly in Southern California, and then little pockets here and there throughout the rest of the country. So I think what we're finding is that in a lot of parts of the country, companies that need those next rounds of capital either are having to connect up with a really friendly VC who's willing to travel where they are, which isn't that many, or they're having to move out to the coast, which disrupts kind of local economic areas.

Or what we're really finding is angels then are working together in groups, and they're syndicating between groups. So you're now seeing maybe 75 percent of angel group deals are syndicated between three, four, five angel groups, family offices, and individuals so they can come up with the capital that the entrepreneurs need. And so the economic development communities are trying to make sure that they have enough angel in those

-- angel groups in those communities so they can support those companies. And we're starting to find that angel groups are around up several rounds and are really the support for those companies.

MR. GRAHAM: Dan, did I --

MS. HUDSON: Did that answer your question?

MR. BALTIC: Yeah.

MR. CHACE: So it sounds to me like angels are a relatively sophisticated subset of the broader Reg D market.

MS. HUDSON: Correct.

MR. CHACE: And so you see them as a proxy. How do individual angels treat the typical investment in terms of dollars? Like what's the median? And how many of -- how diversified are they across investments?

MS. HUDSON: So I think that is -- that range isn't known exactly, but I think the typical individual investment would be somewhere between 5,000 and $25,000, but the range can be quite wide. So you'll find in a group -- so the typical investment is $600,000. So that's a lot of individuals, and it's probably four or five angel groups. We're seeing -- in my angel group, which is the Women's Capital Connection of Kansas City, I think the average individual investment is $14,000 per person, but the minimum investment is $5,000. And we're

seeing that happen in some groups. And on the AngelList, I don't know what the average size investment, but the minimum is 1,000.

MR. GRAHAM: John.

MR. HEMPHILL: Hi. Thank you very much for all this information. It's really very enlightening. I -- one question I have for you is you mentioned -- a lot of people have been mentioning extending the definition of accredited investor to have some sort of concept of sophistication. What about extending the definition of accredited investor to basically take account for certain types of transactions?

For example, where you have a lead investor who is sophisticated that is taking up 60 percent of the deal, and you have 40 percent, and there are limitations on who can invest in that 40 percent. But the fact that you have that lead investor that's doing the diligence, that is making sure it's a good investment basically makes the other 40 percent deemed accredited even though they may not be accredited. There have been certain -- in the history of the creation or the -- looking at the definition of accredited investor, sometimes those types of things have been looked at and rejected.

MS. HUDSON: Yeah, I don't know if I'm familiar with that specific one. I think that certainly happens in a lot of deals where everybody is accredited by current definitions, but you do have a leader that's there. I guess that sounds more complicated, and again trying just to figure out how you would verify and really make that work practically -- it just seems a little bit more difficult in the market. But I think in some ways it describes how a lot of angel deals happen right now.

MR. HEMPHILL: And what about, for example, friends and family rounds which most people start their business by using their Rolodex or whatever, their LinkedIn. So it's people that they know. So having some sort of preestablished relationship even though those people may not meet the dollar limitations, be it income or net assets. Are you in favor of that type of accreditation for those types of offerings?

MS. HUDSON: Well, I mean I'm in favor of making those deals happen some way whether they're accredited or not. I mean I think angels want to make sure that those startups can get backing from friends and family first. If they can't sell them, why should we invest, right? But whether they're accredited or not, I don't know. Right now they're not, and we figure out ways to make sure that the deals can go forward. And so a lot of those investments may or may not be equity investments.

MR. GRAHAM: Sonia.

MS. LUNA: I really appreciate the PowerPoint. It was really comprehensive, and I want to compliment you on the great job you did. The data point that struck me was that 20 percent of folks that are currently accredited investors would be eliminated if we were to adjust the definition to inflationary rates offered.

MS. HUDSON: Right.

MS. LUNA: Okay. But they would be back in the pool if we extended the definition, correct, with education, experience, investment experience? Is that correct?

MS. HUDSON: If that's --

MS. LUNA: In other words it would balance.

MS. HUDSON: Yeah, if that was a choice, yeah, it could work.

MR. GRAHAM: Catherine.

MS. MOTT: I'm going to maybe make some comments because I'm a member of the Angel Capital Association, and I'm a former chairman of the board of the Angel Capital Association. So let me talk about, if I could briefly, about the 32 percent that Marianne referred to as the middle of the country, the flyover, the 32 percent that would be eliminated.

In Pittsburgh, I have doctors and attorneys in

my group that probably make somewhere around $250,000 a year. If it was raised to $450,000 a year, I would -- I could lose those members, and we think it's about 30 percent of our membership. Doctors, physicians in our region, where in New York City they would make 450,000 or 500,000, they make 300,000 in Pittsburgh. So what's representative of Pittsburgh is also representative of Louisville, Kentucky and Oklahoma and some of the other middle --

MS. HUDSON: Kansas City.

MS. MOTT: Kansas City. Same thing with net worth. So I can just reinforce that point. The other thing I think Marianne, one of the things that 2007 study that Rob Wiltbank did is the return on investment with the higher -- with the greater amount of due diligence that was done. And that's one of the things that angel -- angel groups, if you ask me today, act a lot like small VCs. We use the National Venture Capital Association's due diligence checklist. We use their term sheets.

75 percent of our deals were syndicated last year, and it's all because we were able to use the same term sheet. And it looks like a Series A term sheet. And so this ability, this sophistication that has been brought by the industry coming together under a

professional organization as well tends to decrease our losses because of the amount of due diligence that we do.

The other thing I would like to point out is areas like Pittsburgh do not have a great deal of VCs. I mean I started a fund last year. It's a small $30 million fund to be a follow-on, to be a Series B round, because there is a dearth of VCs in our region, and we do see VCs come in and pluck them out and take them out of the region. I mean as angel investors we might -- that doesn't hurt us so much, but it does hurt the local economy.

So one of our deals I was mentioning earlier to Charles is a company called ALung raised $65 million. It's a medical device, by the way, that got compassionate use approval by the FDA and saved the life recently of a transplant patient at the University of Pittsburgh, kept him alive for 22 years because he could not be intubated. And 60 million of that 65 million came from angel investors. We have stayed with that company as it continues to get its approval and continue to make a difference in the marketplace, but that's because we don't have 35 VCs in our backyard, and we know this company, we follow it, it's a spin-out from the University of Pittsburgh, and it's received a lot of NIH money. Thank you.

And SBA, SBIR money, so this whole idea of the impact that I guess I'm trying to make here is that the impact on our community, our local economy is very important to Pittsburgh, and changing the accreditation standards would impact my region more so than it would impact New York or LA or San Francisco. Thank you.

MR. GRAHAM: Thank you.

Tim.

MR. WALSH: Which Tim?

MR. REESE: Walsh. Thank you. I have some questions. Obviously I'm familiar with your organization and everything, but I'm sitting here to kind of -- we're going to get a -- we'll have a chance to opine on this, so I don't need to sell you on it. But do you have any idea of what the impact is to minority startups if the dollar threshold was increased? And I will make the caveat because I do know that they are less prone to have friends and family money to get their businesses off the ground and they tend to turn to SBIR-type funding. So can you talk to anything about that?

MS. HUDSON: Tim, you might probably have a better idea of that than I do, because I think -- there's not good statistics right now on minority entrepreneurs receiving capital, but I believe it is less than 5 percent of angel capital is going to that right now. And

we're really trying to work to get more minorities involved as angel investors, as smart ones so that we can build that pool. So -- but I would imagine if they're not getting it from friends and family, then angels would really be the top amount that they're getting, but the number needs to grow.

MR. REESE: Thank you, and I have a follow-up question. And you talked about portfolio theory to a small degree. Can you inform us on what is the average portfolio balance you should have? I don't mean by sector, but in terms of investments in order to start seeing some returns, do you have an idea of how large a portfolio?

MS. HUDSON: Everybody's got a different theory. I think we generally recommend that an investor has at least ten investments over eight to ten years and that that probably should get them to the chance for a decent return. I think there's some others who would say it's a larger number, but for me I think it's ten, and I think that fits with the data and the research that we have.

MR. REESE: Thank you.

MR. GRAHAM: Mr. Walsh.

MR. WALSH: Thank you, Steve. First question is for Marianne, but also for possibly Julie, Sebastian,

and Keith as well. You had indicated on one of your slides that you were opposed to the elimination of retirement assets for accredited investor because you thought it was important for someone to have the ability to invest with retirement. That's not my understanding of what the potential proposal is.

It doesn't mean you can't invest in your -- it just means you can't use it to see if you're clarified as an accredited investor, correct? So you could still -- you could -- if you had $5 million and you had $2 million in retirement assets, you could still invest -- or the other way around. You could still invest from your retirement as long as you're under the -- over the cap, correct?

MR. GOMEZ: That's right, Tim. What we've heard from commentaries is the idea that they would not count towards the determination of accredited investor --

MR. WALSH: Right, but you can still invest from that.

MS. HUDSON: You could still invest from it, but I guess the other point really is that would wipe out a lot of potential investors. It certainly would wipe me out as an investor.

MR. WALSH: I'm not disagreeing with you, I just want to make sure I'm clarifying. And the second

part is the inflation adjustment -- I still -- I'm still trying to find out why in 1982 it was a million dollars. It makes me think of the Austin Powers and the Dr. Evil with the -- (laughter) -- where that number came from, so I'm not sure why we're using that as the focus. And then the other concept of be it 4 and a half million dollars today seems very penurious. It would actually take a lot of investors out. But hypothetically if you took those numbers to 200,000, 300,000, a million dollars, and you used next year as your inflation adjustment, would you be opposed to that? I mean the numbers are the same, and then it goes up 2 percent or 1.5 going forward. It seems to me that might be a nice compromise.

MS. HUDSON: It would be -- I guess you could talk about -- I mean we're coming from the same place that you are, was 1982 or 3, did they get the numbers right.

MR. WALSH: Well, it was a long time ago, right.

MS. HUDSON: When we were involved in the Dodd-Frank discussions four years ago, one of our points was how do we know that that was the right number. Maybe they were just starting to get to be the right number.

MR. GRAHAM: D.J.

MR. PAUL: I just want to -- I had one point kind of already though we've hit it already to some extent, which is your membership -- correct me if I'm wrong -- is by definition sophisticated. They understand the investment set they're in. If there were, therefore, and just leaving aside the financial test, some sort of written test, some sort of test to demonstrate that they are as smart and sophisticated as they must be in order to participate in your organization, that would mitigate all of this. It would then be 100 percent of your membership if we could come up with some sort of test for that.

MS. HUDSON: Maybe. Yeah, I think that that takes away some of the simplicity and some of their already existing things. I guess you could talk about tests or exams or whatever, but I think you're -- just your past experience and just being able to validate that is simpler and keeps the pool larger.

MR. PAUL: I mean there's precedent for it, it's just I wanted to note that at some level we all -- any of us have a brokerage account, you can pretty much, once you set it up, invest in anything except options. Options then we have to kind of opt into answering some questions which ask some of the questions that you're talking about. But I'm talking about something like that perhaps in a bridge version of the Series 82 or something

that actually is specific to this --

MS. HUDSON: Yeah, I guess the devil's in the details and how difficult is it and all those kinds of things.

MR. PAUL: Thank you.

MR. GRAHAM: Anyone else? Yes, Catherine.

MS. MOTT: I'd venture to say, D.J., that the members -- 65 members of Bluetree Allied Angels, if they had to take a test, they would say I don't need to do this. So I mean it's like, wait a minute, I've been doing this for some time. If I had to take a test to continue doing this, it's like why bother because this is only 10 percent of my total investment assets anyways. I'm doing this trying to enhance my opportunity to create more wealth for myself. So I don't know.

MR. PAUL: Well, also I know that your membership also -- it has pushed back on having to -- and perhaps appropriately or not -- for 506(c), actually verify what their income or their net worth is. This would mitigate that as well. So maybe the lack of intrusion into their financial matters, maybe they'd be willing to take a 20 or 30 question multiple choice test, which I'm sure it happened to be a very long time ago since the last time they took --

MS. MOTT: If it was that kind of a test or --

because I've taken the 7 and 63 many years ago. So -- but if it was that kind of -- if it was an easy -- again, the devil's in the details -- would be the important thing.

MS. HUDSON: Then yeah, I think you're on -- keeping that balance of ease and the impact it's going to have on the market with the sophistication is clearly something you'll be looking at and something you guys are spending a lot of time on, so it's important.

MR. GRAHAM: Keith, did --

MR. HIGGINS: Yeah. One question I had, Marianne, was does the Angel Capital Association have a view on the percentage limitation -- applying a percentage limitation to one's ability to invest in a particular investment.

MS. HUDSON: I think our view relates back to that verification thing. Well, it's two things. It's one that does -- it doesn't compare to other kinds of investment. It feels a little bit like a loss of freedom or something like that, but it's really about, okay, if you do that, how does the issuer or whoever verify -- what are the other things it requires. So it makes it just less practical, more complicated for everyone, which could have an impact on the capital pool.

MR. GRAHAM: Anything else from your end, guys?

Okay. Catherine.

MS. MOTT: I was busy talking to D.J., so I think, Keith, your question about verification, the -- one of the things that individual -- was the question about --

MS. HUDSON: Making an investment --

MS. MOTT: Never mind. Maybe I'll just go ahead and finish my comment. So since I brought it up, the verification issue amongst angel investors has been -- it makes them very, very nervous about handing over their tax returns and their private, personal information to entrepreneurs, and how do they know it's going to be guarded and protected and what -- and so. That's what -- the thought I was thinking about.

MR. GRAHAM: Okay.

MS. MOTT: Sorry I missed your --

MR. GRAHAM: Javier.

MR. SAADE: Hi, Marianne. Good presentation. Nice to see you. Not a question, just some comments as an observer. We are focused on the investor discussion because this is the SEC, and we're talking about accredited investors. But at the end of the day, just remember the economic development side of this, and my point is somebody brought up racial minority gaps, women-owned minority gaps, they're getting more than 50 percent of the degrees, way more in the STEM field. They're not raising the capital through any avenue.

You can look at gaps, geographic. Somebody was talking about venture capital concentration. Four states manage 80 percent of it. And those same four states get 80 percent of it. So there is some significant needs, and one of the reasons I think we're having the discussion to figure out the solution. So I don't want us to -- this is just my humble comment. I don't want us to lose sight of the fact that what we're trying to do here is, yes, maybe expand, maybe contract, maybe look at the investor pool differently, but really it's about getting more money to where it's needed, because it's not going, because the assets have been -- 2008 was something we don't want to repeat.

That consolidation that has happened in banking, five control half of the assets. The other 15 control another 40 percent. So 20 banks out of 7,000, right? So they're not lending to small businesses. It's a very tough situation. Similar things have happened in the alternate investment space. So I just don't want us to lose sight, and that's my comment of what ultimately this is about, which is in a prudent fashion with all the bells and whistles and the controls you need to make sure that as many constituents as you can make happy you make

happy is that the capital is not flowing to the small businesses, and that's just a quick observation from this discussion.

MR. GRAHAM: Okay. Well, thank you for that, Javier. And with-- oh, we have a couple of minutes if there's more -- anyone has another question. Okay, with that, then we're going to break. Thank you --

MR. YADLEY: Wait --

MR. GRAHAM: What -- oh, Greg?

MR. YADLEY: I was just going to say on the percentage limitation, Keith, one of the comments, Marianne, that you made that as quite helpful was in response to how many investments. So the percentage limitation, if you don't win on the first one, you may be out of the box permanently or for a long time, so I think that that is one that would be very hard to sort of regulate, okay, well you can only have this percent, and so if you lose one, so you get one more chance.

You get three balls for a dollar, but -- (laughter) -- but another three for 50 cents. So I -- again, the devil is in the details, and the practical effect, as Javier said, is that we're just reducing the pool of money. The education part that shows great promise, and of course that's sort of baked into the crowd funding legislation and the SEC spends a lot of

time and actually in some of the materials that we all got, one of the things I looked at was the actual exclusion from the House.

And I remember when that was being proposed and drafted and how many different ways you could say that. And the explanation that the SEC has in plain English in about five lines makes it very clear about how that's treated as an asset, how liability is treated. So I think you can get there. One of the things that the gentleman from the AARP talked about is all the changes in the marketplace, and those certainly provide the background.

On the other hand, the ability of plain English information that people can get today leaving aside whether Wikipedia tells it truthfully or not -- truthiness as well -- (laughter) -- truthfulness, there's a lot more information that the average person can get, and a lot of it is more convenient and more useful than the footnotes or the financial statements of a public company that are nearly impossible to read, for me anyway.

MS. HUDSON: Great stuff.

MR. GRAHAM: Okay. So with that, we will conclude. Thank you, Marianne.

MS. HUDSON: Thank you for having me. Thanks.

MR. GRAHAM: That's all very helpful. What we're going to do now is we're going to break for lunch. We will break until 2 o'clock. In about five minutes the members of the staff will take the committee, the committee only, upstairs for lunch and some administrative matters. So with that, we're adjourned.

(Whereupon, at 12:29 p.m., a luncheon recess was taken.)

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

MR. GRAHAM: Can I ask people to take their seats? Let's get restarted. As we were saying at lunch, the primary focus of this committee has to do with the capital formation and investor protection, and that, of course, leads us to 506 offerings and the definition of accredited investor. So we want to just kind of kick things off for this afternoon, and then get everyone's point of view. It's -- without really expressing a view or just kind of making some observations. I just -- sometimes I wonder if there's a problem with the current definition.

I think we heard from a number of people mention is the whole concept of thresholds the appropriate one. Is there anything wrong with the 1982 numbers? Is there anything right with the 1982 numbers? Was anything write in 1982 about the 1982 numbers? So it's -- and what does that have to do with access to information in any event, whether it's -- whether you've got $200,000 of income or 300,000 or 750? Does that really solve the problem that we're attempting to solve for? I'm not sure if there is an answer. I think we have a riddle before us.

There are lots of thoughts, lots of ideas, but again, I also come back to the question I think we should ask ourselves, and that is: To what extent is there actually a problem? And we hear about fraud, and we're all interested in preventing fraud. Nobody is in favor of not preventing fraud, but there's lots of -- again, there's lots of information that is being floated around, and I still wonder to what extent is fraud actually implicated in the context of private placements to friends and family.

It's too easy to kind of paint some of these pictures with a broad brush. And we can talk about raising the thresholds, and if we talk about raising the thresholds, how much does the absolute pool of accredited investors decrease? And how much does the actual -- or how much does the absolute pool -- and then how much is the actual pool? I don't know. I'm not sure who does know, but I think one thing that we can quantify is how much investment is made in this context, and I think we

can kind of get a pretty good sense, too, of how much job creation results from the investments that are being made.

And so again, these are observations. We can -- we're about to have a conversation about it, but I do sometimes worry about when you're -- not to say that this is where we are, but if you're in a situation where you have a solution and you're kind of looking for a problem, you've got to be careful about unintended consequences and putting ourselves in a position where we run the risk of doing significant harm to an ecosystem which is clearly important to the economy and in many ways seems to be working. That's -- these are just some of the things that are going into my mind, and I'd like to open up the floor for comment. Who wants to go first?

MR. YADLEY: Greg Yadley. I'll go first. I think you've teed up the issues pretty well. It is a perplexing issue because if you start from a posture of wanting to ensure investor protection, you would end up one place, and if you want to start with promoting capital formation, you'll end up in another place. I think the place we should start is where we are today. S it's interesting to consider whether a million dollars and $200,000 and $300,000 were the correct metrics in 1982.

But it doesn't really matter. That's where we're starting today, and I agree with your observations, Steve, that there have not been pervasive abuses in this area. And I think it's worthwhile to talk about. In part, I think it's because in a private placement the way we think of them, there is a relationship between the issuer and the early investors, particularly in the friends and family round, and there is trust, and there is the ability to get information, which, again, where the whole exempt offering, who needs to be protected started. There's a reason for people to trust one another.

The gentleman from AARP this morning said a lot of abuse happens in the friends and family situations. Well, that is true, I'm sure, but I don't think that the Securities and Exchange Commission can necessarily regulate how families interact. So I think the numbers are what they are. It was very persuasive to me to see the data from ACA that would show the steep decline in the capital pool if we added the inflation adjustment. So I don't think that's a good idea. I think we ought to keep the numbers where they are. The idea of excluding certain assets has some appeal.

There was a significant reduction in the investor pool when the primary residence was taken out.

But when you get into the area of investment assets, that becomes problematic because at some point at age 65 or whatever, almost all of your assets are retirement assets because that's what you have to look forward to. Presumably at that point you've paid off your mortgage and you've sent your kids to college and your net worth is your net worth. I've already stated today that I think some of the percentage limitations would produce other issues.

The idea of adding to the definition the sophistication qualifications, in a way I mean that's already supposed to be there. It's certainly there in Reg D and all of the rules, and it's there in the case law if you're trying to do a private placement under Section 4(a)(2). I think guidance as to what might be under the facts and circumstances of a particular offering, credentials that would indicate sophistication would be good. But I think for the SEC to be prescriptive would not be good.

I think the Commission and some of its recent rules, including in the verification area for 506(c) wisely tried not to be prescriptive. In response to public comments, the SEC gave more guidance than it originally intended to, and I think the Commission was proven right because a lot of people aren't using it because they still believe that if they're not within the safe harbor, they're on their own despite what members of the Commission and the staff have tried to encourage. But it would certainly be good guidance.

A test -- if it's a basic test, that's fine, but again, as I commented earlier, it is -- while information is good, I jokingly said I can't understand some of the footnotes and some of the more complex transactions, I'm not ashamed to admit that. I do read, and I get paper copies of 10Ks, and I own stock in Bank of America and other large financial institutions, and those are pretty heady things, and it's very difficult to understand.

I've also personally invested in a range of securities, including biotech and other complex matters where I certainly believe I am intelligent enough to read about the business, and just because I am qualified to invest in a real estate deal doesn't mean I'm qualified to invest in a biotech deal. But risk factors do fall into categories, and I think the education idea that I think everybody is in favor of that talks about, as Tim Walsh said, liquidity and ultimate rates of return, things like that, the ability to participate, I think certainly it would be useful to ensure that investors are provided with that information. But to assume that you

could come up with a test that would allow you to invest in derivatives and mining companies and everything else would probably be a fool's errand.

MR. GRAHAM: Thank you, Greg.

Catherine.

MS. MOTT: One of the things we -- you mentioned it already, Steve, and about the ecosystem. So think about in -- sort of in a granular way if we can think about how the little fish are eaten by the big fish and are eaten by the bigger fish and then are eaten by the next whatever. If there is a decrease in the amount of angel capital in the ecosystem, there will be a decrease in the amount of companies that can be invested in be venture companies. There will be a decrease in M&A activity, and there will be a decrease in IPO activity. Angels take the early risk.

They're first in with a decrease in NIH dollars. We're even investing in a lot of life science companies that require funding for R&D, because the SBIRs aren't enough to do it. And the NIH money is not enough to do it. So whatever we do here and we -- and if the accreditation standards are risen and are, I'm sorry, hiked up and it decreases the pool of angel investors, then just understand there will be an impact on everything else down the way, down the path.

MR. GRAHAM: And just to interrupt -- sorry, but if that happens so that we can eliminate 100 percent of the fraud, then I'm all for it. I don't think that's the case.

MS. MOTT: It's not going to eliminate 100 percent of the fraud. And bad actors are going to exist and find ways. And one of the things I was thinking about when I heard the gentleman from AARP, I was thinking about my parents. And they're not accredited investors, but I know they've been subject to scams. Now fortunately they usually call their children and ask if -- but not everybody does, and so -- and the fraud is going to be committed even with those who are not accredited investors.

I will say I have concerns about using or eliminating retirement funds. Many accredited investors, that's part of the picture, that's part of the formula of your net worth. It's the liquid stuff that you have, and quite honestly, I don't know about you, but I try to shelter as much of it as I can from tax income, so a lot of it will be shifted that way. I have concerns about excluding retirement funds from the definition or from investing. One of the things we do at Bluetree Allied Angels as we put our investors through an orientation program, and we talk about -- we basically say all of the

principles that you apply to your public stock portfolio you should apply to this asset class as well.

So that means diversity, that means limiting the amount of investments that are qualified as alternative investments as 5 to 10 percent of your total investments. So there's already a sophistication process with a good segment of the marketplace that occurs. So I would conjecture also -- one other point I would conjecture that I know that the gentleman from AARP is -- deals with a lot of unsophisticated people. But I would wager to say that over the past 30 years because of the internet and Khan Academy and everything else, a lot more older people are a lot more sophisticated than they would have been 30 years ago without the internet, without access to so much information.

So I think there's a lot of people who are retired. I think of people in my church that are very retired, and they're constantly asking me about things that they're reading about investment opportunities because they're reading. They're very informed. So those are my thoughts as I think about this.

MR. GRAHAM: Thank you.

I'm going to go to Sonia.

MS. LUNA: So I wanted -- I don't know if a million dollars is the right number. I don't know if it should have started at that number. I'm not opposed to changing the number as long as we're doing a balancing act by adding something into the mix given the data that we've been shown. So adding to the definition of some sophistication certification, investment experience, et cetera, because then you kind of have a yin and a yang going on, so I am not seeing this problem one way. I'm trying to see a comprehensive solution.

Now from a regulator standpoint, I don't know what that would mean day in and day out. I don't know the cost of actually implementing our definition, so I think when we get to writing or making a recommendation, we should probably also take that into account, what it means to a regulator to actually follow through on this.

MR. GRAHAM: Okay. Thanks.

D.J.

MR. PAUL: Yeah, I mean I would echo some of the sentiments that have already been expressed. I would just start from using a different analogy, maybe the Hippocratic Oath, which is, first, do no harm. This is a system that is working. It's a trillion dollar market. It's often described as the crown jewel. It's very functional, and however clunky the definition was in '82, whatever, it's working now, and we would be -- I think it would be a poor choice to mess about with a system that

is functional and that is responsible for such a significant portion of capital formation in this country. The metrics speak for themselves in terms of like it compared to the various public markets. So I don't want us to suggest something that is a solution in search of a problem that is not there.

However, I do think that there is a problem that needs to be addressed. That's not it. I haven't seen enough data to suggest fraud, so I don't think that that's it. I do think that there's a problem, and the problem is that the definition has strayed from what guidance we do have both statutorily and in the congressional record and specifically from the Supreme Court and the Ralston Purina decision, which is a sophisticated investor is one who can fend for themselves.

And the current definition that we have is a definition, a way of arriving at that, but it is clearly not exhaustive. That's rather plain language for the Supreme Court. And if the Supreme Court had meant that it meant someone who could take the financial hit, which is effectively what the definition is now, then I suspect that the Supreme Court would have said that. So I would like to -- I would like to do no harm, leave the system as it is. That would be my first recommendation. And

then subsequent to that, I would like to broaden it so that we actually have a definition of sophistication that captures the guidance that we have from the Supreme Court, which I don't feel like we have exhaustively now. And I'll leave it there for now.

MR. GRAHAM: Thanks.

MS. HANKS: I just wanted to raise something on the exclusion of assets thing that a couple of earlier speakers have raised, those being a couple of big misconceptions about retirement assets raised today. Number one, that retirement assets are a separate asset class, and number two, that they're somehow stable, safer, a nest egg, those words we used. Firstly, they're not a separate asset class; they are a tax treatment of specific assets.

And when you go back -- and thank you very much for finding the earlier releases from the 1980s -- you've got the SEC specifically saying with respect to determination of income we are not going to take -- we're not going to use, for example adjusted gross income in determining the income of someone. If someone has shielded their income such that they're not reaching that AGI, we're still going to count it as income. So we're not -- we are going to disregard any tax treatment of any of these metrics.

And the second point is that these aren't safe assets. Things you can put in an IRA, you can put race horses in an IRA. You can put startup companies. You can put Bitcoin. You can put gold, you can put anything except collectibles and life insurance proceeds. So there's a lot of self-directed IRAs there which have got a lot of thoughtfully designed, well-taxed, provisioned investments for the future.

MR. GRAHAM: Thank you, Sara.

Charles.

MR. BALTIC: Charles Baltic. I'm very mindful of the need for a balanced perspective and consideration of the joint or dual interests of investor protection and access to capital that, of course, balancing and consideration doesn't dictate an outcome. And I'm also mindful of the ongoing need for maintaining market integrity, and we certainly don't want to taint the well of private capital that has created a lot of benefits that we've talked about today and we've seen some very compelling data in that regard. But I would want any solution or change to be well grounded in evidence.

To my mind, the accredited investor definition based on net worth and income thresholds has been an effective tool to balance investor protection and access to capital. It is a proxy. We've all acknowledged that, and so it is not perfect. But I'm not convinced that the measures that have been proposed or discussed today would not have an uncertain and deleterious impact on capital formation. I'm also -- I would also note that we had a recent change with respect to the Dodd-Frank exclusion of principal residence, which changed the number of households covered, I think from 9.4 million to 7.2 million.

And that is a pretty dramatic increase or decrease in the pool of capital based on households. And we also heard earlier today that for instance something like inflation indexing from 82 to current would have an impact of going from 12.4 million households to 4.4 million households, which would be a very dramatic impact. And so I think the current posture is one that has led to a lot of benefits in the investment community. I'm not convinced that there's a clear alternative at this point. Some alternative measures that have been discussed, including, for instance, a liquidity provision don't have the sort of permanence that net worth and income have. Those are less variable over time, I believe, than liquidity, which can change very dramatically even for sophisticated people. And so I think that right now we've been tasked with reviewing this, and that is an ongoing obligation. But my view is

that I haven't seen compelling evidence for consensus around a particular change being proposed.

MR. GRAHAM: Richard.

MR. LEZA: My feeling that -- after seeing all that data and understanding the venture capital business inside of -- we've got to keep the system the way it is. It's been working. We have people now that are much more educated. They understand risk factors much more than they did in 1982. And I don't see that adding any other things to it will protect investors. I think that everybody is -- fends for himself, and most of the people that are accredited investors now seem to keep things in perspective.

And I just don't see somebody with a little bit of education and a little bit of having a million dollars in the account, that they would put their retirement into risk. They didn't get to that position by making those kind of decisions. I have faith in the -- on the people that doe these investments, and I think that they look at very closely, and they're getting more and more information. And as far as California, this thing has been working very well, so I don't see whether we should add more criteria to it because I'm not sure that you're going to get the additional protection, and I think it will reduce the capital formation.

MR. GRAHAM: Thank you, Richard.

John.

MR. BORER: So I think D.J.'s point about do no harm is a good one and having been in the industry -- the investment side of it at least for a long time or the brokerage side of it for a long time. When things change, there's always uncertainty. And the caution that may be put into the system because of the problem of identifying the right or wrong way to do something and where the safe harbors are could be problematic and disrupt the flow of capital until things settle out irrespective what the intent of the intent of the rule is.

Now with respect to what the -- this provision -- fending for oneself is very subjective. I kind of like it. But in our business, we not only have to follow all these rules, but we also have to evaluate a thing called suitability, which ties into this. Brokers have this responsibility. It's irrespective the wealth of this investor, is this investment suitable for them? And that is the responsibility that's put on the broker to do these things. And it's a highly subjective thing. And because we're to some degree counselors for the investors, more so on the individual side than the institutional investor side which are deemed to be very

sophisticated QIB definition. It's -- we take that into account, and if somebody tells me that because a company is a 34 Act registrant on NASDAQ that that's a safe investment, so the most risky biotech in the world that's on the NASDAQ, anybody can go buy on their E*Trade account or Charles Schwab without any further information or advice, and they've never touched that prospectus.

And yet that same individual can't buy a newly issued, unregistered bond issued by GE. And I think those two point very clearly as to the distinction. And what are we trying to get into? Now the issue of slicing and dicing, and I listen respectfully to the gentleman from AARP, that setting bright-line tests for retirement assets in this world is very, very difficult.

Somebody mentioned a few minutes ago -- maybe it was Greg -- all of my assets are retirement assets, every nickel I have. It's not my 401(k), my IRA, my -- whatever those things are. It's all for retirement. And in many people's cases, those pieces may be very large or very small. If I worked my taxes right, 98 percent of everything I own would be a retirement assets in one of those plans because they would be tax deferred. Sometimes you could have people inherit various of those accounts and roll it again in another generation, et cetera. And on the other hand you have somebody who has zero as defined by this economic study that was reported, so retirement assets, meaning they do not have a 401(k) or an IRA, but might have $100 million.

And should we take and automatically deduct some level of what we feel should be their retirement asset to protect them as well when, in fact, this arbitrary housing for tax purposes of these assets hasn't happened? So I think that what I heard from AARP -- and I know this may sound pejorative -- is that the closer you get to retirement and the older that you are, you should have a different standard. And I know they wouldn't -- and most people wouldn't say, well, that's not right, because we're not going to pick on old people because they're old, and they may be more subject to being misled, fraud, they have less sophistication because they aren't familiar with the internet as others may be.

And certainly since 1982 and today, the availability of information on every part of our society, including fraudulent people doing bad things who have notorious pasts, it's available all right there in front of us whether it's on file at EDGAR or not. But I think if we all the of the sudden say that somebody who's 65 shouldn't be able to do something that a person at 45 can be able to do, because even if they lose all their money,

the 45 year old might be able to get it back, it gets very, very hard I think in the individual application to investors, one versus another.

And another thing with respect to -- I think this -- I thought this before with respect to the residence and certainly with respect to retirement accounts. You can sell your residence and all of the sudden turn it into an investable asset and you can pull the money out -- you pay the taxes that are owed, whether you pay the 10 percent if you're under 59 and a half or not, you can get that money and take it to the racetrack tomorrow, and we don't do anything about that.

And if those people can do that, why wouldn't we, if they have those assets and meet these other income or asset tests be able to apply the same skills or luck that allowed them to create those assets in furthering either building their retirement nest egg or having fun -- I assume a lot of people become part of angel groups the way my mother and her bridge club friends had an investment club in the 1960s. And nobody was telling them what they could or could not do. They were investing individually, but they did it because it was also a social and giving back to society and being part of something.

So I think changing the rule to change the rule

because it's four years is kind of scary. And investor protection is great. I happen to believe that the free market would allow many of these things to be imposed upon individuals as they're thoughtful. And we're trying to protect people against themselves here as opposed to against the massive fraud that is being perpetrated on people in private placement offerings in my view. And I have heard nothing today that tells me that the loss through these private placements is any greater than the combined loss from Enron, MCI, and HealthSouth, which were fully -- and going back to the old days -- equity funding and Franklin National and all those things, the fully reporting New York Stock Exchange registrants.

MR. GRAHAM: Thank you, John.

Chris, do you --

MS. JACOBS: Yeah, I'd like to follow up with one example that is I think quite pertinent. We're talking about the retirement funds of folks, their age, et cetera. But nobody was there to stop 90 year old dad from being a day trader and losing 50 percent of his net worth. And I just don't think we can plug that hole. I just -- I think we're attempting here to legislate financial risk, and I just think it's like morality. We're never going to be able to go there. So I will weigh in on where I would come form on today's topic. I

am not convinced of proof of failure.

I'm just not convinced that we are on a topic with a proven track record of failure, and so I would say don't touch it. Just leave it the way it is. In fact, I might go the other way and say, oh, but let's let the certified financial professionals in because I thought that argument made great sense. These are folks, are CPAs and are folks that are accredited is let them in in the definition, but I wouldn't mess with it. I just -- I don't think it's that broken.

MR. GRAHAM: Mr. Reese.

MR. REESE: Thank you. I was sitting here thinking about this, and it's -- the issue itself is really rolled into a larger, more complex issue than the issue of just the definition of the accredited investor, which made me just sort of think through that as we've all noted that Reg D and the idea of raising capital through private placements has been successful, it's been a successful model, and it's been a success for some of us at this table, and it's been a success for some of the companies we've invested in, and we've seen the results of what that success has done to their lives and the lives of their families and for the communities they support.

I also would not lose sight that Americans and

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America enjoys a certain marketplace that's been unique, which is the ability to lose money on gambling on risky propositions. That's what made America America and has given us the opportunity to be a leader in so many different financial categories because of that and not losing sight that through some other new legislation in the foreign countries, they're trying to plug that hole using crowd funding and the like. I still think that in the minority communities across America that the need for capital is even larger than the pool of dollars that are available today.

Some of this issue that I've come to learn and been educated on is the IPO market for small businesses has shrunk tremendously since 1990s. In the 1990s -- and we can factor in the dot coms, but there were about 2,000 small companies that IPO'd. In 2012, there were 750, and I think that number is even getting smaller because the concentration of capital to go public requires an even larger venture, which is why you're hearing about these outsize IPOs.

So it leaves to the American public what is it to do to get a return, because your savings is not going to give you the type of return to support your lifestyle, and that's where we're driving at this issue is 1 percent on your money is not going to give you that return, so

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people are looking at alternative investments in the way to deal with this. Dodd-Frank has created some other issues in my opinion that we should be looking at. I think investor education is the biggest issue right now in America because of these changes. We should be looking at that.

And since 2008, I know that I have seen an unprecedented number of companies and minority companies that were looking for equity through the alternative markets to be able to meet their debt covenants. Because with Dodd Frank, the way banks could lend money actually changed, and you had to meet certain thresholds, which meant you needed more equity. But the only way that they were going to get this equity is to be able to do to the angel markets and raise capital. So it also provides another source of funding, because what we raise, what's raised in the private equity realm also allows some debt to come in to meet the thresholds to run business.

So I think -- and I do think that the larger issue we'll deal with at another time, crowd funding is supposed to provide if you have a dwindling IPO market, a low savings return because the interest rates and you have a new covenants that have taken away -- to have a certain amount of debt-to-equity ratio we need to find new ways, not contract, but find new ways to provide more

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equity to the business, small business markets in America. Hence I do -- I don't think we should change the rules around alternative and around an accredited investor. In fact, I think I support the fact that we should increase the pool of investors that would fall as an accredited investor, whether through the certification program, whether it be through some other education initiatives, but we should be looking at a way to bring more capital to the small business market given the economic realities of America competing globally with other faster growing countries.

MR. GRAHAM: Thanks, Tim.

Before we get -- well, go ahead, John.

MR. HEMPHILL: Thank you very much. I just wanted to add my two cents to this, and the first thing is that Reg D is an oxymoron. It's a popular regulation. People love Reg D. My clients love Reg D. They love the fact they can go out and raise capital from people. It's been popular since I started working on it in 1982 using that regulation. It's been -- and it's worked. It has worked really, really well. And it's working really, really well right now, so I would just for the issue at hand whether we should amend the definition of accredited investor, I would lend my support to say, no, we should not do that, certainly not to make it more stringent.

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And I also support the idea that we should expand the definition of accredited investor.

For example, one of my partners who does work in tribal laws came up to me a month ago and said can a tribe qualify as an accredited investor. We took a look and the answer is even though they have some huge assets like casinos, they don't qualify. There's no place where they qualify in the definition of an accredited investor. So I think we need to look be it through some sort of public request, of course, some ideas as to how we can expand the definition of accredited investor or where there are holes to try and get more money into the system, because it's a really popular system. It rivals public offerings, and it's a great way to get money into newly started companies and private companies.

MR. GRAHAM: Thanks, John.

Charles, could I get you to just say a few words about the demise of the small IPO and the changes that kind of led up to that and kind of where we are with that ecosystem?

MR. BALTIC: Sure, Steve.

MR. GRAHAM: Because it could be a cautionary tale.

MR. BALTIC: Yeah, it's definitely been the case, and I think we heard some numbers cited earlier on the metrics, but that the phenomenon of the small company going public and raising a limited amount of capital in the public markets had definitely been impacted over time I think for a whole host of reasons that don't strictly involve some of the issues that we're dealing with here today. But they do relate to the ecosystem of a company or an idea or a technology or a discovery getting from inception to a point where it can go public.

So there's a continuum of capital that ranges from the individual capital, friends and family, angel capital, then structured institutional capital starting with venture capital and then crossover public capital and then full public institutional capital. But to get to those later stages for an entity or a company to be attractive to the public market, to some extent it has to be meaningfully de-risked. And some of that goes on in the private market. Much of that goes on in the private market.

Mentioned earlier that from my perspective the venture capital community, which does a fantastic job of fostering innovation tends to be aggregated in the financial centers, and so some of the country is at disadvantage. I would also say that a lot of that venture capital has a time constraint on it, because the life of a fund might be ten years, and so there's a five

year investment cycle and then a five-year harvest cycle whereas a lot of these technologies and innovations take longer than that to get to the point of potentially going to the public markets. So I think there is a funding gap in the earlier stages of development that is to some extent addressed by the private capital rules that we've talked about and would be disadvantaged if those rules were changed in such a way that it limited the amount or number of investors that could participate in private capital.

So there's a host of things that I think have affected the public markets, but one of them is the ecosystem or the feeder system for getting innovation to a point where the public market is willing to accept that risk, and I do think that that's a very important consideration in this matter.

MR. GRAHAM: It's -- I mean we've all witnessed kind of the demise of the small IPO. And we talk about potential solutions having to do with tick size and other things to try to figure out some kind of way to bring that back, and the whole notion that someone mentioned earlier about do no harm, that kind of -- to me, it kind of reminds me of that scenario, and this is a powerful segment of our economy, and do we really want to run the risk of kind of dismantling it. And if there was some

certainty that certain things that we talked about really would solve a problem that has been well defined, then you just kind of follow where things take you in that regard. But as you mentioned earlier, I'm not sure about the evidence.

Catherine.

MS. MOTT: One other thing. There was a very powerful slide that Marianne had shown us, and that was the Kauffman study and the SBA business dynamics statistics report that showed that for the past 30 years, all net new jobs came from companies five years old or less, and if you take that out of the mix, you have net job losses over the past 30 years. And so the other component to this is real job creation that we're talking about.

And to me, one of my investor said that slide makes sense to me because large companies are about doing more with less people, and small companies are about doing more with more people, going from five people to ten people to 50, 100. So the other I mean component we're talking about here is beyond the venture and the capital formation market. It's just -- it's job creation.

MR. GRAHAM: D.J.

MR. PAUL: Yeah, here's the other component

we're talking about, which dovetails into what was just said and a couple other points as well, which is we speak of allowing the democratization of capital and access to capital and helping small businesses and SMEs have access to capital through the Reg D market, and of course that's true. But the data is in, and people don't create wealth through savings. That's just not really true. And we have a $1 trillion market that's accessible on a practical basis. They're a couple percent of the population.

If we want to do some good here as opposed to doing harm, opening that up for the democratization of wealth creation is an obligation that I think this committee might have at least in terms of its recommendations. And for those who are concerned quite rightly with investor protections and unsophisticated investors being taken advantage of, well, then that's fine. Let us then open up, let us leave in place what is in place, and let us open it up only to those investors who by dint of their education, by dint of their credentials, perhaps by dint of some test if we can agree on what that would be, but through some bright-line metric, right, bright-line test, we can establish that person is sophisticated.

That person conforms to the Supreme Court's guidance on someone who can fend for themselves and at least open it up to them, at least open it up for example to registered representatives who can sell these securities. Surely if they can advise their clients to buy them, they ought to be able to buy them for their own accounts. It is nonsensical to think that a young stockbroker who is selling one of these things and then is asked by his client, are you buying it for your own account, can now say I'm not allowed to as opposed to, yes, I am or, no, I'm not, which would be more in keeping with the whole notion of alignment between advisors.

And I used the example of a registered rep, but certainly an attorney that advises or a CPA or a CFA. So there are categories that I think are pretty broadly -- can be pretty broadly agreed upon of individuals who because of their education, because of their professional accreditation, because of their demonstrated sophistication should be included in this pool, and I think that that should be something else that this committee is contemplating as a recommendation.

MR. GRAHAM: Thank you.

Tim.

MR. WALSH: Thank you, Steve. I was originally going to go after you, yourself, and Greg just figured we'd go around, and I got beat to the punch, so I figured

I'd just keep my mouth shut and wait till the end and take all the opinions and advice together. And what I'm stunned at is there seems to be almost a unanimous opinion to -- I think the paraphrase, Mr. Paul, was do no harm, and I agree with that 93 percent. To -- a couple of the caveats, I think we have to do -- we do have to think what Mr. Certner said today about the AARP, because in some ways -- some of the things he said were correct that here are people being preyed upon, but I don't think Reg D is the reason, and I think the SEC has a lot of the tools to take care of that, which isn't the mandate of this body.

But I like Christine and Tim Reese's idea and I guess some others to expand the pool. I think of some of the employees I used to have in New Jersey in their late 20s, early 30s that wouldn't meet the criteria but were -- had the responsibility to invest billions of dollars every year of the New Jersey pensioners money into private placements. And they were as sophisticated as many people I know that make 400, $500,000 a year. But their income levels and asset levels, they couldn't invest in something like that, and that just doesn't make sense going back to the stockbroker analogy. But the one -- the 7 percent, which is I think something we should think about, and I mentioned earlier with the lady from

ACA is the million doesn't make sense to me.

It didn't make sense in 1982 and with these numbers, sometimes you have to just come up with a number, but my concern if we don't think about putting some type of inflation going forward -- and I don't mean this $2 and a half million or $4 and a half million that was in one of the slides, at some point whether it's an advisory body like ourselves or an SEC commissioner or Congress is going to draconian put just some -- another caveat number in, 2 and a half, 4 and a half million, and the ramifications then will be very harmful to the economy.

So I think we ought to consider at least putting a CPI adjustment in going forward. So I think CPI is 1 and a half percent. Next year it would be 1,015,000. I think if you did that together with the combination of CPAs, registered advisors, it's sort of a good compromise, and it certainly wouldn't be draconian like we've talked about this 2 and a half or 450,000 or 2.5 million, which to me just doesn't make sense.

MR. GRAHAM: Good idea.

Sara.

MS. HANKS: Just a quick point on the inflation adjusted thing. I think it's a good idea if it just bear in mind the fact that a lot of the Reg D offerings are

done by very tiny, little companies with just a couple of guys who are going to go looking anywhere on the internet for the documentation to put it together. They're going to get into trouble. So if you do have something that's inflation adjusted, there's going to have to be some kind of -- beyond what's already in Reg D so that they don't get into trouble just by saying, oh, yeah, I looked it up, and I found the number, and the number is just over a million, when in fact it's like 1.2 at some point.

MR. WALSH: Well, I left this -- I mean the IRS puts out a number every year. This is the number, and it's good for one year. I don't think that's a --

MS. HANKS: It could be on the SEC's website, too. It could be -- you meet the definition as it's posted currently on the site. It's a minor thing.

MR. GRAHAM: Is there -- okay. You have something, Tim?

MR. REESE: Well, it was just commentary. I think the commentary is the one thing I think about when we talk about allowing individuals in and Paul's sort of analogy of am I buying it, you're buying it, I'm just a little bit -- we've just got to be a little concerned just there in terms of like when you go into a broker, I would just want to make sure either from optics or from graft that you -- that there's -- we -- there's language if we did go through a level of having non-accredited, certified bodies participate, and they happen to be buying and selling securities on their own and also selling to ma and pa that we have to make sure -- because that's why we have FINRA brokers because it makes sure that we sort of separate a little bit of what could be church and state. If you hop in a deal because you're in and you're getting some fees on it, we've got to monitor that.

MR. GRAHAM: That's kind of -- it's a good point, I think. It sounds kind of like devil in the details. I think the conceptual point is if someone with these qualifications can make a recommendation for someone else to buy stock, he should be in a position to buy similar securities notwithstanding the fact that it does meet one of these thresholds tests.

I haven't heard from Dan. I haven't heard from Shannon.

MR. CHACE: You haven't heard from me because I generally agree with all the statements. Just for the same thing, it struck me earlier that there isn't really -- it's not broken as many have said. There's not a dealer problem. I'm not convinced that the fraud amongst the elderly correlates or means that there's substantial fraud in the Reg D market. In fact, it sounds like

there's generally not. And also one thing that did strike me is 10 percent of the households that are -- or 10 percent of natural persons measured by households that are -- couldn't invest in these seems like actually just a regular guy like an actual reasonable number, it doesn't seem excessive, it doesn't seem -- 1 percent seems quite small, which is what it was initially. You can trust 10 percent of your population to invest in risky securities. You'd sure hope that that's the case, but generally I agree with all the comments, and I would support as well probably increasing the number of people as others have said.

MS. GREENE: So I'll be the last one, and I'm the same way. I don't really have any disagreements with anything anybody said. I would I guess at a minimum consider leaving it the same, but probably lean toward expanding it. I'm sitting here making some notes, and I'm thinking about $200,000 or $300,000, if I'm sitting in a little small town in Texas, $200,000 is way different, and I'm in a position to make a 5,000, $10,000 investment than if I'm making $200,000 and living in Manhattan.

So we don't even -- I mean you said the dollar was set when it was, but if anybody pays any attention to cost of living in the various states, the difference

between California and Arkansas is huge. So -- and then if you have $200,000 and you have no debt, your mortgage is paid, you're buying food and utilities, you may be in a position to spend $10,000 on an investment and fend for yourself, survive the loss, whatever. So that's one note. I'm also, as people from the prior term know, I don't really like trying to protect people from themselves.

So thinking about -- (laughter) -- which is kind of what we're -- when you think about the investor protection, that's kind of what we're trying to do. When I think about a senior and listening to the guy from AARP today, a senior makes a bad, risky investment, and groups are created to protect that group of people, whereas a younger person, middle age and down, makes a bad investment decision, it's either a bad investment decision or he was stupid, but you go on. There's nobody out to protect the 40 year olds that are doing things. So we can solve the AARP's problem by just eliminating anybody who's over 65 can't invest at all. I mean -- (laughter) -- that's stupid, right? But wouldn't that do it?

MR. YADLEY: Shannon, you're absolutely right. Nobody told the kids, and we get those student loans, and then they graduate, they don't have jobs, guess what,

they're underwater.

MS. GREENE: Yeah, so I'm being facetious, and that's part of the way I make my point, but we can take care of the seniors, but that's not really the solution either. So I'm -- I think the line -- the dollar amount drawn is an arbitrary -- I mean it sounded like a lot of money in 1982 I guess. Maybe it's not so much now, and yet it depends on where you live and where you sit on whether that's a lot of money, not a lot of money, do I -- if I make that much money, I'm automatically considered to be able to make investments.

But I'm telling you, if I was trying to live in Manhattan on $200,000, I'm guessing -- never lived there, but I'm guessing I wouldn't have money to make -- I don't care how sophisticated I am. So the dollar amount kind of seems to me an arbitrary number, and I'm with these folks over here. If nothing else, I would expand it, and if people want to be stupid, I mean protect the -- if the SEC wants to work on something work on the bad guys. Don't try to set regulation that protects people from the bad guys.

I mean let us -- let whoever make the decisions that feel like financially they can make with investments, et cetera. And then really attack hard the guys that are out there calling the old lady in the tennis shoes and trying to sell her on a $10,000 deal or whatever. Get those guys, but don't try to make it tighter and tighter and raise that bar and drop half or three quarters of the people who could legitimately make investments and take the risk.

MR. GRAHAM: Thank you. Does anyone else -- Tim.

MS. WALSH: I just had one comment. I think John had mentioned someone buying stocks on E*Trade or Charles Schwab, really made me think of something. The investment firms that issue a lot of these private equity funds, venture capital funds, hedge funds you can buy on your E*Trade account or your Charles Schwab account for 5.99. They actually trade on the New York Stock Exchange. There's also many-levered, closed in funds that -- when I say levered, they borrow money, which are risking a lot of the hedge funds I know that you can buy again for 5.99 a click or whatever. And we don't regulate them.

So again, it goes to what John was mentioning that we're -- the idea we can regulate just the private side because the private doesn't -- we don't understand it or it's bad is incorrect. There's hundreds of billions of dollars of these traded every year that are on the New York Stock Exchange and NASDAQ.

MR. GRAHAM: Thanks. Well, it feels like we have a consensus. It seems to be that the feeling of the group is that we have a system that's almost by definition like any other system is not going to be perfect. There are a lot of things that are noted as issues that are difficult to quantify.

There is a benefit that this sector provides that can be quantified, in terms of capital raise, in terms of jobs created. And so the feeling seems to be that no change should be made, and again, in the spirit of doing no harm, allowing the system to continue to go forward and to work. In addition to that, there seems to be a sense that these numbers -- that we can -- again, who knows if they were right, who knows if they are right, but it's the standard that, again, is in place, and it works, but it probably is a good idea to put something in place so that going forward we -- they continue to bump up.

And there also seems to be a sense that the expanding could be a good idea. Finding an appropriate definition that is not -- that doesn't replace the existing regime, but is additive, that comes up with definitions that we consider appropriate for sophistication. And there's a -- the notion that we're -- that there could be -- that these are -- that people

that have expressed concerns, these are legitimate concerns, but maybe there are other ways to address them, and at the root of some of these issues, maybe Regulation D is part of the problem, maybe not. Again, that gets back to the evidence question.

But it does make sense if we feel that for example seniors are being preyed upon, then maybe we need to do a better job of educating seniors. Maybe we need to do a better job, not that anybody was doing a bad job, but perhaps a better job of enforcement. But in terms of taking a system that -- it's a hugely important ecosystem to our economy, and tinkering with it in that -- in these bases is something that we don't agree to. Is that kind of roughly -- yeah.

MS. LUNA: I mean I think we reached a consensus to expand the definition because --

MR. GRAHAM: Yeah, that's what I --

MS. LUNA: Okay. Okay.

MR. GRAHAM: That's the sophistication part, that's the expansion part.

Yes. Charles.

MR. BALTIC: The only thing I would add is that in the spirit of the committee continuing to fulfill our obligations, having the requisite data to continue to be informed in this subject would be very important, and so

I would encourage that we also be open to ongoing efforts to compile data on numbers of offerings, numbers of investors, actual amount of capital raised in private offerings so that we have the right lens to understand how important this private capital formation is to the economy, and so I think that should be an ongoing effort. I know that the Commission is involved in that, and I would just stress that we should be mindful of that and considerate of that on an ongoing basis.

MR. GRAHAM: Good point.

MR. PAUL: I just second that and then say that that ought to be one of our recommendations to the Commission specifically.

MR. GRAHAM: Yeah.

MR. PAUL: For more data. Right?

MR. GRAHAM: Yeah.

MR. YADLEY: I think that also addresses the point that Tim made that we are in fact doing our work and recommending that the Commission do so, too. This Dodd-Frank requirement is every four years. So I think for now we don't believe that there needs to be a change for the reasons stated, and we do recommend affirmatively that data be gathered so that the Commission will have more hard data about who's investing, how much they're investing. It was pointed out this morning that you

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don't have to file a Form D at the end of the offering. I've never quite understood that myself, because that would certainly -- the whole purpose of Form D is for gathering data relevant to the SEC's mission, and why not have data about what happens, what actually happened.

MR. GRAHAM: Thanks, Greg.

Sara.

MS. HANKS: Just one point about if the definition is to be expanded, it needs to be expanded in a way that is absolutely certain and gives issuers the ability to say yes or no in a binary way. Because we can't forget that the reason we got into this situation in 1980-wherever in the first place was in response to the fact that the predecessor definition of accredited investor was someone who has sophistication in financial affairs, so issuers tied themselves in knots trying to determine whether someone was sophisticated. So we want to learn from the accredited investor verification process and not get issuers into a situation where they can't rely on something that says definitively this. You can rely on this, and that's the end of it.

MR. GRAHAM: I think you make a good point, and it's important that any definition that is developed is one that's going to work. And if people can't figure it out, if it's too subjective, then it's not going to work.

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But the thing that I would be most concerned about is if you were going to replace a current regime with these sophistication definitions. And so it gives me comfort that if the current system stays in place and this is purely additive, you haven't changed anything. You've only created an opportunity to perhaps expand assuming people can figure out.

MS. HANKS: Give some folks more legal fees I suspect.

MR. GRAHAM: Thank you.

Catherine.

MS. MOTT: Perhaps this is what Greg was saying. I think the -- and in light of what Tim was also saying earlier about maybe we should be tying it to some sort of index. We can't do that without the data, without enough data, but I think there is -- there could be a fear that Congress would set it, and without the data, and so maybe that would be a recommendation that in the next -- by the next four years when it has to be under review that we have enough data to make a good recommendation whether or not it's the CPI or something else. I don't know.

MR. GRAHAM: Well, I think the recommendation is that we tie it to CPI.

MS. MOTT: So that was a recommendation?

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MR. GRAHAM: Yes.

MS. MOTT: I don't know. Does that make you uncomfortable?

MR. GRAHAM: I would say let's --

MS. MOTT: I don't feel comfortable without the data.

MR. GRAHAM: Yeah, well, it's --

PARTICIPANT: (Off-mic.)

MS. MOTT: I know, but is --

PARTICIPANT: (Off-mic.)

MS. MOTT: Yeah, but I -- is a million the right number? I don't know.

MR. GRAHAM: Well, see, that takes us back to the whole --

MS. MOTT: I know.

(Crosstalk.)

MR. PAUL: I think that the notion -- and correct me if I'm wrong -- would be we want to do that preemptively so that we don't get something -- I think the word was draconian or additionally arbitrary later. Because at some point in time, whether it's five or ten years, a million dollars is really not going to be a million dollars. So rather than risk some sort of weird action in the future, we could be somewhat proactive. But I do get your -- I would like -- if we had the data

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now we could address it now.

MS. MOTT: That's -- I just don't feel comfortable, but --

MR. PAUL: Okay, no, that's fine.

MR. REESE: I feel comfortable. I mean if we -- (laughter) -- because if it works now and build -- so the idea I think is if you start moving that number around, then you're tinkering with the idea that it works. So the idea if it works is we're talking about protecting ourselves or protecting the marketplace so that for further -- if someone else wants to decide on a number, we've at least offered a number that is tied to the consumer price index, which is by all economists, that's what they use to determine growth wages.

MS. MOTT: You won me over.

MR. GRAHAM: Yes, Richard.

MR. LEZA: Well, it seems to me that we do need to put the index. The other thing that it seems to me that we need to keep this number at about 10 percent of the household, because that seems right. I would hate to see this number flame up and in four years we're talking about the people that qualify under this as close to 20 percent because we started with 1 percent, but 10 percent of the financial people of the household population seems right to me and being able to do this.

MS. MOTT: I wouldn't go there. 10 percent of a million, yes, but 10 percent of 10 million is totally different. I don't think we should put in -- I mean it's a recommendation --

MR. GRAHAM: Well, we don't --

MS. MOTT: It's already a recommendation.

MR. GRAHAM: We don't -- I --

MR. LEZA: Making a comment that --

MR. GRAHAM: These are -- we can't predict the future, and I don't -- I think we can anticipate that there could be issues down the road depending on how the economy develops and everything else. And there may be another need for a rule modification, but right now, I think we're talking about today and I think with currently what is on the table makes sense for me today. It's not -- we're not going to put something in place today that's going to work forever, and we're not going to put something in place today that's going to properly address all things unforeseeable because that's just not the way things work. But I think in terms of what we are trying to do today -- I mean we're focused on a sector of economy. We're focused on the job creation. We're focused on capital formation for smaller businesses.

We're not unfocused on investor protection. We just don't feel that the evidence is there to suggest

that what is currently in place is that big of a problem. And so I think what -- the proposal on the table I think addresses those concerns and allows us to then move forward and discuss other issues.

But, Tim, you had something?

MR. WALSH: Just a last comment on the expansion. I did notice -- someone mentioned the CPAs, CFAs, MBAs, investment advisors, and just for all my fellow lawyer friends on the -- no one mentioned the JD. Just for your --

MR. GRAHAM: Thank you, Tim. (Laughter.) There's a reason for that. There's a reason for that, Tim. Okay, any other comments?

MR. PAUL: I would just say that philosophically if I could have an entire population of America that could take a test and demonstrate their sophistication, I would be comfortable with 100 percent of the population if they could demonstrate their aptitude and their understanding of the risk. So I don't have any arbitrary notion that it ought to be 2 percent, 10 percent, or 20 percent. I would just like it to be smart people as opposed to merely rich people.

MR. CHACE: I agree, and -- put out the 10 percent number, I don't think that's like -- we can call it the right number as much as it doesn't seem an

excessive number at all.

MR. GRAHAM: So -- oh, Javier.

MR. SAADE: Just an observation. I'm not going to take an opposition, but CPAs, JD, whatever the acronym alphabet soup is, when I bought companies for a living, if I was buying some microbiology-based technology, I wouldn't be asking some MBA for advice on how to structure a strippable warrant. I would be talking to a microbiologist to see if the deal makes sense. So as -- if the decision -- it sounds like it is -- is to expand the tent, one of the things I would respectfully -- advice you consider is, yes, you -- it's great to have the financial sophistication, because these are investments.

But if it's a -- if you have domain expertise, something that doesn't -- because lot of people will get upset, a doctor that just started his or her career and knows everything about oncology but hasn't made the threshold is not allowed to invest in an oncology deal. So I would say don't think about it so specifically purely financial, because domain expertise sometimes in these early age stage deals is worth a lot more than somebody that can structure a convertible preferred.

MR. PAUL: I've got to push back on that for two reasons. The first is that we need a bright-line

test, and if we don't have a bright-line test, it's not going to be workable, and domain expertise becomes fuzzy. Who's going to determine whether or not that person has domain expertise. That's first. And second, in the end, you're not buying oncology; you're buying a security.

So you do need some specific understanding of the security that's being purchased, and I think that that -- I mean there's no doubt that domain expertise is incredibly important in evaluating an individual investment, but we're not trying to allow people, I don't think, to invest in specific types -- rather specific investments, but rather in an entire asset class. And so we need something a little bit broader.

I mean I -- if I could -- if we could come up with something, I'm not opposed to it, but -- that's bright-line, but if it's not then we're going to bump into some of the problems that John mentioned and that Sara mentioned where if it's not bright-line, it's going to cause the people to get jammed up as they did from 1974 to 1982. And that would be -- that would create more problems, well, not maybe create more problems than it solves, but it's certainly going to create some difficulties.

MR. YADLEY: I think that's, again, both things are important, but in the context, I think of the discussion we're having. We're talking about sophistication in the sense of people understanding the risks of the investment. So while that certainly goes to each specific -- and that was the point I was trying to make earlier about footnotes and financial statements. I think the advice from a lawyer or an accountant or somebody else who is used to giving advice will be it's a security, it's debt, or it's equity, and it's in line -- the ABCD means this.

There are risks having to do with illiquidity, how returns are affected. It's all of those sorts of things that go beyond the new doctor that says because she believes this is the cure to cancer, I want to invest all my money in it. Well, wait a minute. You've got to understand what the company is going to do with the money, what the FDA is going to do. You've got to convince Wall Street to -- all those sorts of things, and I think so by expanding the asset class, I think we're trying to do what I think the ACA is doing is that they're taking people who have sort of learned about how to play in this sandbox and what it means, and I think the SEC can have a very important role in education in sectors and so on.

So I agree. We don't want to make it so complicated that we're back to what Sara said, and you're

making it more difficult for the issuer, and then the data that the SEC is going to get will be a jumble of data that will be inconsistent, and the agency won't really know who's doing what.

MR. GRAHAM: Thank you. And the good thing is that we're not going to try to come up with a definition. We're going to come up with an idea, then we're going to recommend that the SEC pursue it. What I would like to -- the resolution that I'd like to put on the table is that we recommend to the SEC that essentially we do no harm, that we work to expand the definition because that part makes sense, that we attach a CPI adjustment to the thresholds going forward, that we continue to gather data on this segment so we understand it better, and that's something that should be ongoing as far as this committee is concerned, ongoing as far as the SEC is concerned, and that we encourage that -- we encourage the SEC to find other ways to address situations involving, for example, fraud on senior citizens, that through -- whether that's through -- well, it should be through, as a minimum, increase investor education and also increased enforcement. Does anyone want to supplement that? Did I get it close? Okay, so that's -- anyone want to second that?

PARTICIPANT: (Off-mic.)

MR. GRAHAM: All those in favor?

(Chorus of ayes.)

MR. GRAHAM: All those opposed? Okay. And so what we'll do is we will sit down and try to actually craft a set of recommendations that reflect the sentiment of this committee, and then we'll have it circulated to make sure that everybody's in line with that. And hopefully we should be in a position to submit something to the SEC within how much -- you think we can get that done --

MR. GOMEZ: Steve, would you -- I would think that you would want to have this specific language --

MR. GRAHAM: Oh, yeah.

MR. GOMEZ: -- probably approved by the members themselves.

MR. GRAHAM: Oh, yeah, absolutely. Yeah, that's what I said.

MR. GOMEZ: And that will have to be done in a public meeting.

MR. GRAHAM: Yeah, I think -- well, we'll work this.

MR. GOMEZ: We'll touch base on that.

MR. GRAHAM: But we're going to put something together, and you're going to have an opportunity to look at it and approve it. We'll make sure it's in the right

forum, and we'll get that recommendation to the SEC.

MS. JACOBS: I think in the past --

MR. GRAHAM: Let's --

MS. JACOBS: We have done it.

MR. GRAHAM: Oh, yeah, I know that.

MS. JACOBS: Okay. All right.

MR. GRAHAM: Okay. Well, the idea was that we would spend the remaining time just touching up on kind of your ideas for some of the issues that we should pick up going forward. I think we've mentioned some of them briefly during the day. Among them are disclosure effectiveness, whether that's scale disclosure, more meaningful disclosure, and the whole notion of a core disclosure document. Secondary market liquidity, codifying the 401 and a half, maybe broadening the use of Form S3, those are just a couple of things that are on top of mine from my point of view, and we'll kind of decide on what the agenda is going forward.

But to the extent that you have ideas that you think we should at least consider taking up, you can either let us know in the next few minutes in this context or feel free to shoot us an email. I think that, as I mentioned during lunch, this committee relatively speaking has a short shelf life. Our term expires at the end of September, and we all know what that means.

Looking forward, it seems like a long ways away. Looking back, it's going to be just a blink. So there's -- I want to be able to chart a path forward relatively soon so we can start thinking about what -- in what ways it's going to be feasible for us to make a difference as far as our mission is concerned. So with that, I open it back up.

MS. LUNA: So as a CPA, some of the items that you were mentioning are a little foreign to me, but I catch on quickly, and I would say we should probably maybe get input from other people on what their one, two, and three are for their priorities for the next meeting. I'm open because I -- these are some of the items that you're bringing up just now are a little new to me.

MR. GRAHAM: And we're just -- this is -- nothing is going to be set in stone. This is if you have a comment on what the agenda might look like going forward, then here's your opportunity to make that comment. And -- John.

MR. BALTIC: I think the whole idea on the disclosure side of the relationship between S1 and S3, whether it's expanding S3 or forward incorporation in S1, and then the whole issue -- and maybe we can get somebody to come in and give us a history on this, the idea of issuer registration as opposed to individual securities

registration, so looking at the Australian model perhaps as to how registration works down there. Is a company's 34 Act registrant fully compliant, they want to issue common stock, they can issue the common stock, apply to have it listed or tradable on the exchange, and it's a few days as opposed to having to file a separate registration statement for those.

I think if we can get somebody to come in and give us some background on that and then look at that vis-à-vis S1 and S3 eligibility currently and either expanding S3 or making forward incorporation in S1 available, I think that's going to make the registrants' and issuers' lives far, far easier. Some of this is pretty esoteric, but it's very, very important for these small companies.

MS. JACOBS: John, I think when we're talking about the disclosure, it also is public company disclosure and effectiveness, and if you remember, we as a committee handled this, remember, that 250 market cap, what -- and all of that for the existing public companies. I think that's what -- I think that's what the topic is referring to, not the S1, S2. It's --

(Crosstalk.)

MR. GRAHAM: S3 eligibility, that's exactly what I'm referring to.

MS. JACOBS: All right.

MR. REESE: I was interested in looking at a couple things. One is -- I don't know if this falls under disclosure, the Rule 144(a) and this other notion of large accredited investor, the fact that it represents 10 million in assets and it's a different status than what we've been talking about just now. Yeah, to qualify.

MR. GRAHAM: To qualify?

MR. REESE: Yeah, you're at another level. I don't know what that brings to the market by just coming up with that class.

MR. GRAHAM: Okay. Greg.

MR. YADLEY: An issue that's been around for a while and is always one of the recommendations that the SEC Government Small Business Forum is finders or private placement brokers, individuals who can help companies access small amounts of capital. The larger brokerage firms and there are a fewer smaller brokerage firms, there's a lot involved for them to try to raise small amounts of money. It's really not their sweet spot, and there are a lot of individuals who have contacts that can bring good investors to smaller companies, are willing to do so on a contingent fee basis. That makes them a broker, which means they need to be registered, and

there's not really a category for that. So that would be another piece of the puzzle of how to help smaller companies get access to capital.

MR. GRAHAM: Okay.

MR. CHACE: On the tick size we addressed last session, and I don't think there's -- what else would there be to do in that? Because we recommended a trial, and that trial is now underway.

MR. GRAHAM: Yeah, I don't think there's anything more that we can do. I think the SEC has taken our recommendation. I think that there is a -- is a pilot currently ongoing, or being structured?

MR. CHACE: I don't know.

MR. GOMEZ: There's a comment right now that it's about to end the comment period on a potential pilot program.

MR. GRAHAM: Yeah, and if you recall, we were in favor of just implementing a change in those regs and avoiding a pilot program because pilot doesn't sound very permanent and making these changes is going to require significant investment. As a committee we felt that it was important not to have a pilot, that we actually make a change, but that's not where we ended up. Where we ended up is that we're going to eventually have a pilot in place, and we'll see what happens. But I think that's where we are, good, bad, or indifferent.

Anything else? Well, I think we had a good day. This is a good committee. I appreciate everybody's contribution. It's -- again, this is a tough time of year in terms of things on everybody's plate and to take the time to get on planes and trains and show up and spend the day in a productive way is much appreciated.

So happy holidays to everyone. We will run the process like it needs to be run, but you will have an opportunity to read some recommendations hopefully before the end of the year. So okay.

(Whereupon, at 3:25 p.m., the meeting was concluded.)

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