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ADVISORY COMMITTEE ON SMALL AND
EMERGING COMPANIES MEETING

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 4 Kara M. Stein, Commissioner
 5 Stephen Graham, Co-Chair
 6 Sara Hanks, Co-Chair
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 22 Gregory Yadley
 23 Laura Yamanaka
 24 Michael Pieciak
 25 Mark Walsh

1 PROCEEDINGS
 2 MR. GRAHAM: Okay. Welcome, everyone.
 3 Sebastian, I assume we have a quorum.
 4 MR. GOMEZ: We do.
 5 MR. GRAHAM: All right. Well, again, good
 6 morning, and welcome to the meeting of the SEC Advisory
 7 Committee on Small and Emerging Companies.
 8 Our agenda today includes two timely topics
 9 that were suggested by many of you during our last
 10 meeting. The first item is the accredited investor
 11 definition under the Securities Act rules. And as you
 12 all know, this is the subject of a recent report from the
 13 staff that -- they pretty much cover the issue
 14 extensively. We will hear from the SEC staff about that
 15 review, and then I hope that we can discuss and move to
 16 recommendation.
 17 The definition is a topic that the committee
 18 has been interested in for quite a while. We provided
 19 recommendations to the Commission in 2015, and we are
 20 pleased the staff report is finalized and looking forward
 21 to hearing more about it.
 22 This afternoon we will turn to Regulation D
 23 with an update from the SEC staff and guidance they are
 24 providing in connection with 506(c) and general
 25 solicitation. But for now I'm going to turn it over to

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1 Sara.
 2 MS. HANKS: Before we move into the agenda for
 3 the day, we're going to hear from -- opening remarks from
 4 Chair Mary Jo White and Commissioners Kara Stein and
 5 Michael Piwowar.
 6 Chair White.
 7 CHAIR WHITE: Thank you very much, Sara. Thank
 8 you very much, Steve. And good morning to everybody.
 9 I've seen most of you directly this morning but not
 10 everybody. Thank you for being here. I appreciate it,
 11 and I want to respect what I know is the full agenda that
 12 Steve just described, and so I'll try to keep my remarks
 13 brief.
 14 Let me just sort of start with -- since we're
 15 relatively new to each other, just my overall perspective
 16 on our mission at the SEC and the important spaces that
 17 small and emerging companies that you occupy are -- what
 18 is my sort of overall perspective.
 19 Obviously they're critical drivers of
 20 innovation on our economy and our rules, should provide
 21 them with a range of options for raising capital,
 22 understanding the diversity of business models and
 23 capital needs that these companies have while ensuring,
 24 obviously, at the same time that investors can have the
 25 confidence in those markets that come with strong

1 protections.
2 As it happens, I was actually in Lima, Peru
3 last week for IOSCO's annual conference and was on a
4 panel where I was asked to discuss and did discuss the
5 Commission's approach to some of these issues and some of
6 the recent work that we've done on behalf of smaller and
7 emerging businesses. And one subject that was
8 highlighted there was equity crowdfunding.

9 And on Monday, as you know, our federal
10 crowdfunding rules came into effect, providing another
11 option for small issuers. There's considerable
12 excitement among entrepreneurs and investors for
13 securities-based crowdfunding, and I certainly hope it
14 will provide a new useful tool for small businesses
15 seeking to raise capital.

16 As required by the JOBS Act and our rule, a
17 registered broker or funding portal really does serve as
18 an important gatekeeper between those seeking capital and
19 investors. We were pleased to see that a number of
20 companies have already filed their Form C offerings.
21 Seventeen companies on the first day and I think we're
22 now up to 27 at least as of the close of business
23 yesterday.

24 Nine funding portals have completed the
25 registration process with the Commission and FINRA and

1 be taking up the definition of an accredited investor is
2 a familiar and very important one for all of us. Last
3 year this committee did provide recommendations
4 cautioning that the primary goal of the Commission's
5 review of this definition should be to do no harm in the
6 private offering ecosystem. The recommendation -- that
7 recommendation also suggested including within the
8 definition those investors who meet a test of
9 sophistication.

10 As you know, again, in December the Commission
11 published a staff report that analyzes various approaches
12 for modifying the definition and provides recommendations
13 for potential updates and modifications. I look forward
14 to hearing your discussion on those approaches and
15 reviewing any further comments that are submitted. I've
16 asked the staff to prepare recommendations on how the
17 Commission should modify the definition, and the comments
18 we're receiving obviously will help the Commission in its
19 -- in considering its next steps.

20 I also very much welcome your discussion this
21 afternoon of Regulation D, one of the primary engines of
22 capital formation in this country. Approximately 1.3 to
23 \$1.4 trillion was reported to be raised through
24 unregistered securities offerings in actually both 2014
25 and 2015 in reliance on Regulation D, an amount that

1 more are in process. So we're watching developments very
2 closely.

3 The staff of Corporation Finance and Trading
4 and Markets published compliance guidance in the last few
5 days, and they're obviously available to answer
6 questions, and I think it's very important that we
7 obviously have those interchanges with all interested
8 parties in this. And I think it's also just important
9 that we all keep striving to make crowdfunding work for
10 both issuers and obviously investors.

11 I'm also pleased to note that the Commission
12 published a concept release on April 13 that
13 comprehensively reviews the business and financial
14 disclosure requirements of Regulation S-K among a wide
15 range of other issues. The release discusses scale
16 disclosure for smaller publicly-traded companies, a topic
17 that has been of keen interest to this committee, and I
18 encourage you to review the concept release and provide
19 your input. Our goal is to make sure our disclosure
20 system is efficient and effective for investors and
21 companies, and we need input, obviously, from all
22 stakeholders.

23 Your agenda today, as Steve has outlined,
24 brings to the forefront several other important issues
25 for small and emerging companies. The first topic you'll

1 comparable to the amount of capital that's raised by
2 public equity and debt offerings combined in those same
3 periods.

4 The vast majority of those offerings -- and I
5 know you discussed this at your last meeting -- occurred
6 under Rule 506(b), the traditional pre-JOBS Act exemption
7 which does not allow general solicitation. The activity
8 in exempt offerings is of particular interest now as
9 issuers, investors and their advisors seek to take
10 advantage of relatively new options for capital raising,
11 like Rule 506(c) and its allowance for general
12 solicitation.

13 In 2015 of the approximately \$1.35 trillion
14 reported to have been raised in Rule 506 offerings,
15 approximately 38 billion used Rule 506(c). During 2014
16 and 2015 about 1,600 new offerings were initiated each
17 year in reliance on Rule 506(c). So this is an area,
18 again, that we are monitoring closely, and I look forward
19 to hearing your insights now and later as we go along.

20 The three new methods created by our rules for
21 capital raising under the JOBS Act, Rule 506(c),
22 Regulation A+ and Regulation Crowdfunding, are designed
23 to foster new ways for smaller companies to access the
24 capital markets, and we must ensure that the exemptions
25 are both workable for issuers and providing appropriate

1 investor protection.

2 We all benefit from capital formation that is

3 done in a transparent, safe and efficient way. As you'll

4 hear in your -- I think you'll hear in the update from

5 Enforcement staff this afternoon, we've drawn on the

6 expertise of the staff really across the agency and

7 engaged them in a program that is keeping a watchful eye

8 on how these markets develop. My view, such

9 interdivisional working groups help to make us smarter

10 and quicker in assessing the extent of these new markets,

11 their workability under our rules and the extent of any

12 fraud or other rule violations that are occurring. And

13 this real-time approach should enable us to make any

14 necessary regulatory adjustments and take action against

15 abuses more quickly.

16 So let me stop there by, again, saying thank

17 you for your commitment of time and expertise to the work

18 of this committee. Facilitating small business capital

19 formation is a priority that we all share, and your work

20 and input are really quite, quite important

21 contributions. So thank you, Sara and Steve.

22 MS. HANKS: We'll hear from Commissioner Kara

23 Stein now.

24 COMMISSIONER STEIN: Thank you. Good morning,

25 everyone. I want to welcome you to today's meeting. I

1 really look forward to these meetings because there's

2 such a nice, free flow of ideas, and it benefits the

3 Commission immensely to hear from people on the ground

4 who are actually trying to improve capital formation

5 while protecting investors.

6 Today's discussions are going to focus on, as

7 Chair White pointed out and I know you know from your

8 agenda on the definition of accredited investor and

9 observations regarding unregistered offerings, but in

10 particular, offerings made pursuant to Regulation D.

11 Both topics are part of the ongoing dialogue that we've

12 all been having about small businesses' access to

13 capital, and I think both topics provide us with an

14 opportunity think about and consider how to strike the

15 right balance between supporting small businesses' access

16 to capital while protecting investors.

17 Last December our staff in the Division of

18 Corporation Finance issue their first review as required

19 by the Dodd-Frank Wall Street Reform and Consumer

20 Protection Act of the definition of accredited investor.

21 The definition until the Dodd-Frank Act had not been

22 significantly revised since 1982. Yet an understanding

23 of who fits within the current definition I think is of

24 increasing importance in today's financing markets.

25 Today capital raising opportunities for small

1 businesses in the states are increasingly conducted

2 through unregistered offerings as Chair White pointed

3 out. In fact, more than \$2 trillion was raised privately

4 in 2014. And Regulation D offerings accounted for about

5 1.3 trillion of this amount. In comparison, registered

6 offerings or public offerings amounted to approximately

7 1.35 trillion in 2014. So more money was raised in the

8 private markets than was raised in the public markets,

9 which I think is another thing for all of us to be

10 considering about where we are right now and how

11 important some of these definitions are.

12 The individuals and the issuers that use Reg D

13 vary, but all Reg D offerings depend on properly

14 identifying accredited investors. Does the current

15 definition of accredited investor accurately capture who

16 should be allowed to participate in a Reg D offering? Is

17 the definition too broad? Is it too narrow? The --

18 historically it's been rooted in a bright-line,

19 quantitative test, which for individuals was focused on

20 income or net worth. Question: Does this test place too

21 much emphasis on wealth as a proxy for investor

22 sophistication and risk tolerance?

23 As you discuss the pros and cons of bright-line

24 test, I encourage you to keep in mind the lessons we

25 learned from the recent financial crisis. In 2008 hyper-

1 inflated housing valuations created artificial paper

2 wealth for many Americans. And at that time, the

3 accredited investor definition permitted an individual's

4 primary residence to be included in the calculation of

5 net worth.

6 As a result, many investors qualified as

7 accredited investors. But in reality, many of these

8 individuals were not able to fend for themselves or to

9 bear the risk of loss. I think this became painfully

10 evident upon the crash of the housing market and the

11 obliteration of trillions of dollars of paper wealth

12 during the financial crisis.

13 In light of history, what is the best way to

14 supplement the definition of accredited investor. The

15 staff of the Division of Corporation Finance and many

16 commenters, including this committee, have provided

17 thoughtful alternative factors that we should consider.

18 Perhaps it's time for the definition to become more

19 nuanced and to move away from a one-size-fits-all

20 approach.

21 For example, should we layer onto the

22 quantitative thresholds qualitative indicia of

23 sophistication such as professional credentials or

24 perhaps experience in engaging in exempt offerings.

25 Similar to Reg Crowdfunding and Reg A+, should we

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1 consider investment limitations? How can we gather and
2 analyze data to test the definition to make sure it
3 continues to be appropriate.

4 So to some degree I'm talking about back-
5 testing, right? We make the changes. How do we know if
6 they're working or not? What were we hoping to
7 accomplish when we made the changes? To answer these
8 questions we will need to think through how to craft a
9 definition of accredited investor that's flexible enough
10 to differentiate between investors. It would need to
11 take into account the wide range of investors that exist
12 from the soon-to-be retiree who is reaching for yield in
13 a low interest environment to the angel investor who is
14 seeking to identify the next big disruptor.

15 Finally, I look forward to the second
16 discussion agenda item today, the market for unregistered
17 offerings. We began the discussion about unregistered
18 offerings and Reg D in the last advisory committee
19 meeting, and I'm -- you know, I'm interested in hearing
20 about the developments in this market and recent
21 observations. I'm particularly interested in your
22 discussion of the usage or perhaps the lack of usage of
23 Reg 501(c) which removed the ban on general solicitation.

24 So I look forward to the meeting today. Thank
25 you for everyone's pro bono participation. We really

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1 appreciate it.

2 MS. HANKS: Thank you.

3 Commissioner Piwowar.

4 COMMISSIONER PIWOWAR: Thank you, Sara and
5 Steve.

6 First, since I was not able to make the
7 February meeting, I want to take this opportunity to
8 welcome everyone, our new members, our returning members
9 and our observers. Today's agenda is quite ambitious and
10 I look forward to hearing the discussion and seeing any
11 resulting recommendations. As Steve mentioned, the
12 committee will be discussing, among other things, the
13 accredited investor definition and Regulation D. In
14 fact, the Commission adopted the notion of a so-called
15 accredited investor in 1982 when it had adopted
16 Regulation D.

17 In a few minutes, staff in our Division of
18 Corporation Finance will make a presentation of their
19 December 2015 report on the review of the accredited
20 investor definition. Section 4-13 of Dodd-Frank directs
21 the Commission to review the definition as it applies to
22 natural persons to determine whether it should be
23 adjusted or modified. The staff report fulfills the
24 statutory mandate by providing valuable information on
25 the history of the accredited investor definition and

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1 important insights on alternative regulatory approaches.

2 After the staff presentation the committee will
3 discuss the accredited investor definition. I'm sure
4 there will be a lively discussion about alternative
5 accredited investor definitions. But I want to ask the
6 committee to consider going beyond that discussion,
7 perhaps after today's meeting, but before making any
8 recommendations to take a step back and ask the question:
9 Should the Commission consider doing away with the
10 notion of a so-called accredited investor altogether?

11 As I've said before it essentially divided the
12 world of private offerings into two arbitrary categories
13 of individuals: those persons who were accorded the
14 privileged status of being an accredited investor and
15 those are who are not. In short, if you made more than
16 200,000 in annual income or had a million dollars or more
17 in net worth, then you were in the privileged class. You
18 could chose to invest in the full panoply of investments
19 whether public or private.

20 If not, the government decided that for your
21 own protection you were restricted access to these
22 private investments. The committee has the opportunity
23 to move beyond the artificial distinction between so-
24 called accredited and so-called non-accredited investors
25 and challenge the notion that non-accredited investors

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1 are, in fact, being protected when the government
2 prohibits them from investing in high-risk securities.

3 For example, the committee could do as I do and
4 appeal to two well-known concepts from the field of
5 financial economics. The first is the risk-return
6 tradeoff. Because most investors are risk-averse,
7 riskier securities must offer investors higher returns.
8 This means that prohibiting non-accredited investors from
9 investing in high-risk securities is the same thing as
10 prohibiting them from investing in high-return
11 securities.

12 The second economic concept is modern portfolio
13 theory. By holding a diversified portfolio of assets,
14 investors reap the benefits of diversification. That is
15 the risk of the portfolio as a whole is lower than the
16 risk of any individual asset. I do not have time today
17 to give a full lecture on the mathematics and statistics
18 of portfolio diversification, although I'd like to.

19 So I'll just assure you that the correlation of
20 returns is key. When adding higher-risk, higher-return
21 securities to an existing portfolio, as long as the
22 returns from the new securities are not perfectly,
23 positively correlated with, which means they move in
24 exactly the same direction as the existing portfolio,
25 investors can reap higher portfolio returns with little

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1 or no change in overall portfolio risk. In fact, if the
 2 correlations are low enough, the overall portfolio risk
 3 can actually decrease.

4 These two concepts show how even a well-
 5 intentioned investor protection policy can ultimately
 6 harm the very investors the policy is intended to
 7 protect. Moreover, restricting the number of accredited
 8 investors in the privileged class can have additional, or
 9 what economists call second order effects. The
 10 accredited investors may enjoy even higher returns
 11 because non-accredited investors are prohibited from
 12 buying and bidding up the price of high-risk, high-return
 13 securities.

14 As a result, small businesses may face higher
 15 costs of capital. Remarkably, if you think about it, by
 16 allowing high-income and high-net worth individuals to
 17 reap the risk-return benefits from investing in certain
 18 securities, the government may actually exacerbate wealth
 19 inequality and hinder job creation and economic growth.

20 Again, this is just a suggestion for the
 21 committee to consider perhaps after the meeting, but
 22 hopefully before making any recommendations. In any
 23 event, I look forward to an informative presentation by
 24 the staff and a lively discussion by the members of the
 25 committee. Thank you.

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1 MS. HANKS: Thank you. And we look forward to
 2 considering that interesting suggestion.

3 We're now turning to the SEC staff who are
 4 headed today by Keith Higgins, director of the SEC's
 5 Division of Corporation Finance, and Betsy Murphy,
 6 associate director of the Division of Corporate Finance.
 7 Betsy.

8 MS. MURPHY: Good morning. I'd like to
 9 introduce the other CorpFin staff members joining me at
 10 the table. In addition to Keith, we have Sebastian Gomez
 11 and Julie Davis from the Office of Small Business Policy.

12 I'll also give the standard disclaimer for any of the
 13 SEC staff members speaking today, any views that they
 14 express are their own and do not necessarily reflect the
 15 views of any member of the Commission or any other member
 16 of the Commission staff.

17 Thanks. Back to you.

18 MR. GRAHAM: Okay. Now everyone here
 19 understands the importance of access to capital for small
 20 business. The overwhelming majority of capital raising
 21 by small and emerging companies is done using Regulation
 22 D of the Securities Act, that the accredited investor
 23 definition is a central component of Reg D, in particular
 24 Rules 506(b) and (c). While it is just one definition of
 25 the securities laws, it is one that plays a key role in

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1 the unregistered markets.

2 The definition of accredited investor is
 3 intended to encompass those individuals and entities with
 4 the appropriate level of financial sophistication and the
 5 abilities to sustain risk of investment or the ability to
 6 fend for themselves. I think we're all familiar with the
 7 current definition of accredited investors. I'm not
 8 going to review that. But for investors qualifying as
 9 accredited, it has significant consequences because it
 10 allows them to participate in investment opportunities
 11 that are generally not available to non-accredited
 12 investors such as offerings by private funds or seed
 13 investment and early stage companies.

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

20 For companies and other market participants,
 21 the size of the accredited investor pool is of
 22 significant interest. And given the critical importance
 23 of the exempt offering market to the economy, that
 24 interest is not confined to the small business community.

25 The current definition as we all know by now

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1 was adopted by the SEC in 1982. The Dodd-Frank Act
 2 directed the Commission to review the definition as it
 3 relates to natural persons every four years to determine
 4 whether the definition should be modified or adjusted for
 5 the protection of investors, in the public interest and
 6 in light of the economy.

7 As the SEC was conducting that first review,
 8 this committee adopted the following recommendation in
 9 March of 2015. One, as the Commission reviews the
 10 definition of accredited investor in Rule 501 under the
 11 Securities Act of 1933, the primary goal should be do no
 12 harm to the private offering ecosystem. Accordingly, any
 13 modifications to the definition should have the effect of
 14 expanding, not contracting the pool of accredited
 15 investors.

16 For example, we would recommend including
 17 within the definition of accredited investor those
 18 investors who meet a sophistication test regardless of
 19 income or net worth. As a further example, the tax
 20 treatment of assets included in the calculation of net
 21 worth should be disregarded.

22 Two, to take into account the effective future
 23 inflation on a going-forward basis, the Commission should
 24 adjust the accredited investor thresholds according to
 25 the consumer price index.

1 Three, rather than attempting to protect
2 investors by raising the accredited investor thresholds
3 or excluding certain asset classes from the calculation
4 to determine accredited investor, which we believe are
5 measures of dubious utility, the Commission should focus
6 on enhanced enforcement efforts and increased investor
7 education.

8 And, four, the Commission should continue to
9 gather data on this subject for an ongoing analysis.

10 I am pleased that the staff's report discusses
11 all of these issues and the recommendations include
12 allowing individuals to qualify as accredited investors
13 on other measures of sophistication. And we have with us
14 again today Michal Seaman, special counsel from the
15 Office of Small Business Policy.

16 Now Michael was the primary staffer working in
17 the study. He will give us an overview of the review
18 they conducted, including a summary of the staff
19 recommendations for potential updates and modifications
20 to the definition. Hopefully he will help us to
21 understand the various scenarios that are -- that are
22 envisioned and their possible effect in the pool of
23 capital available for offerings in the 506.

24 So, Michael, I'll turn it over to you.

25 MR. SEAMAN: Thank you very much, and good

1 and used income threshold of \$200,000 individually and
2 net worth threshold of \$1 million.

3 Those thresholds remain in place today. And
4 just to give you an idea of what those numbers look like
5 in today's dollars, \$200,000 in 1982 is approximately
6 \$500,000 today and a million dollars in 1982 is
7 approximately \$2 and a half million today. To give some
8 perspective in terms of the number of U.S. households
9 that qualified today and back in the '80s, in 1982,
10 approximately 1.8 percent of U.S. households qualified as
11 accredited investors. Today over 10 percent of U.S.
12 households qualify.

13 So that kind of highlights one of the
14 criticisms that we've heard about the definition, simply
15 that using financial thresholds that have not been
16 adjusted over time to reflect inflation potentially
17 renders the definition over-inclusive in that it possibly
18 includes individuals who do not have the financial
19 sophistication that the Commission originally had in mind
20 when it set the thresholds back in 1982.

21 Another -- on the other side of the coin,
22 another criticism that we often hear about the definition
23 is that by using financial thresholds, it's under-
24 inclusive in that it doesn't take into consideration
25 other indicators of financial sophistication that people

1 morning. It's been a very great opportunity for me to
2 work on the report and I've found that I've said the
3 words "accredited investor" so many times over the last
4 year or so that they kind of turned into one word, and I
5 kind of mumble them sometimes. So apologies in advance
6 if I do that today, and I'll try to take things slowly
7 and not do that.

8 As you all know and as the chair mentioned and
9 as Commissioner Stein mentioned, the size of the
10 Regulation D market is very large in the United States
11 with over \$1.3 trillion being raised using Regulation D
12 over the last couple of years. So it's a very, very
13 robust, very active market. And being an accredited
14 investor is very important in order to participate in
15 that market. So that's why the definition is very
16 important and why we've been looking at it recently.

17 As Steve mentioned, the definition is intended
18 to encompass those persons whose financial sophistication
19 and ability sustain the risk of loss of an investment or
20 ability to fend for themselves render the protections of
21 the Securities Act registration process unnecessary. As
22 the Commission's rules currently define accredited
23 investor, they use financial thresholds in terms of
24 income and net worth to determine what natural persons
25 qualify. The definition was originally adopted in 1982

1 have.

2 So there could be somebody who's very smart,
3 very well-educated, has a great knowledge and
4 understanding of the unregistered markets and investments
5 and many different degrees from different -- you know,
6 years of study and different certifications, but because
7 that person just doesn't have a job that pays over
8 \$200,000 or hasn't accumulated \$1 million of net worth
9 because they have a lot of education loans they need to
10 pay back, they don't qualify even though they may be very
11 financially sophisticated.

12 So those are kind of two of the criticisms that
13 we often hear about the definition.

14 That being said, not everybody is critical of
15 the definition, and many people think that the definition
16 shouldn't be changed, and oftentimes those people point
17 to factors like the definition by using financial
18 thresholds is very easy to use, it's worked very well
19 over time and that if the Commission were to revise the
20 definition in a way that would contract the size of the
21 accredited investor pool, it could potentially have an
22 adverse effect on capital formation.

23 So why did we do the report? The Dodd-Frank
24 Act requires the Commission every four years to take a
25 look at the definition of accredited investor as applied

1 to natural persons. Chair White instructed the staff to
2 conduct a review and prepare the report as part of the
3 Commission's first review of the definition. On December
4 18th last year, the Commission authorized publication of
5 the report and the report contains a number of
6 recommendations from the staff.

7 The recommendations are structured in terms of
8 alternatives that the Commission could consider if it
9 were to go ahead and revise the accredited investor
10 definition. And the benefit of structuring the
11 definitions in this way is that it allows you to look at
12 the definitions in a couple of different ways. You could
13 look at them as a package, 11 things that the Commission
14 could do all at the same time to change the definition,
15 or you could also look at the definitions as more of a
16 menu, things that the Commission could pick and choose if
17 it were to change the definition.

18 Now that being said, I think that there are a
19 couple of recommendations that work well together instead
20 of being applied just on a one-off basis.

21 So I wanted to just briefly go through the
22 recommendations that were in the report. The first three
23 recommendations deal with the income and net worth
24 thresholds, and the first recommendation is that the
25 Commission could consider leaving the thresholds where

1 The next set of recommendations in the report
2 are suggestions of alternative ways that investors could
3 qualify as accredited investors, not -- regardless of
4 their income or their net worth. So the report suggested
5 five of these. The first one is that the Commission
6 consider whether it could establish an investments test
7 whereby people with certain level of investments would be
8 able to qualify as accredited investors. And the number
9 that the report suggested as a possible number was
10 \$750,000.

11 Now the idea here is that potentially
12 investments are a better indicator of financial
13 sophistication than net worth is, because net worth could
14 include things such as vehicles and other assets that
15 don't have any relation to experience or knowledge about
16 investing.

17 The second alternative criteria that the report
18 suggests is allowing people who have achieved certain
19 professional credentials to qualify as accredited
20 investors. And the three that the report suggests as
21 potential ideas are individuals who have a Series 7
22 certification, which is the general securities
23 representative certification; Series 65 certification
24 which is the NASAA uniform investment advisor exam
25 certification and the Series 82, which is the limited

1 they are today, so \$200,000 of income, \$1 million of net
2 worth, \$300,000 of joint income with the spouse, but
3 applying investment limitations to people who qualify
4 based on those thresholds. And the idea that the report
5 tosses out in this area is potential 10 percent limits in
6 terms of income or net worth. So somebody who qualified
7 having a \$200,000 income would be able to participate in
8 offerings as an accredited investor, but would not be
9 able to invest more than \$20,000 in any given offering by
10 any given issuer in a 12-month period.

11 The second recommendation that the report
12 contains is that the Commission consider creating new
13 alternative and higher income and net worth thresholds
14 that take into consideration the impact of inflation that
15 has occurred over time. And the report suggests that the
16 Commission could possibly use \$500,000 of individual
17 income, \$750,000 of joint income and a million dollars or
18 \$2.5 million of net worth.

19 So these two recommendations are potentially
20 recommendations that might work well together.

21 The third recommendation that involves the
22 income and net worth thresholds is it's a recommendation
23 that this committee suggested in last of last year, and
24 that -- it's that the thresholds be adjusted on a regular
25 going forward basis to reflect the impact of inflation.

1 representative for private securities offerings.

2 The reason why these three certifications were
3 suggested as potential alternatives is because each one
4 takes into consideration to some degree an individual's
5 experience and knowledge of investing in the private
6 securities markets.

7 The next alternative in this section of the
8 report has to do with investment experience, and it would
9 allow individuals who have acquired over the course of
10 their lives a good amount of experience investing in the
11 private securities markets to be accredited based on that
12 experience. And the report suggests that possibly anyone
13 who has participated in 10 private securities offerings
14 by 10 different issuers would be an accredited investor.

15 And the report kind of goes into a little more
16 detail and talks about what types of offerings might be
17 the ones that would qualify for this. So we probably
18 wouldn't have something like a crowdfunding offering in
19 mind, but it would be people who have participated in one
20 way or another on Reg D offerings in the past.

21 The next recommendation is that the Commission
22 consider whether knowledgeable employees of private funds
23 -- so these are individuals who are involved in
24 investment decision making processes every day, but are
25 not necessarily officers or directors of the fund,

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1 whether they should be allowed to participate in
 2 offerings by their own funds as accredited investors.
 3 And the last recommendation in this area is
 4 that the Commission may want to consider whether it would
 5 be possible or feasible to create an examination that
 6 somebody could take and become an accredited investor
 7 based on sitting down and taking an exam that tests their
 8 knowledge on private securities offerings and all of the
 9 risks and things associated with those markets.
 10 The report acknowledges that there would be a
 11 lot of logistical things to consider if the Commission
 12 were to think about this as a potential, including who
 13 would write the exam, who would administer the exam, when
 14 would the exam be updated, how long would passing the
 15 exam be good for.
 16 So that's kind of an interesting idea that is
 17 kind of written in more of a loose way than some of the
 18 other recommendations because the staff recognized that
 19 there would be a lot of logistical things to think about.
 20 But nonetheless, it's an interesting idea that we came
 21 across in the course of preparing the report.
 22 So those are all of the main recommendations in
 23 the report with respect to how natural persons could
 24 qualify as accredited investors. There are a couple of
 25 other recommendations that are in the report, and I'll

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1 mention those just briefly because a large percentage of
 2 accredited investors are not individuals, but they're
 3 entities.
 4 The report does have a section on the
 5 definition of entities and briefly the idea that we
 6 suggested for the Commission to consider is rather than
 7 focus on the type of entity -- because right now the way
 8 that an entity could qualify is that there's a list of
 9 different types of entities and if you're on the list --
 10 for example, if you're a bank or if you're a corporation
 11 or if you're an insurance company, you're on the list and
 12 you could potentially qualify as an accredited investor
 13 based on being on the list.
 14 But if you're not on the list -- and there's
 15 many different types of entities that are not on the
 16 list, for example, limited liability companies are not on
 17 the list because the list was created at a time when
 18 limited liability companies didn't really exist.
 19 So there's a number of different types of
 20 business entities that aren't on the list that are kind
 21 of excluded from being an accredited investor definition
 22 right now. So the report suggests that perhaps the
 23 Commission treat all entities equally and any entity that
 24 has an excess of \$5 million of investments be treated as
 25 an accredited investor.

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1 The next recommendation has to do with spousal
 2 equivalence and it suggested the Commission consider
 3 spousal equivalents to be treated similarly to the way
 4 spouses are in the definition in terms of pooling their
 5 financial resources to qualify based on the net worth and
 6 the income tests.
 7 And then the final recommendation in the report
 8 -- this is one that the Commission would not adopt on its
 9 own because it depends on other changes to the definition
 10 in order for this one to make any sense -- is that if the
 11 Commission does change the definition in any way, the
 12 report suggested the Commission consider grandfathering
 13 current investors who qualify based on the accredited
 14 investor definition as written today and who continue to
 15 qualify in the future based on the definition as written
 16 today for future offerings by any issuer in which they
 17 are currently an investor.
 18 So this -- the idea here is that it's kind of
 19 an anti-dilution protection for people who have already
 20 participated in offerings by certain issuers.
 21 So that is the summary of the recommendations
 22 that are contained in the report. The Commission opened
 23 up a comment box when we published the report, and we've
 24 gotten about 30 comment letters today. Some of them are
 25 very good, very long and address all of the

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1 recommendations. We're hoping to get many more. We're
 2 excited to see what recommendations this committee comes
 3 up with. And just a couple of quick themes that we've
 4 seen is that we're not surprised to see that there are
 5 people on all sides of the debate when it comes to the
 6 comments.
 7 So there are some people who think that the
 8 Commission should do nothing with the definition because
 9 it's worked very well in their opinion. There are people
 10 who think that the thresholds -- the financial thresholds
 11 should be increased. There are some people who think
 12 that they should be decreased. So we're not surprised to
 13 see lively debate on all sides of the topic.
 14 One thing that almost everybody does agree on,
 15 though, is that the Commission should consider having
 16 alternative ways for investors to qualify that are not
 17 simply based on income and net worth thresholds. Not
 18 everybody agrees on what exactly those alternative ways
 19 should be, but it seems like there's almost universal
 20 agreement that possibly having some different methods for
 21 qualification is something for the Commission to
 22 consider.
 23 So that is the end of the summary that I had
 24 about the report and I'm happy to take any questions that
 25 the committee has either now or during the course of

1 their discussions about the definition. Thank you.
 2 MR. GRAHAM: Well, thank you, Michael. Thank
 3 you for your time this morning and thank you for the time
 4 you've spent putting this report together.
 5 I would like to hear from everyone on the
 6 committee and just to kind of kick things off I'll say a
 7 couple things that come to mind so that everyone else can
 8 kind of collect their thoughts. But while you're here,
 9 it's good to have you as a resource.
 10 I've heard a lot of good ideas, but I'm not
 11 sure if I understand the problem we're trying to solve.
 12 Yes, the thresholds were essentially set in 1982, but
 13 does that make them wrong? We're dealing with an
 14 important ecosystem that is supporting capital formation
 15 quite well and have not -- I've not heard words actually
 16 failing from an investor protection point of view. And
 17 if we start tinkering too much, we could very end up
 18 unintentionally damaging a system that is clearly very
 19 important to the small business community and quite
 20 frankly important to the country at large.
 21 So absent better articulation of the problem
 22 that we're actually trying to solve as opposed to just
 23 simply going and reviewing to see if we think there's an
 24 issue, I would be reluctant to do too much.
 25 Again, there are a lot of good-sounding ideas

1 that I think are attractive at least on their face. I
 2 think just the whole notion of putting -- taking
 3 thresholds and coming up with the 500,000, 750,000, 2.5
 4 million changes, I think that if -- I can understand the
 5 logic that underlies that suggestion. Certainly things
 6 like including spousal equivalents is just kind of
 7 bringing things in line with the times I think. And
 8 Commissioner Piwowar's suggestion about portfolio theory,
 9 taking that into consideration, that just makes my head
 10 explode. But I think -- but it sounds definitely worth
 11 of consideration.
 12 But has anyone shown that investments in this
 13 sector are any more problematic than the public markets,
 14 markets by the way that are made available to
 15 unaccredited investors spectacular failures? And are we
 16 seeing increased fraud in this segment? I'm not sure
 17 that we are. And while 1982 was not yesterday, at least
 18 two things come to mind. One, who's to say that the
 19 numbers in 1982 weren't too high? They're just numbers.
 20 And, two, I think the context has changed
 21 dramatically. We talk about information and the ability
 22 to educate oneself and certainly with the advent of the
 23 internet and other technology, it's -- 2016 is quite a
 24 different place than 1982.
 25 So -- and also to develop a framework where we

1 tell certain investors that there's a limit to how much
 2 they can invest strikes me as paternalistic and
 3 potentially off base. The goal has to be to prevent
 4 fraud and not to prevent losses resulting from legitimate
 5 business failures. And I think the idea is to protect us
 6 from fraudsters and not to protect ourselves -- not to
 7 protect us from ourselves.
 8 So from -- I think the -- in terms of coming up
 9 with a more nuanced definition as well, what's it -- what
 10 is attractive about Regulation D for all of us that have
 11 been around long enough to know about 146 and all the
 12 rest was the fact that suddenly there was certainty and
 13 there was reduced complexity, which is something that we
 14 should be striving for with our rules.
 15 So I continue to be in favor of preserving the
 16 core of what we have largely because it works. And
 17 certainly I continue to be in favor of expanding the
 18 definition as well. It's -- I think more is better, but
 19 you start getting into some of the suggestions with
 20 respect to defining certain levels of -- certain classes
 21 of sophistication, and I think that is going to get
 22 complex and it may end up getting to be a little more
 23 complicated than we would like. But as long as that's
 24 not the only way and as long as we preserve the core, I
 25 think that it continues to work.

1 Those are just a few of my initial thoughts.
 2 So -- yes, Catherine?
 3 MS. MOTT: Michael, thank you for that report
 4 and the summary. I read it, but it was good to go back
 5 through and pull out the highlights. So I'm going to
 6 echo some of Stephen's thoughts. When I look at 1982,
 7 that was an arbitrary number, and what was the basis for
 8 which that was selected.
 9 And I also am going to waive the American flag
 10 here. So when I say this it's that I look at 1982, 1.8
 11 percent qualified; 2014, 10 percent qualified. And I
 12 think about my own market as a -- running and angel group
 13 and running a venture fund is that we are the economic
 14 engine for net job creation in the United States. And
 15 actually when you look at the corporate numbers, they're
 16 net job -- what do you call it -- net job losers.
 17 They're always doing -- they're about becoming
 18 bigger with less people. We're about becoming bigger
 19 with more people. And so when I think about these
 20 things, I think it's really critical for us to think
 21 about do no harm, especially when the world economy is --
 22 right now is a tech economy. And for us to be
 23 competitive in the marketplace, I believe that this has
 24 to be a very robust market. So one of the things we
 25 shouldn't do is limit it to the point that we become less

1 competitive globally.

2 I also think around the numbers, around 2.5

3 million as a threshold with 500 annually, that might

4 really work well in Los Angeles or New York City, but for

5 me in Pittsburgh or somebody in Louisville, Kentucky or

6 elsewhere, there's some disparity there because doctors

7 in my angel group are making 300,000, but if they were in

8 New York City, they'd be making 550,000.

9 So putting those numbers around -- I think it

10 unfairly limits the middle of America where the middle of

11 America needs it more than Silicon Valley and Boston and

12 New York.

13 The other thing I would like to comment on is

14 if we pick something like \$750,000 investments as a

15 threshold, we're doing the same thing we did in 1982.

16 We're picking a number. And what basis are we picking

17 that number?

18 And then finally one of the things I think

19 about when -- you know, I'm thrilled when we see the

20 increase in private offerings. The market drivers for

21 that, though, is what we have to give thought to. One of

22 the things I'd like to understand about those numbers is

23 when I think about the public companies delisting and

24 taking private capital because it's no longer an

25 opportunity for them to grow, there are limits because

1 they have to report quarterly, which is fine, but if they

2 don't get the numbers properly -- don't hit the market

3 expectations, they can't invest long-term. And so they

4 delist. So how much of that 1.-some trillion that I'm

5 trying to remember what it was now is actually coming

6 from private capital because public companies have to

7 delist.

8 The other is: How much of this is driving --

9 is because of the tech economy? I mean it's something

10 that we didn't have in 1982 but we have now. And so

11 private capital is needed for that, and it has been

12 growing because we've been educated by the internet and

13 other things.

14 And finally, how much if it is driven by the

15 JOBS Act itself? So I'd just like to -- I think we need

16 to understand those numbers. I think those are -- I look

17 at it as an exciting thing, not a dangerous thing, and I

18 think it's really healthy for our economy. Thank you.

19 MR. GRAHAM: Thank you.

20 Kyle.

21 MR. HAUPTMAN: Yeah. I like what you said,

22 Stephen, about we're supposed to protect from fraud, not

23 from ourselves and the investments we pick. But at the

24 beginning you said you're not sure what the problem we're

25 here to solve is. Isn't that the problem, that the

1 current definition is protecting us from ourselves?

2 MR. GRAHAM: When I said I didn't know what the

3 problem was, I was being facetious.

4 MR. HAUPTMAN: All right. Fair enough. Yeah,

5 I just -- it is odd to me that in SEC the rulemaking, not

6 only does it require -- as a place for advisors to advise

7 on these things, CPAs, lawyers to certify private

8 offerings, it has a committee of this room to suggest on

9 the appropriate accredited investor rule and it has lots

10 of SEC staff. There are folks in this room on this

11 committee who don't meet the standard.

12 I'll tell you right now I don't. So it's odd

13 to me that I'm being asked to opine on it when this same

14 committee won't allow me to invest \$5,000 on it. But I

15 do have a seat at the table to advise on trillions of

16 dollars of offerings. It just -- I don't know.

17 If it was Excel, it would be one of those

18 circular errors and to have staff who -- I don't know

19 anybody's finances, but to have a place in the regulation

20 for all of these professionals, including the members of

21 this group who are not eligible to invest even a small

22 amount of money outside of the new crowdfunding, it just

23 strikes me as an opportunity to review it and ask which

24 part of it that -- what I consider a circular error is

25 the issue.

1 MR. GRAHAM: Yeah, and I would tend to agree

2 with that. It's, again, I -- we have a system that

3 clearly works. We have a system where I haven't seen a

4 lot of evidence of fraud and -- or otherwise the need for

5 the kind of investor protection we're used to thinking

6 about in terms of enforcing our laws and that sort of

7 thing. So that works. So let's not bother -- let's not

8 adversely affect the core.

9 But there are a lot of good ideas that come

10 into the subject of expansion, and I mean you've

11 mentioned something which I think pretty much hits it.

12 And that's we've got so many people that are -- they're

13 very sophisticated and can advise others in these kinds

14 of investments, but are not in a position to make the

15 investments themselves, which makes absolutely no sense,

16 at least in my view.

17 Mark.

18 MR. WALSH: Good morning. Sorry I was late.

19 I'm with the SBA, and I will echo Betsy's original

20 statement. This is my personal opinion. I have seen

21 very little dramatic evidence that there is a direct

22 correlation between wealth and sophistication. So to

23 suggest that wealth as a yardstick implies sophistication

24 I think is specious to begin with.

25 The second is that I've also seen correlations

1 that show that wealth and sophistication, in fact, are
2 disconnected. There are Harvard MBAs driving taxicabs
3 who would fail virtually every single test that has been
4 suggested or currently exists who are more sophisticated
5 in the types of deals we're talking about.

6 And as a personal -- as an angel investor in 30
7 to 40 deals where I constantly self-certify that I am
8 accredited, I always kind of giggle at that because it
9 just strikes me that, in fact, people with an unusual
10 appetite for risk will always find a way to bet their
11 money. Now it could be the pink sheets or -- I mean
12 there's just a significant number of ways that people
13 with an undue appetite for risk and low incomes will find
14 ways to waste income. Darwin was right.

15 So I wonder if we might be looking at the wrong
16 end of the telescope. I heard the assertion that this
17 has worked. I would heretically challenge that. I'm not
18 sure -- what has it worked? What's an example recently -
19 - recently of an example where the accredited investor
20 rule has saved people money that they would have lost if
21 they had been able to invest it.

22 And I would suggest the final point I'll make,
23 which actually you made, which I think is incredibly
24 important is that today I can go on the internet today
25 and I can find out virtually every single thing about

1 everybody in this room -- their social security number,
2 their income, their neighbors, everything about them
3 today is available.

4 So the fact or the assertion that unaccredited
5 investors have as much blindness about the prospects of a
6 company as they did in 1982 when it was written is also
7 specious. So I think if information is readily available
8 in a wide variety of pathways for people that have
9 appetites for risk that may or may not be appropriate for
10 their income, have we fixed anything or solved anything
11 or corrected anything with this since '82? I'm not sure
12 I see the evidence. I believe as was stated a while ago
13 that it should be removed.

14 MR. GRAHAM: Greg.

15 MR. YADLEY: Thank. I want to talk early so I
16 don't have to echo too many other people's views here
17 because I think Commissioner Piwowar set it up and Mike
18 just said the same thing. I think more effort, talking
19 about how to open it up to people who are not accredited
20 would be important.

21 And it's the logical extension of our
22 discussion previously at this committee where we talked
23 about some of the fallacies in trying to protect people
24 and for example protecting seniors. Obviously everyone
25 wants to protect seniors, but what is a senior now? And

1 I deal with this representing corporations that are
2 looking at director age limits and things like that.
3 That's not a proxy at all for sophistication either.

4 What has been earlier mentioned in terms of the
5 ability of investors to invest in the public market where
6 there is a high failure rate and unfortunately instances
7 of mismanagement and fraud, there's not necessarily more
8 in the private market.

9 The securities laws and the mission of the
10 Commission has always been based on disclosure, and
11 disclosure is one of the answers here along with more
12 education.

13 Education is one of the factors that people
14 have mentioned as a potential other criterion for
15 accredited investor statute. That's also a slippery
16 slope, because how much education do you need to invest
17 and do you need different kinds of education to invest in
18 different deals?

19 I think I used the analogy the last time that
20 I'm a sophisticated securities lawyer, but I do have
21 trouble when I'm reading the footnotes to Bank of
22 America's 10-K.

23 I have invested in deals involving science. I
24 didn't take very much science since high school, but
25 overall I think that I can make risk allocations.

1 Excluding retirement assets was another idea that had
2 been mentioned.

3 Again, all these I think fall within the idea
4 that we need to protect people from themselves. And, in
5 fact, as we age up, almost everything that we invest in
6 becomes our retirement assets. So I guess I second or
7 third the viewpoint that we really should be talking
8 about expanding the sphere of Americans who can invest in
9 transactions in the private market and not restricting
10 them.

11 MR. GRAHAM: Thanks, Greg.

12 Sara, you --

13 MS. HANKS: Yeah, I had a question for Michael,
14 in fact, on data. One of the things that is a constant
15 theme both in the SEC's report and on our sister
16 committee, the investor advisory committee,
17 recommendations and in our recommendations, we keep
18 saying you should continue studying the data. The
19 trouble is I'm not sure that we actually have the right
20 data.

21 Steve mentioned earlier measures of dubious
22 utility. And I think here we're looking at metrics of
23 dubious utility. One of the most interesting things that
24 I think is in the staff's report is the Swedish study
25 where contrary to what Mark said -- and maybe it's

1 because they're Swedes -- but there's a study there that
 2 shows that financial sophistication does, in fact,
 3 increase with wealth. And that's a very, very
 4 interesting data point, but it was one of the very few
 5 relative data points that we've actually got.
 6 Because the metrics we've got are how many fall
 7 into this bucket, how many fall into this bucket. If you
 8 took this measure out, how many would be in this other
 9 bucket. But we're not answering the basic question, as
 10 Steve said, which is: What problem are we trying to
 11 solve here? What could we be looking for? What data can
 12 we access that would actually help us answer this
 13 question.
 14 And I know that's a very difficult thing to
 15 answer at the moment, but until we know what we should be
 16 looking for, I'm not sure that we have a decision to
 17 make. What data sets are out there, Michael, and what
 18 would we like to be looking for here?
 19 MR. GOMEZ: Can I chime in and -- Sara, I think
 20 one of the challenges as looking at data is understanding
 21 who is actually investing versus who is just not
 22 interested in investing. And I think part of the
 23 challenges is understanding that. Now the difficulty is
 24 once you come up with a definition that encompasses a
 25 group just because they're not investing now, it doesn't

1 mean that they're not going to invest in the future.
 2 A lot of the data that we have looks at
 3 percentage of the populations that either qualify under
 4 the current thresholds or would potentially qualify on
 5 the revised thresholds. I think it would be very
 6 interesting through the comment process for people who
 7 are active investors to provide some more information
 8 that would help the Commission understand who is actually
 9 investing out of that pool of 10 percent of the
 10 population. Do we really have 10 percent of the American
 11 population investing in Reg D offerings, or is it a much
 12 smaller pool of those investors?
 13 I know the Angel Capital Association has done
 14 some surveys of their members who are active investors in
 15 that area. It would be interesting to see what the
 16 profile of those members are. Also challenging is the
 17 fact when you add other measures of sophistication, it's
 18 sometimes difficult to understand whether those measures
 19 of sophistication will encompass new people that would
 20 come into the pool, or are they just the same people who
 21 currently qualify under the definition.
 22 So, for example, if you are a -- if you pass
 23 the Series 83 examination, are most of those individuals
 24 who already qualify under the current definition? If you
 25 already have \$750,000 in investments, are you likely to

1 already exceed the \$1 million net worth test anyway?
 2 Part of the getting additional data I think
 3 would come through commenters that chime in in response
 4 to the report, and I think all of those comments and
 5 views would be helpful as the Commission continues to
 6 consider the topic.
 7 MR. GRAHAM: Well, Sebastian, at a minimum we
 8 get Kyle. When you -- we talk about the data, we talk
 9 about the fact that, for example, we know what the
 10 definition of accredited -- what today's definition of
 11 accredited investor is. But we don't know precisely who
 12 is doing the actual investing. And so -- but, again, it
 13 just kind of gets me to my point: Why are we trying to
 14 find the answer to that question? I'm still trying to
 15 appreciate that.
 16 I think we started out someplace which, as
 17 Catherine suggested and I think I may have suggested it
 18 as well, that was arbitrary. 1982 I think was probably
 19 arbitrary. But that's kind of where we are.
 20 And, Mark, when I say that something works,
 21 what I mean is that we have a system in place where small
 22 businesses are able to raise \$1.3 trillion a year. Don't
 23 ask me why, but that does happen and with the current
 24 system.
 25 So that's -- anyway, Lisa, you had --

1 MS. SHIMKAT: Yes. And I'm kind of going to
 2 echo what you were saying, too, to hurry and jump in
 3 before it's all -- before it just is echoing.
 4 The -- I disagree a little bit because the no
 5 complaints could come back to we're not measuring the
 6 right stuff. And maybe instead it's doing a really good
 7 job to have the qualified investor, is it for prevention
 8 of fraud or protect losses. And then it's the chicken
 9 and the egg. It feels like we have a very circular
 10 conversation there.
 11 And especially being in the Midwest I
 12 thoroughly agree the cost of living there, you know, a
 13 4,000 square-foot home, 115,000. And so it kind of puts
 14 some things in perspective.
 15 (Off-mic comment.)
 16 Well, after I get rid of a few kids, I'll let
 17 you know.
 18 But -- so that needs to be taken into
 19 consideration, too. And you spoke about 1.8 to 10
 20 percent, but the 10 percent I don't think is a bad
 21 number. Maybe we should look at it as, wow, that should
 22 actually be closer to 20 percent. The 1.3 trillion, why
 23 isn't it 2 trillion? Do we -- where are our
 24 opportunities? And, yes, what the commissioner said made
 25 my head explode, too, but at the same time it was like

1 the Wizard of Oz. You pull that curtain back and think,
2 oh, hey, there's other opportunities here. And I think
3 maybe that's another way to look at it.

4 But it's about also, Stephen, what you said,
5 too, the why side, asking those why questions. Why the
6 number? Is the number for protecting those losses or
7 preventing fraud? Why the sophistication if there are
8 other avenues? Are we regulating the wrong side of it?
9 Is there the other end of it that maybe the enforcement
10 side can focus on that versus the investor side?

11 And it's a totally changing landscape. And,
12 yes, we don't have the demographics. There could be
13 those investors that are being counted twice because
14 they're here, they're investing in this as well. So we
15 need to maybe look at positioning ourselves for what our
16 overall intent is. And that's where asking why the three
17 to five times -- why are we doing this, why do we need to
18 know this and what is our overall goal and how is it
19 going to make it better.

20 So I think those are things that maybe this
21 regulation is giving us or the qualified side is giving
22 us more of an acceptable loss of capital investment is
23 because there could be a portion that we're not
24 capturing, but it's not the portion that is speaking up,
25 it's not the portion that's writing in. And it's just a

1 there. I work with some of these clients. When I was --
2 when I worked for large corporations that were SEC
3 reported, things went like a top. You didn't have to
4 address many of the issues that you do when you're first
5 starting and taking clients through that process of
6 beginning to become more formal, having to register,
7 having to do things differently.

8 So I would suspect -- and this is just
9 qualitative -- that once we start to have an equal level
10 of examination that perhaps there is a little bit -- I'd
11 be surprised if there weren't more, frankly, let's say
12 educational opportunities that could borderline onto
13 aggressive types of reporting. I think in the past it's
14 been okay because we've had a limited pool of investors.

15 But that brings back to the point of
16 Commissioner Piwowar that was saying are we in a way
17 limiting then the general population to participate in
18 the growth of the economy? So as we push our people more
19 into retirement to rely less on governmental assistance,
20 defined contribution or defined retirement plans from
21 large corporations, they are being forced to go to other
22 avenues of investments, which I'm not disagreeing with.

23 But by conceptually if we're limiting that
24 population not to have access to this, are we in essence
25 limiting their future and their retirement also? So

1 different thought on it, and I just wanted to share that.

2 MR. GRAHAM: Thank you.

3 Laura.

4 MS. YAMANAKA: Well, actually, yeah, you've got
5 to weigh in early because everybody says great things
6 here. But as to why, I have a different perspective why
7 we're here. We're here, in my opinion, to protect and
8 encourage and increase the greatest capital system in the
9 world right now, right, with all our faults, with all our
10 issues, with all our complaints.

11 And when I look at that, although I respect
12 stability -- hey, I'm an accountant, right? You know,
13 our goal is stability. On the other hand, to some other
14 people's points, are we missing out on an opportunity for
15 capital formation that has grown tremendously?

16 So if I look at the infrastructure that we've
17 put into place for public corporations with the SEC
18 reporting, that's huge. We've got another segment of the
19 population or our business that has grown to be a
20 comparable size and kind of -- it appears to me that the
21 regulation process is not supported, frankly, on the same
22 level as far as infrastructure support. We don't know, I
23 think, about the fraud because we don't look at it, we
24 don't have the mechanisms in place to identify it.

25 I'm going to throw a qualitative statement in

1 these are just a couple of questions that I have, one on
2 throwing it out there to think -- for people to think
3 about as far as what our greater purpose it, and then,
4 two, I really wish we could get some additional data on
5 the fraud.

6 I also suspect we don't hear about it as much
7 because when those businesses go under, it's less
8 spectacular. It might be regionally of interest, but
9 it's much more notable when you have an Enron or
10 executive life or something else in that case.

11 MR. GRAHAM: And to your point, what's to
12 prevent the unsophisticated investor from buying Enron
13 stock?

14 MS. YAMANAKA: Yeah, you're absolutely -- well,
15 absolutely.

16 MR. GRAHAM: I think like Mark was saying I
17 think, a fool and his money will soon be separated. We
18 don't need to --

19 MS. YAMANAKA: And I think we have to accept a
20 certain -- I mean we all have to accept a certain amount
21 of risk, right? And in reality unless we close it down
22 absolutely, we are going to have those situations in my
23 mind. But that's my opinion.

24 MR. GRAHAM: Annemarie.

25 MS. TIERNEY: I actually echo Laura's comments

1 also. One of my thoughts was that we see the data that
2 public market returns are just not where they were in
3 1982. Probably in 1982 if you invested in a public
4 company, you could expect a pretty substantial return
5 over the life of your investment. Those dynamic is
6 changing now. The real returns in investment seem to be
7 in the private company space as opposed to the public
8 company space.

9 And I also had the exact same point in my
10 brain, Laura, which is that significant numbers of U.S.
11 investors are not going to be getting a pension when they
12 retire. We're going to be relying on our 401(k)s, we're
13 going to be relying on our portfolios. And if the most
14 significant access to return is in the private company
15 space, why would we limit that opportunity.

16 I really react very badly to the idea of a
17 dollar investment limit. We've already imposed that in
18 Reg A and Crowdfunding. You're protecting people against
19 loss as opposed to protecting people against fraud, which
20 I don't think is the best way for the market to be
21 developing. I don't need somebody to say to me you can
22 only invest this much in an opportunity that I really
23 believe is right for me in my own specific circumstances
24 with my own specific risk tolerance.

25 I don't that at the SEC you should be imposing

1 investors and improve capital formation after the Great
2 Depression.

3 So there was a huge amount of fraud. It was
4 all done in private offerings. So the idea was to
5 improve disclosure, to allow investors to have certain
6 basic information they could rely on, whether it was
7 audited financials or other required disclosures, and
8 they would be able to compare investments. So they'd be
9 apples to apples.

10 So if you go back to those acts, both of them
11 severely restricted the ability to do a private offering.

12 You could do an offering with 15 of your closest wealthy
13 friends, and that was sort of the only way to get out of
14 the disclosure requirements of the '33 Act in particular.

15 Going forward, go to 1982 -- but the subsequent
16 years you have the '40 Act, which is mutual fund
17 protections and thinking through things, again, in a
18 different way because of problems in the marketplace,
19 still very firmly based on disclosure. We get to '82,
20 and we're basically saying, again, it's a new world,
21 we're going to open up the ability to have more of these
22 unregistered offerings, so you don't have to submit
23 paperwork to the Securities and Exchange Commission. It
24 doesn't have to be in the same form, so investors compare
25 apples to apples, and you're going to be providing it

1 suitability on investors as a general rulemaking
2 endeavor. I think it should be up to investors to make
3 those decisions for themselves. And over the last 10
4 years we've been limiting those opportunities and those
5 choices for U.S. investors, which I just don't think
6 there's a basis for.

7 And I would like to understand: Is there data
8 that shows that it's more risky to invest in a Reg D
9 offering than in the public markets?

10 Commissioner Stein, you referred to the
11 implosion of the markets for housing prices and the
12 public markets, but that was housing prices in the public
13 markets. People lost trillions of dollars of wealth in
14 the public markets. I don't know what the data looks
15 like in the private space, but that would be something
16 I'd be really interested in learning.

17 COMMISSIONER STEIN: I think they lost it every
18 during the --

19 MS. TIERNEY: I think you're right.

20 COMMISSIONER STEIN: -- financial crisis just
21 for the record. Anecdotal at this point. But can I just
22 say one thing? I think one of the things -- maybe this
23 is being securities geek -- is I go back before 1982 to
24 the '33 Act and the '34 Act, right, which are sort of
25 foundational here for how we thought about how to protect

1 people who can rely on -- who are sophisticated enough to
2 decide whether to part with their money based on the
3 information that is being provided.

4 We go on down the line, we have private equity,
5 we have venture capital, we have all these wonderful
6 things happening in the marketplace. But I think one of
7 the underlying issues is -- and I hear it over and over
8 even from the very sophisticated players is sometimes
9 it's hard to demand and get the information you need to
10 make the investment. It depends on your leverage so to
11 speak as an investor about whether or not you can get the
12 information you need.

13 So I guess I would reframe this. In my mind we
14 have a growing private market. It is now bigger than the
15 public market. I think there are issues about how is
16 that affecting price discovery and the public marketplace
17 if we're having more and more happen in the private
18 space. And if more and more is happening in the private
19 space, maybe that's okay. But what type of disclosures
20 or information should be required to sophisticated,
21 accredited players or the less accredited players? We're
22 talking retail investors.

23 So I think we have this -- we've been using
24 this accredited investor standard as a gateway for
25 whether you get to invest in the private market or the

1 public market. Maybe that's not the right gate.
 2 But I think the bigger issue from a conceptual
 3 standpoint is this divide between private and public and
 4 what does it mean for the private marketplace if it's --
 5 you know, it's easier to get money through the private
 6 than the public. What does it mean for the public? And
 7 do we need a different conception now eighty years more
 8 than that after the Great Depression.
 9 So I think that, again, securities geek, but
 10 sort of framing it differently is these are all part of
 11 the same continuum of capital raising and the world is
 12 changing and we're being disrupted as everybody knows in
 13 this room, but I think we have to think through both
 14 sides of the equation, the private and the public and how
 15 we help investors make the best decisions they can to
 16 take on as much risk as they might be willing to take on.
 17 But we have these different tools in our
 18 toolbox for investor protection and how should we use
 19 them in 2016 and beyond? So that's -- again, I think it
 20 goes back pre-1982, severely limiting access to private
 21 offerings, starting to open that up, using this
 22 definition as the gateway whether it's the right one or
 23 not. And where are we now in 2016?
 24 MR. GRAHAM: So, Commissioner, are you asking a
 25 different question of -- are you asking whether we should

1 be focused on disclosure as opposed to a definition --
 2 COMMISSIONER STEIN: No, I guess I'm saying as
 3 we talk about the definition in the private space, it
 4 very much implicates the public as well, and I think we
 5 need to actually be thinking about both, you as a
 6 committee, us as a Commission.
 7 (Off-mic comment.)
 8 MR. GRAHAM: Okay. And I think some -- okay.
 9 Let's -- one, two, three.
 10 MS. KASSAN: Thank you. I just wanted to
 11 mention we haven't talked about rule 504. I have -- I'm
 12 an attorney and I have clients that are fairly small
 13 raising a few hundred thousand. And they use Rule 504
 14 and then they do state-level compliance. So, for
 15 example, in California, you can have up to 35
 16 unaccredited investors.
 17 So I think that's another interesting question:
 18 Why is it that if the issuer's only raising a million
 19 you actually don't have to be accredited to invest. So
 20 it would be interesting to see, you know, look at some of
 21 the 504 offerings and see if there's -- what the data is
 22 on the unaccredited investors that are investing in
 23 those.
 24 And then I also have a question, which is: Has
 25 there been any consideration of the issuer or the

1 offering side when talking about accreditation? You
 2 know, maybe there's a different standard for different
 3 types of issuers or different types of offerings. I feel
 4 like there may be certain areas -- certain types of
 5 issuers or offerings where fraud may be more likely,
 6 where maybe you have a higher standard. So there's a lot
 7 of discussion about the investor, but I'm just wondering
 8 if there's been any consideration of the other side in
 9 terms of throwing that into the mix of the definition.
 10 MR. SEAMAN: So in the report we do talk a
 11 little bit about that idea in terms of whether the
 12 definition should be tailored in different ways and based
 13 on the type of issuer is one of the things that the
 14 report does address and talks about. But at the end of
 15 the day, none of the recommendations that were set out in
 16 the report actually recommended the Commission consider
 17 doing that.
 18 And I think that speaking personally like
 19 possibly one of the reasons was that would just
 20 complicate the definition in potentially a way that would
 21 make it a little bit more unwieldy than it is currently.
 22 MR. GOMEZ: And, Jenny, anecdotally -- here,
 23 Sebastian. The echo in this room, sometimes it's hard to
 24 figure out where it's coming from. Anecdotally I think
 25 we've also heard from people mentioning how they would

1 view it differently. Some people have said, well, if
 2 you're invested in a hedge fund, your risk is going to be
 3 a lot less. Therefore maybe the standard should be
 4 different if your investment is in a hedge fund.
 5 Some people have taken the opposite view and
 6 says, well, why trust your money to the hedge fund,
 7 instead the risk would be less if you actually can meet
 8 with the people at the company and understand their
 9 business. And so I think while the idea had been
 10 mentioned, at the same time I think a lot of people
 11 differ onto how they would apply it and they would come
 12 up at different answers based on the way they look at it.
 13 And it's not necessarily pointing to one type
 14 of issuer and saying these issuers can deal with a light
 15 accredited investor versus a heavier accredited investor.
 16 MR. GRAHAM: Yes.
 17 MR. GUTIERREZ: So, first of all, appreciate
 18 this conversation. I really wanted to make three
 19 comments. The first is that I do think it is important
 20 for us to review these types of things besides the fact
 21 that it's mandated by Dodd-Frank, I think it's important
 22 for us to take a look at this periodically to see if we
 23 are actually answering the right question.
 24 The second comment is as I was reading the
 25 report, the recommendations, it felt as if there was this

1 connection and this correlation of you have more
2 investors, and thus you have a bigger problem, which I
3 had an issue with. I don't believe that that correlation
4 should be there, and I think it should be closer to a
5 reexamination of the issue of are we getting the proper
6 disclosures within Reg D and dealing more with the
7 issuers rather than with the investors on this problem.

8 The final comment I wanted to make is I wanted
9 to bring sort of our or my perspective of dealing with
10 small business owners, right, that quite frankly would
11 not qualify under these new qualifications. However,
12 they are incredibly sophisticated. They may be
13 incredibly sophisticated in those industries in which
14 they'd like to put money out. And so from the
15 perspective of these millions of small business owners
16 changing the rules on them would actually be incredibly
17 limiting.

18 And I really would like for us to keep that in
19 mind as to who exactly we're talking about when we're
20 talking about investors. You have this incredibly robust
21 small business community led by business owners and
22 changes that would limit their opportunity I think would
23 be very hard-pressed for me to be supportive of. So
24 thank you.

25 MR. GRAHAM: Thank you.

1 Was it Robert or Brian?

2 MR. HAHN: So I work for a biotech company that
3 operated as a private company for 11 years before we went
4 public. Several times a year we present our data at
5 different scientific meetings, and we've been approached
6 by people in the field, by scientists who are very
7 excited about our novel approach to drug development and
8 wanted to invest in the company. But as a private
9 company, they didn't qualify, they weren't able to.
10 Biotech companies fail because of bad science, usually
11 not fraud.

12 We're -- and in the biotech industry we're very
13 open to expanding. Even to Commissioner Piwowar's
14 recommendation or comments about getting rid of limits,
15 if we keep the limits, either reduce them or come up with
16 some other way to expand this pool.

17 One of the reasons we went public was because
18 of lack of options for funding as a private company. And
19 a lot of times we were permanently -- we were actually
20 all VC-backed and a lot of times with our three rounds of
21 VC funding, you're beholden to the VC to dictate the
22 valuation and the term sheets. And I think there's a
23 bigger pool of investors, that would actually help small
24 companies determine the true value of the company instead
25 of just having it dictated to you.

1 MR. GRAHAM: Robert, did you -- okay.
2 Patrick.

3 MR. REARDON: Thank you. I've got a comment
4 letter on file on this, and so I'm not going to repeat
5 what's in there. But, Commissioner Stein, I think
6 there's two issues here. One is disclosure material
7 information and -- with which I vigorously agree that
8 anybody who makes a private placement investment needs to
9 have all material information in front of them and that
10 that is essential. And there's no dispute from me that
11 they need that, that that's important. That's just a
12 rule you play by. If you're going to sell securities,
13 you have to disclose all material information, 10(b)5.

14 So the other side is do you prevent fraud. And
15 if -- my experience has been that all the rules in the
16 world are not going to prevent crooks from being crooks.

17 So are you fixing something -- do you fall into the trap
18 of fixing something that you can't fix? In other words,
19 are we trying to prevent fraud here? I'd like to. I'd
20 like that there would be something we could write on this
21 piece of paper that says -- that would prevent fraud, but
22 I'm afraid that's ineffective. I think what you're doing
23 is you're burdening honest people with trying to deal
24 with crooks.

25 The crooks have to be dealt with by

1 enforcement, and I'm all in favor of vigorous
2 enforcement. Kick their butts. I'm from a state that
3 once sent a securities violator to prison for life
4 because that was his third offense and he was a three-
5 time loser. So he went to jail for life for securities
6 fraud. And there's no regret on my part about that.

7 So that -- and I don't mean to disagree with
8 you, and I hope -- I mean I think fraud is -- and you've
9 got a tremendous budget here for fraud, plus you've got
10 the 50 states chasing fraud. So -- plus private
11 litigation. That, to me, is an issue.

12 Chair White, you gave a speech at the end of
13 March in the Silicon Valley that was very interesting.
14 And I think that one of the --

15 CHAIR WHITE: I barely got out alive just so
16 you know.

17 MR. REARDON: Oh, you barely got out alive?
18 Well --

19 CHAIR WHITE: I did, though.

20 MR. REARDON: Well, I'm glad you did. We're
21 happy to have you back. And in that speech you were
22 talking about that the -- all this money has flowed into
23 the private sector and that it's not subject to the
24 scrutiny that it gets in a public offering. And I agree
25 with that.

1 And funny thing, I call around and talk to
2 clients and friends I have in business where I come to
3 these meetings because they all -- every once in a while
4 they give me a nugget of something. And I was talking to
5 a man who had been a CFO of a private company. And he
6 said, "Yeah, I remember S-16," that form which was the
7 simplified form for public offerings under \$1 and a half
8 million. Was that right? I can't -- it was a very small
9 amount.

10 Well, we have gone a long way from that. And I
11 look back and I'm -- maybe my perspective is different
12 than some people, but I look back and I look at like
13 Sarbanes-Oxley, I look at Dodd-Frank, I look at other
14 things, and I see that the takeaway that I have is that
15 money runs away from overregulation. Okay? So the risk
16 we run in the private sector is if we overregulate, it
17 will go somewhere else, which means offshore. And we'll
18 have other people investing.

19 Now do I think this one step is going to do
20 that? No. But I think somewhere in the back of your
21 mind you've got to be saying we have to balance here what
22 we're going to do and put it in some sort of perspective.

23 The one thing I'd like to see is for it to be easier to
24 do public offerings once again. If money's running away
25 from the public sector, have we overregulated that?

1 And I understand there are a lot of -- Congress
2 has done a lot of this, and you've got to do what
3 Congress tells you to do, but -- and that's another
4 discussion. But you're the only three people in this
5 room that can think about that because this is really a
6 policy decision.

7 But I'll just raise that question and say we've
8 -- somewhere there's a balance out there and two tree --
9 that's a forest comment. Two or three tree comments.
10 One is that remember that net worth requirements and
11 income requirements discriminate against geographic
12 areas, that if you are -- have highly rural areas, you're
13 going to have fewer accredited investors in those areas.
14 And companies tend to invest or tend to get their
15 investors from people in their neighborhoods. So you're
16 precluding that.

17 The other thing to keep in mind is that higher
18 standards also discriminate against socioeconomics. And
19 I'll tell a quick story. I once had a -- excuse me, I
20 once had a client come in to me, and he had a widget.
21 And this man misused words and very limited formal
22 education and -- but I like take these on kind of with
23 the -- sometimes because if they're interesting, I always
24 think that the airplane was invented by two bicycle
25 mechanics from Dayton, Ohio. So it wasn't a bunch of

1 guys from MIT.
2 And -- but -- so I took him on, and I told him,
3 well, here's some names, call some people and get going
4 on your widget. And he comes back and not the names I
5 gave him, he comes back with two fellas who told him,
6 well, we're going to get professional athletes to invest
7 in your deal. Not a good sign. And nor can you contact
8 the professional athletes, you're not allowed to talk to
9 them.

10 And so he's all excited about this, and there
11 are some other signs that this is bad. And I said these
12 -- this is not good. These signs are not good. I'm
13 afraid they're going to take you. And I didn't know how
14 they were going to take him, but he was getting set up.

15 And so the client just wouldn't -- I was saying
16 there was no Santa Claus, and he was saying there is a
17 Santa Claus. And finally at the end of the conversation,
18 "Mr. Reardon, you're fired," which was okay with me
19 because if I couldn't convince him that he was going to
20 get taken, then he needed to go to the cleaners without
21 me.

22 And -- but those are the kind of people, they
23 don't know a lot of accredited investors. They don't --
24 the people -- they are all working people that they
25 associate with and the higher you make the standard, the

1 harder it is for that guy, assuming he gets a good
2 investor, to go out and get good investors. And the
3 airplane was invented by some mechanics in Dayton, Ohio.

4 So, anyway, I would also say that net worth
5 versus -- excuse me. I feel like Marco Rubio. Net worth
6 and income standards versus amount invested, those are --
7 that is what in Texas we call messing in your chili.
8 Then you get into what everybody's net worth is or income
9 and that gets into a bunch of things that people don't
10 want you looking at. And I'd be careful about that. And
11 I think those are my comments.

12 MR. GRAHAM: Thank you, Patrick.
13 Greg.

14 MR. YADLEY: If I had any sense, I'd let
15 somebody else go after Patrick, but I'm -- I think, first
16 of all, I'd like to thank the chair and the two
17 commissioners for being here so long with us and
18 listening attentively because I think what we all agree
19 on is -- and the history review that Commissioner Stein
20 gave us instructive -- the world has changed immensely
21 and this private-public dichotomy that we go back and
22 forth on helps inform us about what we should do except
23 that there's so many things now and the Commission should
24 be commended for experimenting sometimes with
25 congressional prodding, which is sometimes not helpful.

1 But crowdfunding will change some of these
2 things that we've taken for granted. 506(c), which is
3 not being used that much yet, when it does that will
4 change things. But a couple of observations and back to
5 what I said earlier that disclosure is the key. But
6 disclosure is really sunshine, in the words of the
7 Supreme Court justice, being the great disinfectant.
8 It's not that investors -- retail investors read 10-Ks
9 and annual reports or that analysts read all of them
10 either.

11 But the fact of the matter is the disclosure
12 standard is very high and it's very general, and that has
13 worked pretty well because it forces people to think
14 about what you want to say about your company and your
15 investment and the with encouragement of forward-looking
16 statements which is a relatively new phenomenon, what
17 will happen in the future. And so now it's out there,
18 and you have to stand behind it. And that's been very
19 important for investors whether they read it or not.

20 But the public or the private markets have also
21 been gatekeepers of sorts, and 506(b), while it was
22 restrictive in that you could only approach people that
23 you knew and not everybody quite understands what general
24 solicitation is because it's not defined, but in essence,
25 people did invest, particularly in smaller offerings with

1 growing companies with somebody they knew.

2 Back to what many of us have said, if
3 somebody's a crook, there's nothing you can do about it.

4 But if somebody is an honest business person, their
5 money is invested in their business. In fact, their
6 entire net worth is invested in that business. And,
7 yeah, they're out soliciting money and all the
8 gazillionaires, from Zuckerberg to Gates to everyone
9 else, they dedicated themselves to their business and
10 people trusted them, the idea and the management. So
11 that's one thing that has helped us conclude on this
12 committee that we don't see that much fraud out there,
13 people dealing with people they know.

14 The second thing is I'm in the middle of
15 selling a very successful private company that started 18
16 years ago, and it was going to be a company that grew and
17 was sold within seven years. All the investors were
18 individual investors, the management group had had public
19 company experience and venture experience.

20 And based on the fact that this had more risk
21 than other deals they'd done, they said, "We're only
22 going to have individuals who can make their own
23 decisions about us, not funds where people have somebody
24 else's money." So it's taken us this long to get to a
25 sale.

1 The observation of the chairman yesterday as
2 we're trying to get this deal across the transom is it
3 was much easier to sell the two public companies we
4 started, and that's true because all the information was
5 out there. The reason it's harder to sell a private
6 company, as we all know, is private equity is the name of
7 the game. And private equity people do due diligence.
8 They hire accountants, they hire lawyers, and the
9 standard is very, very high. It's their money that
10 they're responsible for and their carried interests and
11 everything else.

12 And as companies go through more and more
13 private equity stages before they finally go public,
14 investors have that same ability to make a decision on
15 the management team and on the prospects -- and this has
16 been self-regulating. The private equity groups decide
17 what to look for, they get the information they need, and
18 when I was a younger lawyer I had no opportunity to
19 invest in these funds, because, A, I didn't have the
20 money like Kyle, and, B, the minimum investment was more
21 than I could have had and certainly more than the
22 investment limitations that we would put on -- some of
23 the limitations that people have suggested.

24 But over time -- and I lost money in my very
25 first private deal, and that was instructive, too,

1 because it made me a little more cautious the second
2 time. Diversification is clearly the key because even
3 these private equity investors and venture capitalists
4 hit on one or two out of ten.

5 So the system is working now and it is self-
6 regulating and I think we should encourage it and we
7 should, as this committee's mandate is to look for
8 other ways to promote public companies because the one
9 thing that the private companies do not have today is
10 liquidity. And no matter how bad a public company may
11 stumble, you can make the decision to sell your stock now
12 or hold it. And with a private company you can't.

13 So -- and I guess that's probably the answer to
14 Steve's first discussion is we're studying this not
15 because there's a problem. I agree with you. I don't
16 think there's a problem. But with all these changes,
17 maybe we're not letting enough people in and we need to
18 be careful about it. So thanks.

19 MR. GRAHAM: Yes.

20 CHAIR WHITE: Just a couple of comments. I
21 mean obviously the SEC comes from sort of the -- one of
22 its main, core purposes obviously to protect investors,
23 how do you best do that. And I certainly take the points
24 of you're going to have fraud and it's going to be out
25 there and how do you best sort of -- how do you prevent

1 it and do you prevent it.
 2 The questions about is there more or less fraud
 3 in the private markets, in the Reg D markets than in the
 4 public markets, press our folks this afternoon I urge you
 5 on that, our Enforcement people who will be here. I took
 6 advantage of my Blackberry to email them to tell them
 7 that question had indeed come up. I had to send four or
 8 five to get what I think may be -- but I think what --
 9 yeah, I mean a couple points on that. I mean, one, I
 10 think you will hear I think from them a sense -- and I
 11 said there's a sense and then there's data.

12 And the data is hard to come by, I mean in a
 13 reliable way. There's sense that there is more fraud in
 14 the private markets than the public markets. Press them
 15 on that. I mean and the data isn't what you'd want it to
 16 be. The other thing I would just comment on that is that
 17 I mean when we obviously did the lifting the ban on
 18 general solicitation obviously rightly so, lots of
 19 concerns about is this really going to be a huge uptick
 20 in fraud and lots of harm to investors.

21 So what we've -- I figure we've done on all
 22 these new changes to some degree -- and I hope it pans
 23 out, I sort of referred to it in my remarks -- but is to
 24 try to monitor out the gates how these new spaces are
 25 working, not wait three years and say how much capital

1 got raised, how much of it was moved from one method to
 2 another and is there fraud out there, are there other
 3 rule violations harming investors. And you'll hear,
 4 again, this afternoon -- I don't want to steal all their
 5 thunder about 506(c), although we've talked to you about
 6 it before.

7 And it's -- I think the sample's not big enough
 8 yet and that has other issues in it. But I think we've
 9 not seen yet and hopefully will not a real uptick in
 10 fraud in that space yet. So it's something -- but we're
 11 trying to watch it as it sort of comes out of the gates.

12 To go to Patrick's point about sort of public-
 13 private, I mean I do think we have a responsibility in
 14 the public markets obviously to protect investors and
 15 we've been at that for many, many years, but also to make
 16 our rules workable in the public sector as well. I mean
 17 that's part of our responsibility, too, and we're very
 18 focused on that. I mean so none of this is very easy,
 19 but, anyway, I appreciate the conversation tremendously.
 20 It's been terrific.

21 MR. GRAHAM: Kyle.
 22 MR. HAUPTMAN: If I could ask you guys a
 23 question, to Commissioner Stein's point about things
 24 changed since 1933 and 1940, the amount of financial risk
 25 that our government's allow Americans to take has gone up

1 considerably, but sometimes in negative return ways, by
 2 which I mean the 48 states that have a lottery -- Hawaii
 3 and Utah if you're interested don't. Over 40 states have
 4 casino gambling. So I think I know Commissioner
 5 Piwowar's view on this because he stated it earlier.

6 But to Chair White and to Commissioner Stein,
 7 so as a non-accredited investor, a thousand dollars
 8 Powerball tickets, a thousand dollars on a blackjack
 9 table, a thousand dollars to an American entrepreneur,
 10 the only one of those that I should be arrested for is
 11 the last one?

12 CHAIR WHITE: I don't think you'd get arrested,
 13 at least not by the SEC.

14 MR. HAUPTMAN: The one of those I am --

15 CHAIR WHITE: The issuer might have a problem.

16 MR. HAUPTMAN: Yeah, the only one of those I am
 17 prohibited from doing is the final one. Is that correct?

18 CHAIR WHITE: Yes. One other comment, and I
 19 think this goes to maybe Lisa's comment about when you're
 20 basically thinking of what's the purpose of the
 21 accredited investor definition in terms of protecting
 22 investors and you want to sort of define the universe as
 23 to those who can fend for themselves, what does that mean
 24 and does it have an element of protecting a certain --
 25 and, again, I understand the philosophical discussions on

1 this -- certain investors against loss as opposed to
 2 protecting just against fraud.

3 And so both of those concepts are inherent in
 4 the discussion and analysis and further debate on
 5 accredited investor. If a certain amount of fraud is
 6 inevitable, we all don't want any fraud. Obviously you
 7 may not have fraud if you're not, Kyle, in that
 8 investment that happened to have fraud in it. So I'm not
 9 asking you to thank us or anything, but I mean -- I just
 10 mean it's got a lot of vectors I think.

11 MR. GOMEZ: And if I may just to add a little
 12 star to Kyle's point, I think, Kyle, it depends on what
 13 exemption the issuer's relying on, and I think it would
 14 be interesting to hear the views of the Commission as to
 15 how the requirements of different exemptions limit who
 16 can participate. If Kyle was investing a thousand
 17 dollars in an exempt offering done pursuant to Regulation
 18 A, the issuer would have no problem.

19 If Kyle was investing a thousand dollars in an
 20 issuer that it's using the new crowdfunding rules, again,
 21 no problem. If you go to 506(b) or 506(c), then there
 22 could be a problem under -- well, there definitely would
 23 be a problem under (c) and under (b) it would depend
 24 whether you're sophisticated or not and fit within one of
 25 the 35.

1 So I think one interesting thing when -- it
2 seems like a lot of the conversation today has focused on
3 accredited investors, private and that's the only way to
4 invest. There's different exemptions that permit non-
5 accredited investors to invest. So is there a difference
6 between the exemptions? And, if so, do those differences
7 actually highlight for us some of the factors we need to
8 think about in determining whether someone should invest
9 in a 506(c) offering or not.

10 MR. GRAHAM: Well, that's kind of a complicated
11 question or a number of complicated questions are
12 embedded in what you just said, Sebastian.

13 MR. GOMEZ: I trust that the committee will be
14 able to peel the different layers of the onion.

15 MR. GRAHAM: We most certainly can, but I'm not
16 sure if we have that much time. But -- and in partial
17 response you don't have the Facebooks of the world, for
18 example, doing Reg A offerings. A lot of the real
19 opportunities are going -- are not going to be in the
20 deals that -- where they're only trying to raise a half a
21 million bucks. I mean there's a lot more to that, but
22 that's one thought that comes to mind.

23 Catherine.

24 MS. MOTT: One of the things I wanted to say, I
25 wanted to piggyback on what Greg and Patrick were saying,

1 was that in many cases we are your enforcers. So if I
2 could give some examples, one, we were on the board of a
3 -- this is my angel group -- on the board of a company
4 where the CEO was having the company pay his Jaguar
5 monthly payment. Of course because there was board
6 oversight, the CEO was fired, and we brought in another
7 CEO who was -- successfully ran the company.

8 So to some extent, we are your enforcers. I
9 mean the reason -- you know, I think Patrick was saying
10 these are your neighbors. We drive by and make sure the
11 lights are on, there's cars in the parking lot. You
12 know, there's -- I mean we make sure that the issuer is
13 of good standing. We do the background checks.

14 But not only do we do the background checks, a
15 lot of times you know this CEO, you know them. They're
16 spinning out of the university and they work for the
17 university and we know how much NIH money they got or --
18 I mean there's just so much you know about them.

19 And the other piece I would say to this is it's
20 the attorneys they work with. Even the attorney that
21 represents us, when they're -- when the issuer is working
22 with an attorney that's a rather novice in the securities
23 business, my attorney's helping that attorney to get it
24 right. So there's a lot of this -- just like Patrick was
25 trying to help that potential client to get it right. So

1 to a lot of extent, we are your enforcers.

2 MR. GRAHAM: Mark. And I don't know what
3 you're about to say, but one question that I did want to
4 come back to you on was you seemed to toss out the idea
5 that maybe we should be thinking about eliminating this
6 concept altogether. And if I heard you right then, I
7 would like to kind of hear your ideas for what you might
8 do in its place if anything.

9 MR. WALSH: Far from being a libertarian, which
10 I am not, I just -- I think we might step back. It
11 strikes me that this organization is in the business of
12 protecting individual investors from corporate
13 misbehavior. That's regulation. I think this specific
14 thing we're talking about today is protecting individual
15 investors from their own misbehavior. And I'm not sure
16 that those two actually coexist in a very convenient way.

17 So philosophically I then say to myself if the
18 SEC is in the business of protecting individual investors
19 from corporate misbehavior, why is limiting individual
20 "misbehavior" under its rubric.

21 As an example, if the janitor at Winthrop House
22 at Harvard University who knew Mark Zuckerberg in 2006,
23 had been offered in a correct and paperwork -- correctly
24 paperworked way, a chance to buy into Facebook at a
25 valuation of a million and a half dollars and that

1 janitor was mandated to be below some ceiling that this
2 room put forth, could that janitor sue us for stopping
3 him from making a lot of money that he should have made
4 because he knew Mark and it worked out?

5 I think that this is an incredibly crass
6 example, but I'll give it. My brother's a doctor, and he
7 once said that states that don't have helmet laws for
8 motorcycles are a self-correcting problem. And what I
9 mean by that is to use some of the examples before, I
10 believe that people that rashly find ways to waste their
11 money are always going to find ways to waste their money.

12 So when the SEC starts to creep into moving
13 from protecting individual investors from corporate
14 misbehavior into limiting individuals' behavior which is
15 what this is about, I think we should reexamine the
16 entire prospect of what this means. And the final point
17 I'll make is about information again.

18 You talked about 1930 and 1982. I believe you
19 might as well be talking about 1830 and 1882. I went to
20 business school with Jeff Skilling of Enron. In 1930
21 Jeff Skilling could have committed crimes and then come
22 back and reissued new paper two years later and no one
23 would have known. In maybe 1982 he almost could have
24 pulled the same thing off.

25 But I think there is virtually no chance of a

1 serial misbehavior in the securities industry with today's
2 transparency, is able to commit the same types of
3 misdeeds that we saw in 1930 and 1982, and I think that
4 this transparency level that we all now experience as
5 citizens and business people is an important feature of
6 how I would ask that we reexamine the essence of this
7 whole rule.

8 MR. GRAHAM: Thank you for that.
9 Please, please.

10 CHAIR WHITE: I was only going to say there are
11 a lot of recidivists out there. We see them every week
12 in our calendar for cases. So it's not -- it -- and
13 that's sort of a continuous flow of data. So I mean I
14 don't think it -- I mean I think in -- clearly there's
15 more information flow, clearly there's more transparency
16 that may stop certain things from repeating themselves,
17 but we see no want of repeaters.

18 MR. YADLEY; But just to add to that, of
19 course, the bad actor limitations are now becoming
20 pervasive and that's very salutary.

21 MR. GRAHAM: Commissioner Piwowar.

22 COMMISSIONER PIWOWAR: Yeah, I wanted to make -
23 - on a different topic. So Sara mentioned that Swedish
24 study and the fact that we don't have a lot of good data
25 here in the United States, and that study is very

1 informative in the fact that it shows that richer, better
2 educated households make better investment decisions.
3 And let's suppose for argument's sake, that that
4 translates into better outcomes. Right? And so what
5 that means is that for me it means that we need to invest
6 a lot in investor education to educate the less
7 sophisticated, maybe poorer, maybe less educated
8 individuals.

9 What it does not mean -- and this is a flaw
10 that so many -- in logic that so many people in this town
11 make all the time is that to then move to the argument
12 that, well, because the less sophisticated people have
13 worse outcomes than the more sophisticated people, we
14 need to limit their investment opportunity set. That's a
15 completely irrelevant discussion comparison.

16 The comparison that needs to be made, the
17 thought experiment needs to be: Would these less
18 sophisticated individuals be better off with expanded
19 opportunities -- investment opportunities set. And I
20 would argue that they would be based upon the portfolio
21 diversification effects, all those sorts of things. So
22 keep that in mind and please don't make the same mistake
23 that so many people in this town make.

24 MR. GRAHAM: Thank you.
25 Michael.

1 MR. PIECIAK: Thank you very much. I just had
2 a couple of points that I wanted to make to follow on
3 Chair White's comments and also Annemarie's comments from
4 earlier about risk. Unfortunately, the states don't have
5 a comparison to say that one private market or public
6 market is more or less risky. However, we do conduct an
7 annual enforcement survey by the states collecting data
8 that's not anecdotal but not sort of a hundred percent
9 obviously complete and reliable because it's a voluntary
10 survey.

11 But always ranking among the top in those
12 surveys is 506 offerings. Anecdotally in Vermont I know
13 we spend a lot of time examining either 506 offerings or
14 what would otherwise be private 506 offerings when we're
15 talking about enforcement. But at the end of the day,
16 again, the data is not complete and it's not absolute.
17 So I think it sort of ties back to this data issue.

18 And also staying on the risk topic, I mean not
19 just the regulatory risk but also the business risk of a
20 business failing, of a startup not making it, whatever
21 the sort of terminology is, I mean I think that's another
22 component to consider in the 506 space, and I think it
23 comes back to data again.

24 In Vermont in our state-based crowdfunding
25 regime, we require a post-effective or post-offering, I

1 should say, filing that says how many investors invested,
2 how much they invested, was the offering successful. I
3 think something along those lines would be useful in
4 terms of a data collection aspect for 506 as well.

5 MR. GRAHAM: Okay. Anyone else? Well --

6 MR. WALSH: Can I just -- I just -- one last
7 thing on the Swedish experiment if you don't mind. It
8 just strikes me that many know this rap about in
9 economics the Arizona effect, which is the state of
10 Arizona has the highest per capita incidents of emphysema
11 of any state in America not because there's something in
12 Arizona that causes emphysema, but everybody with
13 emphysema is told by their doctor to move to a dry
14 climate called Arizona.

15 So the impact of the data is not necessarily
16 correct. And I wonder if in Sweden if the outcomes of
17 more wealthy people have better financial outcomes is not
18 due to because the sophistication of them, but the amount
19 of advice they're able to afford. So I think it you wrap
20 advisors -- wealth people off and get -- to give them the
21 good advice, their outcome is not a function of their
22 personal sophistication but that the advice they're able
23 to afford.

24 And I wonder if to your point actually about
25 education and information, that making it more available

1 may, in fact, level the playing field of the advisory
2 level of that outcome as opposed to the personal
3 sophistication element of the outcome.
4 MR. GRAHAM: Okay. Thank you. Well, we were
5 supposed to end at 11:30. It just happens to be 11:30.
6 So thanks, everyone, for a very good discussion and we're
7 going to break for lunch. But, first, I guess for
8 archival purposes, there will be a photograph taken of
9 this committee outside in five minutes on the steps. All
10 right. Thank you.

(Whereupon, a brief recess was taken.)

AFTERNOON SESSION

11 MR. GRAHAM: Okay, why don't we get started?
12 I'm going to turn this over to Sara. But
13 before I do that, I want to just kind of recap a little
14 bit what we talked about this morning.

15 And, you know, it seems to me, you know, where
16 our discussion led us was pretty much to a confirmation
17 of this committee's prior recommendations. I think, you
18 know, that with, you know, perhaps a need to underscore
19 of how, you know, raising thresholds would discriminate
20 against regions where the cost of living is lower and
21 likely discriminate against women and minority
22 entrepreneurs as well.

23 I think we also -- there also seemed to be some

1 consensus on expanding the definition of accredited
2 investor to cover nonfinancial measures. I think
3 certainly I am supportive of the concept. And as far as
4 specifics are concerned, I think that requires more
5 thought. But certainly it was kind of intriguing to me
6 to -- you know, the part of our discussion that talked
7 about the way our current regime might be excluding
8 people that really should not be excluded, they're being
9 excluded unfairly.

10 And so I think with these -- with coming up
11 with different ways to qualify as accredited in the
12 context of any given offering, I think it would be -- I
13 think an objective should be to find a way to include
14 those who we are currently robbing of opportunity, quote,
15 unquote, for their own good.

16 Does anyone have anything to add? Greg.

17 MR. YADLEY: I think it's a good idea to
18 restate what we did -- what we said last time, beginning
19 with the do no harm. And while I too am open to
20 nonfinancial measures as additional criteria, not
21 changing the current monetary thresholds except for a go-
22 forward inflation adjustment, I think we simply need to
23 be cautious because simplicity is a virtue and the fact
24 is that, right now, we have a definition that has worked
25 well and has stood in as a proxy, whether it's the

1 perfect one or not, for sophistication. An element to
2 that is that, with some amount of wealth, someone is able
3 to hire someone to help work through whether a particular
4 investment is suitable.

5 I think, similarly, if we're going to look at
6 nonfinancial criteria, they should be simply understood
7 so that it will be easier for issuers to comply with
8 them. And as the Chair said this morning, when we were
9 talking about data collection and making reasoned
10 decisions based on hard facts or, as Sara said, metrics
11 that are applicable to the situation, along with any
12 revision to the rules, the -- to elicit information that
13 the Commission Staff can use to see how it's working,
14 starting at the time of implementation.

15 MR. GRAHAM: Thank you, Greg. I would agree
16 with that.

17 Mark?

18 MR. WALSH: Just one other point I want to make
19 about the dollar figure, since '82 is staying the same.
20 I think it's an interesting point. We talked about
21 geography, with cost of living and stuff like that. But
22 I would also flip it and talk about what it takes to
23 start a company, so the investment opportunities -- now,
24 I'm particularly familiar with the technology space. But
25 in 1982, it took about \$100 million to start a big

1 technology company. In 1992, it took about 50. In 2002,
2 it took about 10. Today, it probably takes about a
3 million dollars and you can have a successful e-commerce
4 or other technology oriented product or service or
5 successful company.

6 So the two vectors are almost matching each
7 other. Which is, you know, the layer announced in '82
8 and set forth, but the structural need of capital for the
9 companies. And I think the May 16 debut of the million
10 dollars or less is a recognition. And I applaud the SEC
11 for this, that the amount of dollars it takes to be
12 successful also is dropping.

13 MR. GRAHAM: Thank you. Anyone else?

14 What we will do is put together a draft
15 recommendation, we will, and get it circulated to that
16 everyone can take a look at it and we will put ourselves
17 in a position to hopefully make another recommendation to
18 the SEC within the next several weeks.

19 I would anticipate that we would get a draft
20 circulated -- actually, I have a telephone call. We'll
21 let you know. Okay.

22 So Sara, I want to turn it over to you.

23 MS. HANKS: Okay, so we are going to move on to
24 the second topic for today.

25 If you recall from our last meeting in

1 February, a number of us asked for a discussion of the
2 definition of general solicitation, which is a continuing
3 uncertainty in the markets, and how it's impacting the
4 use of Regulation D. And we came up with a number of
5 questions during the course of that.

6 So, for example, what can an issuer do at a
7 venture fair? What is an issuer allowed to do at a demo
8 day? What is an issuer allowed to do in an elevator when
9 he comes across someone who looks like he might be a
10 little bit accredited and he would like to pitch to him
11 at the demo day? And we all know this happens all the
12 time.

13 How does a company that starts out with a
14 506(b) offering, that is the non-generally solicited
15 version, make sure it doesn't trip up by suddenly making
16 a general solicitation and therefore having to convert
17 that offering into a generally solicited 506(c) meeting?

18 And if you are doing a 506(c) offering, what's
19 required to meet the reasonable steps to verify standard
20 in the statute and the rule. And I will note that we are
21 hearing, anecdotally at least, a lot of folks who are
22 saying reasonable steps to verify is too hard or too
23 uncertain, or we just can't do it or we don't want to do
24 it, and therefore some of those offerings are being
25 structured either as 506(b) offerings or, even more

1 restrictively, the counsel is dropping to a 4(a)(2)
2 private placement; we're not even going to rely on
3 Regulation D, we're not going to file any Reg D forms,
4 therefore leading to a lack of transparency for the
5 Commission to know what, in fact, is going on. And those
6 deals are effectively going dark. So that would be not
7 such a good thing.

8 The Division of Corporation has put out some
9 guidance in this space. So we are going to hear from
10 them today. David Fredrickson is chief counsel of the
11 Division of Corporation Finance. He assumed that role in
12 February of 2014, having served as assistant general
13 counsel in the SEC's Office of General Counsel since
14 1998. David has advised the division and the Commission
15 in the implementation of numerous rulemakings, including
16 rules to implement Sarbanes-Oxley, Dodd-Frank and the
17 JOBS Act.

18 David's Office of Chief Counsel is one of the
19 offices responsible for no action, interpretative and
20 exemptive positions taken by the division on the
21 securities registration process and exemptions from it.
22 In this role, he has been actively involved in the
23 Staff's guidance surrounding Reg D, 506(c) and what may
24 or may not constitute general solicitation.

25 David, we're very happy to have you here today.

1 Thank you.

2 MR. FREDRICKSON: Thanks very much for the
3 opportunity and the introduction. Good afternoon, all.

4 I have stuff prepared but, obviously, if
5 there's something else you want to talk about, you know,
6 raise your hand and let me know and we'll talk about
7 whatever you'd like.

8 So we've been implementing 506(c) for the last
9 couple of years. The first sets of questions were about
10 reasonable steps to verify and the nature of the safe
11 harbors that the Commission provided in the rule. So a
12 little over a year ago, we put out guidance, what we call
13 CDIs. And the basic thrust though of those was, to the
14 extent that someone was outside the safe harbor, the
15 Staff wasn't going to create new safe harbors, but
16 encourage people to think, were you within the general
17 principles that the Commission outlined in the release.
18 And at least anecdotally, we've heard that that's given
19 some people a little more encouragement to trust their
20 judgment in determining that they can rely on the general
21 principles and aren't looking to us for further safe
22 harbors.

23 The second set of inquiries that we got were
24 around the nature of general solicitation. It's somewhat
25 ironic to us that the Congress and then the Commission

1 allowed general solicitation and then it became a burning
2 question as to what it was. And in the end, it is still
3 a factual matter. But we, last August, put out further
4 CDIs to try to give some scope and contour to this area
5 that we hope gives guidance to practitioners.

6 And so in the first instance we, you know,
7 wanted to start with some clear statements that we still
8 think, based upon what the Commission has said, that to
9 the extent you are making an offer of securities on an
10 unprotected Internet website, you're making a general
11 solicitation. We have seen those who try to have website
12 -- password protected sites and other efforts to limit
13 the nature, and we've given guidance in the past on that.
14 But certainly if you are broadcasting through the
15 Internet, that's a general solicitation.

16 We also received a fair amount of question
17 about some old guidance we'd given about having a
18 substantive preexisting relationship. The Staff for a
19 number of years has said that, to the extent that you are
20 making an offer to someone with whom you have a
21 substantive preexisting relationship, you are not engaged
22 in general solicitation. Most of the Staff guidance in
23 the past about such a relationship has involved broker
24 dealers. And so the first step that people asked was,
25 well, what about registered investment advisers? Well,

1 that makes sense too. They both are subject to certain
2 duties, regulatory oversight. And so to the extent that
3 those professionals had a substantive preexisting
4 relationship, that was something that we would be
5 comfortable would suffice.

6 It gets more interesting and hard once you get
7 out of that, but certainly we didn't want to foreclose
8 that possibility. We issued a no-action letter to
9 Citizens VC, which I will talk about the substance of
10 which a little bit later. But they were not registered
11 in any capacity but they were offering a platform on the
12 Internet to attract and qualify accredited investors.
13 And then once they went through that process, then sort
14 of opened the curtain and showed them particular
15 offerings. And we thought, you know, that they had put
16 in place sufficient procedures to create a relationship
17 and then could do so.

18 We think it's hard but not impossible for
19 issuers to have -- create substantive preexisting
20 relationships. There is old Staff guidance, back from
21 the '80s, I believe, that to the extent that an issuer
22 goes back to those with whom it has done previous deals
23 or suppliers, contractors, others with whom it has
24 developed a relationship and understands their financial
25 sophistication, that such relationships could also be

1 substantive or preexisting.

2 So what do we mean by substantive, preexisting
3 relationship? Substantive is about what you know about
4 the person. Do you have enough information about their
5 financial sophistication in order to make an assessment
6 as to whether or not they are an accredited investor?
7 And you do, in fact, review that information before
8 making.

9 Preexisting is that the relationship has to
10 exist before the offer. We don't want the process around
11 finding -- getting to know the potential investor to, you
12 know, conflict or overlap with the actual offering
13 communications. And so, you know, we hoped that most of
14 that was a restatement, but a clarification of where we
15 think that line of thinking goes.

16 Now the Staff had always said that having a
17 substantive preexisting relationship is just one way of
18 not having a general solicitation. And that sort of
19 challenged us to think, well, what's another way? And
20 we're certainly aware, and have been for a long time,
21 about the practices of certain groups, often called angel
22 investors. And what is it about that that doesn't, in
23 many instances, lead us to believe that that's a general
24 solicitation?

25 And in thinking about it, it's several things.

1 One, it's the network and the reasonable basis that
2 those within that network share a level of
3 sophistication. So that even if the issuer is already
4 engaged in an offering, so isn't preexisting, and the
5 person that you may ultimately try to make an offer to,
6 you have no previous relationship, you have a reasonable
7 belief that the person you initially contacted in that
8 angel group is sophisticated. And that when they
9 introduce you to their tech specialist or pharmaceutical
10 person, that you have a reasonable basis for believing
11 that they are sophisticated and that that's not a general
12 solicitation.

13 Of course, in the end, this is always a
14 question of fact. And the broader the group, the less
15 the sophistication. The extent to which someone uses
16 nonselective means in reaching people in that network,
17 then it looks like a general solicitation. So that was
18 what we tried to offer in how we are thinking about why
19 angel groups are not -- may not be, depending on how
20 they're constituted, general solicitation.

21 We also tried to give some guidance as to what
22 is not an offer. It wasn't revolutionary, but we tried
23 to communicate that certainly we don't think and the
24 Commission hasn't said that every communication by an
25 issuer is an offer. It has to be something about the

1 securities. So to the extent that the issuer is
2 communicating information about its business, products in
3 the regular course, that those communications, even on
4 the Internet, are not an offer.

5 And so that was at least the construct that we
6 wanted to sort of put forth. And then particularly with
7 respect to demo days, then sort of kind of walk through
8 what that meant.

9 So to the extent that there's a demo day where
10 you're talking about your products and services, and
11 you're not offering securities, it's not a general
12 solicitation. To the extent that the people you've
13 invited to this demo day, you have a substantive
14 preexisting relationship or they're part of some network
15 of sophisticated investors, then you probably are not
16 engaged in a general solicitation.

17 Even if you are engaged in a general
18 solicitation and you widely broadcast the invitation to
19 the event, you can still take advantage of taking
20 reasonable steps to verify who you sell to. And so we
21 hoped that that would obviously not solve every question,
22 but at least provide a framework for how to think about
23 these issues. And always the, you know, application may
24 require some judgment. But at least we were trying to
25 provide, you know, a framework that would give some rules

1 of the road.

2 And I guess with that, I'll stop and see if

3 there's anything --

4 MR. WALSH: How do you view social networks?

5 Did you look at any way that a relationship generated on

6 a social network could be validated? I mean, I have --

7 we all have friends on Facebook we have a relationship

8 with, and often air quotes there to some extent. And I

9 may see that this friend on Facebook just bought a house

10 in the Bahamas, and so I may have a whole bunch of

11 indicators that would suggest sophistication and

12 capacity.

13 Where do you see that going?

14 MR. FREDRICKSON: I don't have a solid answer.

15 We have thought about that a bit, yes. I think I am,

16 you know, not to brag, over 500 LinkedIn contacts. Yes,

17 golden club member.

18 (Laughter.)

19 MR. FREDRICKSON: And I couldn't possibly

20 imagine saying that any, you know, fraction of that were

21 people that I had a real notion as to whether or not they

22 were sophisticated or not.

23 Are there closer networks? Are there other

24 indicia that people might have, under particular facts

25 where, you know, it's not simply they are, you know, a

1 professional network like LinkedIn, whatever that means,

2 I think it may be possible. But I don't think we're

3 anywhere close to saying that, you know, there's any

4 particular form of medium that is always going to be

5 okay.

6 Yes?

7 MR. YADLEY: Thank you. And that was very

8 clear.

9 And one of the issues I've had recently in

10 trying to talk to non-securities lawyer clients about how

11 all this works is, they see some circularity in all of

12 this. That we're trying to define what general

13 solicitation is not and if somebody is accredited or

14 otherwise meets some sort of ability to bear the risk and

15 fend for herself, then they get confused and say, I

16 really don't have to worry about what general

17 solicitation is, as long as I'm -- before I actually

18 offer the security, know that they're accredited, I'm

19 okay. In a way, that is 506(c).

20 The demo day interp, though, or CDI, sort of

21 takes it a little bit of a step further, in that the

22 issuer could actually, under certain facts and

23 circumstances, already be offering a security. And as

24 Sara pointed out in the introduction, I think people are

25 careful, at least to the extent they get advice. They're

1 not making offers at the demo day. But when they're

2 talking with somebody that they meet there afterwards,

3 they are.

4 So I'm wondering whether at some point the

5 concepts become so close that we just have one big 506(c)

6 and then we're okay, except to the extent some of the

7 things we talked about this morning, there's somebody we

8 want in an offering who is unaccredited?

9 MR. FREDRICKSON: Obviously, hopefully, the

10 entrepreneurs will be seeking counsel on some of these

11 questions. But I think part of the intent at least of

12 the first round of guidance we gave was to try to take

13 some of the mystery out of reasonable steps to verify.

14 It's a real requirement. It should be rigorous. And yet

15 just because the Commission outlined three things that

16 will always work doesn't mean those are the only way that

17 one can reasonably verify that someone's accredited.

18 And so I don't know why, at least based on the

19 data our economists are able to gather, that 506(c) is

20 not near the levels, either in number of offerings or

21 number of amount of money raised, and to what extent it's

22 simply -- you know, no one wants to be first in the pool.

23 And, you know, once people get comfortable that, you

24 know, it's not that hard, it has to be done, but to the

25 extent that one can take the reasonable steps to verify,

1 that it's a natural part of communications with potential

2 investors.

3 MS. KASSAN: I have two questions. One is that

4 I remember in the original proposed rule, I believe,

5 there was a requirement that you file the Form D 15 days

6 before you start the general solicitation. But whatever

7 happened with that?

8 MR. FREDRICKSON: The Commission proposed that

9 as part of a separate rulemaking, that was proposed on

10 the day that the Commission adopted the changes to

11 506(c). That's still a pending rulemaking. And so the

12 Commission could come back to that. The Commission is

13 very, very busy. But that is still an outstanding

14 proposal.

15 MS. KASSAN: Because that would sort of take

16 away that option of saying, whoops, I made a public

17 solicitation, I can just switch over to 506(c).

18 MR. FREDRICKSON: We received a fair amount of

19 comment on that.

20 MS. KASSAN: Great. And then my other question

21 is, if -- I've seen a lot of people send out kind of mass

22 e-mails, I don't know how many people were -- you know,

23 it was b.c.c., so I have no idea how many people received

24 it, and they would probably argue that everyone in the

25 b.c.c. list was someone that they had a preexisting

1 relationship with. And I kind of -- my instinct says,
2 even if you have a preexisting relationship, you really
3 shouldn't be sending out a mass e-mail. Is there any
4 thought about that?

5 MR. FREDRICKSON: Again, one of the factors
6 that we think is relevant is the means of communication.
7 And obviously, e-mail has the capacity to forward on
8 what you receive. And so it seems difficult to contain,
9 once you send that out. So that would seem to be hard.

10 MS. MOTT: David, one of the things I will tell
11 you I've observed about demo days and pitch contests is
12 that some clarification around general solicitation has
13 changed the behaviors. So when I attend an event like
14 that now, there are no financials being presented, like
15 there used to be. You know, and if you want to have a
16 private discussion with an investor, then you're
17 arranging to have it in a separate room or a separate
18 place so you can have that private discussion. So that
19 has cleared up the behavior, I think, having this
20 clarified.

21 One of my concerns is that there are a large
22 segment of investors who are -- angel investors who do
23 not want to go down the 506(c) route and actually will
24 not. When you apply to angel groups -- I lead an angel
25 group -- you have to be 506(b) or you're not going to be

1 entertained, your application will not be entertained.
2 So they are very careful about protecting that and having
3 to go through all the steps to verify.

4 In other words, and I think Patrick alluded to
5 this earlier this morning, the more difficult you make
6 it, the more the market is going to pull away from it.
7 And especially when you have a huge segment of the market
8 currently used to self-certifying. You know? And
9 they're not interested in sharing their tax returns with
10 anybody, especially the issuer. Sometimes it's very
11 challenging for them to even share it with each other.
12 So they prefer to keep that information private and not -
13 - and not risk it getting into the hands of anybody else.

14 So I just want to caution everybody that, just
15 by simply saying shouldn't we all just go down the path
16 of 506(c), I think there's a risk that it would be a
17 shock to the marketplace and you would lose a
18 considerable amount of individuals who are taking the
19 risk to invest in startup companies.

20 MR. FREDRICKSON: And if I could follow up, do
21 you think the reluctance is simply about not willing to
22 share that financial information? And are there not
23 other ways to establish the sophistication and experience
24 of the angel investors?

25 MS. MOTT: So, one is they don't --

1 MR. GRAHAM: Before you answer that, Catherine,
2 this kind of goes into it. A question for you is, is it
3 intended that the way you determine whether or not
4 someone is an accredited investor is different, depending
5 on whether it's 506(b) or 506(c)?

6 MR. FREDRICKSON: There is a clear statutory
7 and rule-based requirement in 506(c) to take reasonable
8 steps to verify.

9 MR. GRAHAM: Understood, but at the end of the
10 day --

11 MR. FREDRICKSON: There's an obligation under
12 506(b) to have a reasonable basis to determine whether
13 someone is.

14 MR. GRAHAM: Understood. Different words, but
15 do they mean the same thing?

16 MR. FREDRICKSON: We think they're a lot closer
17 than it seems many practitioners do. But I don't know
18 all practices, so I'm certainly not blessing all
19 practices by saying that. I think, to be a credible
20 506(b), reasonable basis means reasonable.

21 MR. GRAHAM: And so it has seemed that if it's
22 reasonable in that context, it should be reasonable in
23 the 506(c) context.

24 MR. FREDRICKSON: I won't say always and ever.
25 But those words are obviously the same. And I think

1 they are driving at the same goal of what's your basis
2 for believing that someone is accredited, and that should
3 be a real discipline. And whether that's always sharing
4 tax returns, we don't think it has to be. That was
5 simply one way the Commission said, ever and always, you
6 can satisfy. But are there other ways? Absolutely.

7 MR. GRAHAM: So it's the same.

8 MS. MOTT: Yeah, so I didn't see it as the
9 same, and I don't think the marketplace sees it as the
10 same. So for -- yeah, I was going to say, our lawyers
11 are going to tell us that as well.

12 MS. HANKS: Could we just have a couple of
13 words on the ability to rely on a third party? Because I
14 think one of the issues that Catherine has raised is
15 there's no -- no angel investor truly trusts an unknown,
16 small company to keep sensitive information sensitive,
17 private.

18 And so there are third party validators. And
19 angel groups could be one of them. I mean, in theory, is
20 that not a reasonable thing to say? If the angel group
21 itself has established accreditation, that could be
22 reasonable steps in certain circumstances?

23 MR. FREDRICKSON: In certain circumstances, I
24 assume it could be. Again, this is the problem, you
25 know, that we had in the rulemaking, that the third

1 parties that we identified, registered brokers,
2 registered advisers, lawyers and accountants, we felt
3 that the professional regulation that guided them gave us
4 sufficient comfort that, ever and always, that would be
5 okay.

6 Are there other methods that could be, that
7 would satisfy the principles that the Commission
8 outlined? I assume there could be. But without -- it
9 would be hard for the Staff to bless that concept,
10 because what's an angel group and what steps they're
11 taking, we simply wouldn't have the insight to.

12 MR. GRAHAM: You wouldn't necessarily have to
13 bless it. But as a concept, if you thought it was fine
14 for 506(b) purposes, then you should think it's fine for
15 506(c) purposes. Not defining what is -- necessarily
16 what is fine or not.

17 MR. FREDRICKSON: I'll think more on that. But
18 that's a fair question.

19 MS. HANKS: It's certainly something that angel
20 groups could develop a best practices, which -- I mean,
21 the ACA could take a lead on that.

22 MS. MOTT: The ACA already has. Interesting
23 enough, we have an -- what we call an established angel
24 group certification. And what that means is that you
25 show, you know, your documents and your policy, you know,

1 information about assets or income has to be within the
2 last three months. We try to then say that, to the
3 extent that it's outside but still reasonable, that could
4 be a basis for taking reasonable steps to verify.

5 MS. MOTT: So I believe the current -- the
6 marketplace would perceive that as problematic, now that
7 I have to pay someone to verify every quarter that I'm,
8 you know, I'm an accredited investor, when I've been
9 doing this for years, or --

10 MR. GRAHAM: But not necessarily, because it's
11 a safe harbor.

12 MS. MOTT: I see. Got it. All right. Sorry.
13 So I missed that.

14 MR. GOMEZ ABERO: Catherine, question. Could
15 you -- could you describe to us what had generally been
16 done in an offering? Let's say we're going to pre-2013,
17 so we only have 506. There is no difference between
18 506(b) and (c).

19 Could you tell us what a deal looked like? And
20 then what the investors did in order to participate?
21 What was the practice that, as an angel investor, who had
22 the relationship with the issuer and what information was
23 provided to the issuer as to who the investors were? And
24 what, if anything, did the issuer ask or check about
25 angels as potential investors?

1 for membership and show the steps that you take. And if
2 you do that, you get to verify that you've got accredited
3 investors in your group. Then you get the EAG
4 certification.

5 But I don't know how that would stand up. I
6 mean, we just -- we just did that on our own, not legally
7 saying that, you know -- I mean, it's just like, are
8 there best practices being deployed? And then the answer
9 is, check, yes, you're deploying best practices based on
10 what we know and understand.

11 So back to this third party, I think the third
12 party is an option. Even outside -- but I'm very
13 concerned still about the marketplace, because you have
14 again a large segment of the population who has been able
15 to self-certify. And now they have to pay someone to
16 certify. And then, if I understand the verification,
17 like these are people who are sophisticated and create a
18 portfolio of early stage companies. So they're investing
19 probably once a quarter, sometimes twice a year. So then
20 every time you invest, I believe, if I understand it, you
21 have to get -- you know, verify every three months or
22 four months or something like that.

23 MR. GRAHAM: Ninety days.

24 MS. MOTT: Ninety days.

25 MR. FREDRICKSON: Under this safe harbor, the

1 MS. MOTT: So typically -- so do you want to
2 know about what the issuer did with the angels? Okay.

3 So typically, an issuer comes to an investor in
4 the group and says, you know, I have a deal. I have a
5 company I'm starting and I would like to, you know, pitch
6 to your group. And they have to go through an
7 application process and a screening process, with
8 probably a small committee of -- of members of that
9 group.

10 And if they make the cut through this screening
11 process, then they will pitch to the entire group. But
12 probably after they do due diligence. Some do it after
13 the meeting, the general meeting, some do it before.

14 The due diligence is about a four-page
15 checklist. Which it's the National Venture Capital
16 Association's checklist, so it's identical. So it looks
17 at everything, from corporate documents to insurance
18 documents, to financials, market research, IP analysis,
19 all that.

20 And then, if there is enough interest through
21 the group to proceed through the investment, then the
22 attorney for the angel group and the attorney for the
23 issuer, you know, get together with either the lead
24 investor of that group and the entrepreneur to negotiate
25 the terms. And typically it turns out to be a preferred

1 stock, sometimes a convertible note. But typically, in
2 most of the cases anymore, what we're seeing is preferred
3 stock round. It looks just like a Series A, a Series A.
4 The only difference is we're calling it Series Seed.
5 But it's a Series A. But that's essentially what we're
6 looking at as far as documents.

7 Did I answer your question? I'm not sure.

8 MR. GOMEZ ABERO: I think you described a lot
9 of what the angels ask the issuer. I'm not sure I got,
10 and maybe -- I'm not sure I got what is it that the
11 issuer wanted to know about the investors.

12 MS. MOTT: Okay, so when we -- okay, so we sign
13 documents, investment documents, that come from the
14 issuer. And, obviously, they have to check how they --
15 how they're accredited. Okay? And that is confirmed by
16 the attorneys as well. Maybe that's what you were
17 looking for. Sorry.

18 When you said process, I was ready to -- okay.

19 Thanks.

20 MR. WALSH: So you're saying the issuer's
21 attorneys validated that your angels are accredited
22 investors?

23 MS. MOTT: It's between -- let's put it this
24 way. How can I say this? When we fill out the
25 documents, when the investors fill out the documents,

1 they're completing those documents. The investor
2 questionnaire, okay. They're completing the investor
3 questionnaire. And then a copy of that goes to that -- a
4 copy of all of that goes to that attorney.

5 MR. WALSH: Yeah, so just if I could add some
6 flavor to this, just because you asked about sort of pre
7 whatever year it was. So I worked at AOL and I'm still
8 friends with Ted Leonsis. So Ted Leonsis calls me up and
9 says, I have a deal for you. And this is the preexisting
10 -- I mean, David, to your point, this is the examples I
11 think of relationships like this.

12 So your teams have systemically created a
13 structure that maps this. But in personal behavior, Ted
14 Leonsis calls me up and says, I have a great deal for
15 you. I take the call and, of course, look at the deal.
16 But then to your point, the exact same process, I look at
17 the deal, I love the company, meet management with Ted or
18 whatever, and then I sign a document that asserts that I
19 am an accredited investor.

20 I don't know whether the issuer, whether the
21 company that Ted introduced me to, ever checks that my
22 statement is true. But that's sort of not my problem,
23 right? I made an assertion. It's up to them, I guess,
24 to validate it.

25 Is that what you were hoping to find? Or does

1 that violate where we are with the structure?

2 MR. GOMEZ ABERO: Just the question.

3 (Laughter.)

4 MR. GRAHAM: It's facts and circumstances,
5 Mark.

6 MR. WALSH: Sorry?

7 MR. GRAHAM: I said, it's facts and
8 circumstances. So I think --

9 MS. TIERNEY: Can I? Sorry, I was going to
10 interject. A few things.

11 First of all, I'm confused by the idea that
12 506(b) requires some active steps on behalf of the issuer
13 to actually reasonably confirm that an investor is
14 accredited. Based on the line of no-action letters, IPO
15 Net and others, and practice over the years, I think the
16 practice has been if you get an investor to complete an
17 investor questionnaire and they're representing to an
18 investor that they're an accredited investor, I think the
19 guidance out there is that the issuer has the ability to
20 rely on that representation in the context of accepting
21 that certification that the investor is an accredited
22 investor.

23 I don't think I've ever heard, in the case of
24 506(c), that a company had more of an obligation, if they
25 were getting a certification, representations in the

1 subscription documents that somebody is accredited, that
2 there was more that they needed to do -- (b). Yeah.

3 So in (c), we wrote a comment letter on the
4 original proposal for 506(c), we really, really supported
5 the idea of a safe harbor, nonexclusive safe harbor. We
6 were very happy to see the Staff do that. But I think
7 it's really important to remember that the Staff
8 repeatedly said, this is nonexclusive, there's other ways
9 to do this, facts and circumstances. This is a
10 nonexclusive safe harbor.

11 But at Second Market, I think I talked about
12 this at the last meeting we had, we had a business for
13 two years where we verified accreditation in the context
14 of primary offerings by investment funds and other
15 companies raising capital. And it is really challenging
16 to get human beings to give you their tax forms. We were
17 a registered broker dealer, we were, you know, governed
18 by Reg S-P and FINRA rules for confidentiality of client
19 information. But there is still a really low tolerance
20 for providing private documents.

21 What we started seeing as an increasing
22 practice was representation letters from lawyers and from
23 CPAs, which was surprising to us, that the investor was
24 accredited. So once you got that letter, we'd pass it on
25 to the issuer and they had the ability to reasonably

1 assume that that person was verified to be accredited.
 2 So that's how we saw the market developing.
 3 But I agree with you, and I think I talked
 4 about this at the last meeting, too. One real challenge
 5 for a net worth individual is having to get reverified
 6 every 90 days. I mean that's just, I think, unnecessary.
 7 These are high worth individuals. And it's the law
 8 firms representing the issuers that are being very
 9 conservative in this space, because so few companies are
 10 actually utilizing general solicitation.
 11 I think, Patrick, you sent us around something
 12 that said that you've seen situations where the states
 13 are starting to ask, you know, issuers how verification
 14 was, you know, handled. I'd like to know sort of what
 15 the states are looking at and what they're seeing, if
 16 Mike knows.
 17 But I really do think that there are places
 18 where there's so much friction in the nonexclusive safe
 19 harbor, that companies are less likely, and their law
 20 firms are less likely to encourage them to use 506(c) and
 21 generally solicit.
 22 MR. FREDRICKSON: I guess just a couple
 23 reactions, if I could?
 24 What's reasonable is always a question of
 25 facts. I would think that if a complete stranger walked

1 up and had only a certification and a check box, even in
 2 the old 506, pre-(b) world, that that would form a
 3 reasonable basis to believe that someone was accredited.
 4 I suspect, in most instances, there is something else
 5 going on. There's prior relationships, there's
 6 reputation, there's introductions, there is something
 7 that is giving flavor to when the introduction is made
 8 and they say, I'm certified. It's sort of like, well, I
 9 know other things about you and that confirms for me.
 10 And translated to the Internet world, that's
 11 why it's particularly scary on a 506(c) basis, to canvass
 12 strangers. And if all you get back is a certification,
 13 that's not, in our view, a reasonable step to verify.
 14 But I -- you know, I guess sort of I'll stop
 15 with, the Commission doesn't require recertification
 16 every 90 days. If someone would like to be conservative
 17 and know that they are within the safe harbor, that was
 18 provided. Whether there are other ways that one can, you
 19 know, attain a level of assurance that they are taking
 20 reasonable steps to verify, you know, the Commission laid
 21 out an analysis of how to get there.
 22 MS. TIERNEY: I completely agree with you. But
 23 I think again, my own -- our own experience was that
 24 issuers and their counsels were being very conservative
 25 because they didn't want to be the first one to have an

1 enforcement action knocking on their door. So they were
 2 following the letter of the nonexclusive safe harbor to
 3 the law and it is -- if you verify -- annual income, you
 4 only get one, you know, you get one tax filing a year.
 5 So we didn't feel like it was necessary to get more than
 6 a confirmation that the investor felt like they were
 7 still expecting to be accredited based on the current
 8 year's net income. But we certainly were going back and
 9 relooking at tax filings that we had already looked at
 10 and verified.
 11 In net worth, though, you have to get them to
 12 refresh their bank statements. And that really irritated
 13 the crap out of a lot of really, really wealthy people,
 14 to the point that they stopped being willing to invest in
 15 the 506(c) offerings. Because the law firms, again, were
 16 saying, no, no, no, you're the broker dealer, you're
 17 doing the attestation, the documents have to be dated
 18 within 90 days, and then your certification is only good
 19 for 90 days. So if you had a round that hadn't closed
 20 and we verified somebody on May 1 and that round hadn't
 21 closed within 90 days, then we had to recertify while the
 22 round was still, you know, in process. And that doesn't
 23 feel like it's necessary.
 24 But people wanted that level -- right, exactly.
 25 MR. WALSH: Is "irritated the crap" a technical

1 term in the investment community?
 2 MS. TIERNEY: That's an official securities law
 3 term, yes.
 4 (Laughter.)
 5 MR. GRAHAM: It's right there, Mark, with
 6 "messaging in my chili."
 7 MR. PIECIAK: I was just going to answer
 8 Annemarie's question. I saw that in Patrick's edition
 9 and I was actually going to get back to Patrick and ask
 10 what states that may be, because I was interested in
 11 knowing the specific circumstances of the request.
 12 MR. REARDON: I don't know. I can try and find
 13 out for you, and send that around supplementally.
 14 MR. PIECIAK: Yeah, it would be interesting.
 15 Because I would assume, and this is an assumption, that
 16 that particular state had some facts and circumstances at
 17 their disposal that questioned the verification process.
 18 MR. REARDON: Yeah, I was just thinking, good
 19 luck with a blue sky administrator in convincing him that
 20 these safe harbors are not requirements and that whatever
 21 you did that's not in the safe harbor is reasonable. You
 22 know, not you, but certainly others would say, no, we
 23 want to see that. Or your attestation is 91 days old.
 24 You know, as far as explaining this to people
 25 who have invested in this before, explaining the

1 securities laws to any layperson is, you know, it's like
2 explaining a black hole, you know. It's just -- they
3 don't get it. You know, that's why we spend years and
4 years learning about it.

5 Think about when you get out of law school. Or
6 maybe you'd taken securities reg. But even if you had,
7 it's so weird, the way the system works.

8 MR. FREDRICKSON: Its mysteries delight me
9 every day.

10 (Laughter.)

11 MR. GRAHAM: Michael?

12 MR. PIECIAK: I had a question pertaining to
13 the offering or the offeror definition. I guess my
14 question is, I mean, it's both sort of old format and new
15 format with social media and maybe a local road show or
16 demo day and, you know, when a product is being described
17 over social media or at one of these demo days. I mean,
18 is it appropriate to say, you know, we're looking for
19 partners of all kinds to come, you know, and if so, come
20 and contact us. Because, I mean, that's something that
21 we see in social media and demo days.

22 And then also in the demo day piece, or I guess
23 in social media as well, whether there are specific
24 questions that get posed like, well, what were your
25 revenues this year or, you know, how -- what's your

1 growth plan? And they start getting into specifics and
2 how entrepreneurs should handle those questions.

3 MR. FREDRICKSON: Yeah. I certainly don't,
4 sitting here, have anything helpful. The Commission has
5 traditionally seen "offer" as quite broad. Without much
6 imagination, you know, how easily those conversations can
7 turn into an offer, even if it starts more neutral.

8 We tried in the CDIs to give some contours to
9 what was on more one side -- more likely to be on one
10 side and what on another. But these are tough judgment
11 calls. But if there's suggestions on how to approach it,
12 if there's other things that we might be able to say,
13 we're willing to think about it. But those are tough
14 calls.

15 MR. GRAHAM: Okay. Any other comments?

16 MS. HANKS: Anything else that we need to get?

17 MR. GOMEZ ABERO: Can I just add one thing?
18 This goes to a little bit of reaction to something that
19 Annemarie mentioned. I think a lot of the times when we
20 think of 506(b), this reasonable belief standard comes
21 up. I just wanted to point it out, and I think a lot of
22 you know this.

23 But when you look at the definition of
24 accredited investor in 501(a), technically, the
25 definition has, in addition to other requirements, it

1 starts with language that says that an accredited
2 investor is someone who in fact is an accredited investor
3 or someone who an issuer reasonably believes is an
4 accredited investor.

5 And I think, in many respects, when you then
6 translate that into 506(b), you get to the fact that the
7 issuer either reasonably believed that the person was an
8 accredited investor and, to the extent it had a
9 reasonable belief, then the issuer likely would be in
10 good shape. Or, in fact, the person was an accredited
11 investor.

12 So I think it begs the question as to, if you
13 have an issuer in 506(b) that does nothing, but happens
14 to get lucky that all of the investors are, in fact,
15 accredited investors, then arguably you are still within
16 the 501(a) definition of an accredited investor.

17 Now, contrast that to 506(c) that, in fact,
18 imposes the specific requirement for the issuer to take
19 reasonable steps to verify. That is not a requirement
20 that exists in 506(b). So I think we often -- in part of
21 the conversation, we talked about 506(b) and this
22 reasonable belief, and 506(c) reasonable steps to verify.

23 But I think it's very important to keep in mind that the
24 way "accredited investor" is defined, it gives a little
25 bit more leeway to an issuer that is doing it under (b)

1 than it does under (c), because of the language that
2 specifically requires the verification under (c).

3 MR. GRAHAM: And so are you underscoring the
4 part that says that it has to actually be an accredited
5 investor? In other words, the point we made is that you
6 don't have to verify but you could get lucky when you're
7 dealing with 506(b)?

8 MR. GOMEZ ABERO: All I'm pointing to -- and,
9 by the way, the beauty of technology today is that
10 instead of carrying all my five volumes of federal
11 securities rules, I can carry them right here. So if you
12 look at 501(a), it says that an accredited investor shall
13 mean any person who comes within any of the following
14 categories. So that's an accredited investor. And then
15 it goes on to the categories that we talked about this
16 morning.

17 Or who the issuer reasonably believes comes
18 within any of the following categories.

19 So I think it's important to keep that in mind
20 when you look at 506(b). Because 506(b) itself did not
21 impose any additional requirements. 506(c) does. But
22 506(b) looks back at the accredited investor definition
23 in 501(a). And 501(a) does make this distinction between
24 someone who is in fact an accredited investor or someone
25 the issuer believes is an accredited investor, reasonably

1 believes is an accredited investor.

2 MS. KASSAN: And that definition also applies

3 to 506(c). So even if you -- if you take reasonable

4 steps and you make a mistake and somebody is not

5 accredited, presumably that would be acceptable, no?

6 Right? Yeah.

7 MR. FREDRICKSON: Take reasonable steps.

8 MS. KASSAN: Yeah, you have to take -- yeah.

9 You can be wrong, as long as you reasonably believed that

10 the person was accredited after taking reasonable steps

11 under 506(c), you'd be okay.

12 MR. YADLEY: I think what Sebastian said is

13 really consistent with what Annemarie said the practice

14 was. And so with all the other information that David

15 acknowledged you used to have in the old days before

16 somebody signed that subscription agreement and made

17 those representations, you really felt, well, belonged to

18 this country club, was introduced by this guy, or was in

19 business with this -- this woman and she vouches for him

20 and now he has said he is, without any other knowledge

21 that would cause you to disbelieve what has been

22 certified to, that was acceptable.

23 So the rule makes sense. 501(a) is a good

24 definition. But it does bear, and certainly we always

25 advised people what you just said.

1 Look, even if the person is accredited, this is

2 a new requirement. So if you're going to use general

3 solicitation, you have to do this. And then you get into

4 some of the discussions that Annemarie referenced. And

5 sometimes people say, well, maybe I'll just see how much

6 money I can raise before I do that. And I say, yes.

7 Because I believe that the most protection an issuer can

8 get is to deal with people they know and that they're

9 honest with. And somebody that just appears over the

10 Internet, you don't know. And you don't have the same

11 dialogue and they're not around the corner, so you can't

12 visit.

13 MR. GRAHAM: Okay, thank you Greg.

14 Is there any other -- yes.

15 MR. REARDON: Just a couple of practical

16 things. Your form might say that the issuer -- whatever

17 form you're using for 506(b), and I imagine I'm preaching

18 to the choir and this is already done, but the form ought

19 to say in bold letters at the top that this information

20 is important, it's used by the issuer to comply with the

21 securities laws, and it needs to be accurate in all

22 material respects, or something like that. You know, if

23 you want to hire me to do it, I'll make it a little

24 better.

25 In other words, it should say that, look this

1 is securities law stuff. Because people do execute these

2 things at a hundred miles an hour.

3 And the other thing I would suggest people do

4 is, if you have investors that you deal with regularly,

5 is these people all get their taxes done. And put in

6 their hands a form, a letter, and say, the next time you

7 get your taxes done, get the accountant to fill out this

8 letter. And if you got the letter, it's no longer

9 current, it's beyond 90 days, you can worry about it.

10 But I would rather be -- have a letter that's

11 120 days old and at least it's signed by an accountant

12 and you don't have to ask for all this stuff. Because

13 they're going to go to the accountant every year anyway.

14 And just give them a form and say, get your accountant

15 to do this. And, you know, see if there's any pushback

16 from the accountant or an extra charge or anything like

17 that. Should be a good way to start this.

18 MR. GRAHAM: Okay. Thanks, Patrick.

19 We kind of went off on a little bit of an

20 accredited investor tangent. Does anyone have anything

21 they want to run by David dealing with general

22 solicitation?

23 Okay. Then is Margaret here? Okay. So, thank

24 you, David.

25 The topics that we have considered and will

1 consider during this -- determined at this committee will

2 bring out a diversity of viewpoints on which reasonable

3 minds can differ. The landscape for unregistered

4 offerings has been dynamic in recent years. Changes to

5 historical cornerstones, like the accredited investor

6 definition and the ban on general solicitation in

7 unregistered offerings, have revealed some deeply held

8 opinions along with the hope of new opportunities for

9 capital formation.

10 But steady throughout this dynamic time, one

11 thing that we can all agree on is that robust enforcement

12 of the securities laws is critical to protecting

13 investors and maintaining confidence that is essential to

14 foster a positive environment for capital formation. We

15 all require the assurance that there are protective laws

16 in place that will be enforced against fraudsters and

17 other bad actors.

18 We are pleased to have Margaret Cain,

19 specialist attorney from the SEC's Division of

20 Enforcement, join us today. She will talk about some of

21 the enforcement activities the SEC is undertaking in

22 connection with the JOBS Act exemptions.

23 We note that Staff from multiple divisions

24 across the SEC are engaged in actively monitoring each of

25 the JOBS Act rules, 506(c), Reg A, crowdfunding. They

1 look at the rules from the capital formation perspective
2 and whether there are ways the rules can be improved.
3 They also keep an eye on the landscape and the
4 perspective of whether there is adequate investor
5 protection.

6 Margaret plays a key role in this JOBS Act task
7 force and will focus today on what Enforcement is seeing
8 in this area. And as we understand, you've been
9 forewarned, we certainly are curious about the level of
10 need, if you will, of enforcement activity in the private
11 sector versus the public sector.

12 MS. CAIN: Thank you. Thank you for that kind
13 introduction. Thank you so much for having me here
14 today.

15 I want to manage expectations. I hope I can
16 answer your questions. I will do my best. And if I
17 can't, then we'll see if we can find out the answers that
18 you need after this session.

19 So as he said, I am Margaret Cain. I am a
20 specialist attorney here in the Division of Enforcement.
21 Sorry, I have these glasses.

22 I appreciate the opportunity to speak with you
23 guys today about what the Division of Enforcement is
24 doing in the Jumpstart Our Business Act or JOBS Act
25 space.

1 Just a little bit of background on me. I have
2 been at the Commission for almost 17 years. The majority
3 of that time was spent as a senior counsel in Division of
4 Enforcement, where I was tasked with investigating
5 potential violations of the Securities Act, so insider
6 trading, market manipulation, unregistered offerings,
7 Ponzi schemes, that sort of thing.

8 For the last few years, I have been a
9 specialist attorney in the Enforcement Division's Office
10 of Market Intelligence, where I am working very closely
11 with our Microcap Fraud Task Force, and I am also working
12 with the JOBS Act Task Force and working with the
13 Division of Enforcement in providing guidance in that
14 area.

15 So, as you know, the JOBS Act was passed in
16 April of 2012 and it required the SEC to adopt rules that
17 removed the ban on general solicitation and advertising
18 and create an exemption called Rule 506(c). That's where
19 we see the majority of our cases.

20 On September 23, the Rule 506(c) went into
21 effect. And then in March of last year, the SEC also
22 adopted rules that updated its rules for smaller
23 offerings that allow companies to raise up to 50 million
24 in a 12-month period. And then, as you know, this past
25 Monday, the crowdfunding rules went into effect. They

1 were adopted on October 30 of 2015. All of these
2 exemptions are subject to the bad actor
3 disqualifications, pursuant to Dodd-Frank.

4 In advance of the rules under Title II becoming
5 effective, Chair White asked the divisions to collaborate
6 and formalize a Commission-wide working group outlining
7 objectives and steps for a program to monitor the use of
8 506(c) following the adoption of the rule. And
9 similarly, the Chair has asked the divisions to continue
10 and build upon that expertise and the relationships
11 developed in the 506(c) space to monitor and review the
12 equity crowdfunding exemption as well, just in a less
13 formalized way.

14 So in that capacity, the Division of
15 Enforcement routinely provides advice and guidance to
16 Staff investigating issues related -- or that implicate
17 the new rules created by the JOBS Act. We oversee a
18 crowdfunding working group which is multivisional and
19 sometimes works with outside self-regulatory
20 organizations. And we work with the rulemaking divisions
21 to plan training for Enforcement Staff and monitor the
22 evolving landscape, because this is kind of a moving
23 target, so to speak. Things change constantly in this
24 space. And, finally, we assist the division in creating
25 programmatic objectives in this space.

1 So, as you may know, tips, complaints and
2 referrals, or TCRs, as we colloquially call them inside
3 the building, are submitted to the Commission on any
4 number of potential violations. Some actually are
5 securities violations and some may, you know, actually
6 need to be referred out because we don't have a
7 regulatory scheme to address them. But all of these TCRs
8 are put into one centralized database where we have Staff
9 in the Office of Market Intelligence that are reviewing
10 these TCRs as they come in.

11 And the TCRs related to this new regulatory
12 regime, so for crowdfunding exemption or Rule 506(c) or
13 even Regulation A receive the exact same treatment. The
14 same Staff are -- these TCRs are streamlined and the same
15 Staff are reviewing them to ensure consistency in their
16 analysis and triage and assignment, where appropriate.

17 So in October of 2012, shortly after the JOBS
18 Act was passed, OMI decided to start tagging any TCRs
19 that may come in and highlight potential violations of
20 these exemptions. And we've -- since that time, we've
21 handled dozens of TCRs in this area. Of those, a number
22 of them warranted further review. And some went on to
23 become active cases and some even were filed.

24 Some of them were referred off to state
25 regulatory agencies or to criminal agencies. And some

1 became the focus of an examination that was done by our
2 Office of Inspections and Examinations.

3 Current investigations in this space are
4 primarily focused on issues surrounding the following:
5 Failure by issuers to take reasonable steps to verify
6 accredited investor status and then, subsequently, sales
7 to unaccredited investors; unregistered broker dealer
8 activity, where we have an intermediary or third party
9 providing investment advice or receiving funds as part of
10 monies raised, transaction-based compensation or what
11 appears to be transaction-based compensation; and, fraud.

12 The subject matter of these investigations has
13 kind of run the gamut. We have everything from oil and
14 gas investments to real estate, sometimes investment
15 funds with unrealistic rates of return or very
16 exaggerated rates of return, and digital currency. It's
17 very topical.

18 The Commission has filed eight cases to date,
19 including three settled cases and five cases that are
20 currently in some form of litigation. The cases have
21 involved some variation of offering frauds, unregistered
22 broker dealer activity, and violations of the
23 registration requirements.

24 generally speaking, it probably does not come
25 as any surprise in light of some of the other speakers

1 step. We spent a lot of time this morning talking about
2 the definition of accredited investor. And one of the
3 things that I think we all wrestled with was the -- the
4 maybe lack of understanding of how much, you know, how
5 much fraud, how much enforcement activity might actually
6 occur within that sector.

7 So, in other words, is there -- is there a
8 problem tied to -- tied to fraud, if you will, in the
9 context of private placements? Where, if you -- where
10 one way of addressing the problem is increasing the
11 thresholds under the definition of accredited investor?

12 Was I especially unclear in formulating that
13 question?

14 MS. CAIN: No, I understand the question and I
15 understand the desire for a firm answer there. I'm not
16 sure that we have that information to answer that
17 question adequately. I think in kind of the paradigm of
18 looking at cases, that's maybe not the way we would
19 necessarily look at a case, in terms of the investor --
20 accredited investor definition.

21 We're looking at cases -- when we look at
22 potential violations, we're looking to see have actions
23 taken place that might potentially implicate any of the
24 federal securities laws? And there are just elements to
25 each exemption. We just look to see if they've been met

1 you've heard today, the activity in the Rule 506(c) space
2 has been relatively light, especially when you look at it
3 in comparison to issuers using the Rule 506(b) exemption.

4 However, my sense is that, based on the absence of
5 internal controls and disclosure requirements, we have
6 seen more fraud in private markets and private offerings
7 than we have in the public space.

8 I have two examples of recent cases filed in
9 this space. In the SEC versus Ascenergy, LLC, et al.,
10 matter, which is Release Number 2399 -- I'm sorry, 23394,
11 the Staff filed a civil action against Ascenergy and its
12 CEO for offering fraudulent oil and gas investments. The
13 Staff obtained a temporary restraining order halting the
14 offering, as well as an order freezing the defendants'
15 and the relief defendants' assets.

16 In the Michael G. Thomas matter, which is SEC
17 Release Number 9801, Michael Thomas made materially false
18 and misleading statements in general solicitations to the
19 public concerning a pooled investment vehicle. Relief
20 included a cease and desist order from committing fraud,
21 as well as a five-year industry bar of Thomas.

22 So those are my prepared remarks. I'm happy to
23 take questions and try to elaborate where I can.

24 MR. GRAHAM: You know, thank you for that.
25 Again, I think one question that we have -- backing up a

1 or not met.

2 MR. GOMEZ ABERO: Can I add -- can I add a --
3 Sebastian, right here in the corner.

4 (Laughter.)

5 MR. GOMEZ ABERO: Can I add something, Steve?
6 Because as part of the Staff report, we talk not just
7 internally with Enforcement, but we talk to other
8 regulators to try to ascertain whether there could be a
9 direct link between the \$200,000 threshold and whether
10 someone is more likely to be subject to fraud or not.
11 And, as we talk to a number of regulators, part of the
12 challenge is that in many of the -- and Margaret, I'm
13 just speaking here and if I'm completely wrong, just let
14 me know.

15 But the feeling that I got was that in many of
16 the cases, the fraudster was not actually conducting an
17 analysis as to whether their prospective investor was at
18 \$190,000 or \$210,000 in income. In fact, they were
19 looking to just get quick, easy money from an
20 unsuspecting investor.

21 In some of the cases, the investors that were
22 defrauded, the fraudster did not take any steps to
23 determine whether the investor was an accredited investor
24 or not. And in some cases, those investors would not
25 have qualified as accredited investors. In some other

1 cases, the investors who were defrauded were nowhere
2 close to the \$200,000. In fact, they exceeded it by
3 multiples of that and they were still subject to the
4 fraud.

5 But throughout the questions that we asked, it
6 was something that the theme that at least came across to
7 me was that the fraudster was not trying to comply with
8 some type of rule and regulation and then went above and
9 beyond that. The idea was the fraudster was going to get
10 the money as easily as possible from the investor and had
11 no regards for any of the SEC rules, whether that was
12 accredited investor or general solicitation or
13 preexisting substantive relationship. They didn't focus
14 on any of that stuff.

15 MR. GRAHAM: So the fraudster didn't submit a
16 questionnaire to the potential victim in advance of --

17 MR. GOMEZ ABERO: Surprisingly enough, they did
18 not.

19 MS. CAIN: I echo what you say, Sebastian. And
20 I think, to the extent -- and this is generally speaking
21 and, of course, my opinion. But to the extent that
22 there's any attention paid to trying to meet, for
23 instance, the requirements of 506(c) by a fraudster, it's
24 just to give the appearance of legitimacy, as opposed to
25 actually thoughtfully trying to comply with the

1 exemption.

2 MR. GRAHAM: No, our real question was, okay,
3 we have a definition. We're taking a look at the
4 definition. We're trying to determine whether or not
5 something should change with respect to that definition.

6 And our question is, well, is there a correlation
7 between today's definition and fraud? And we don't see
8 one and we haven't heard anyone make that connection.
9 But since you're in Enforcement, we thought we'd ask you
10 the question.

11 MS. CAIN: I don't have the answer to that
12 question, unfortunately, in any kind of definitive or
13 meaningful way. That's just not -- we don't collect --
14 I'm not aware of any data that we collect in that regard.

15 MR. GRAHAM: That's not surprising.
16 Mark?

17 MR. WALSH: So first, thank you for TCR.
18 Because I try in my new career in the government to get a
19 new TLA -- which stands for three-letter acronym -- to
20 get a new TLA every single day. And you've fulfilled my
21 daily quota. Thank you for that.

22 Are there other patterns from the TCRs that you
23 got? Any geographical patterns, any other type of
24 patterns from it? That's question A. And the other was,
25 I think you touched on this, the ratio of TCRs in the top

1 of the funnel and those you ended up crystalizing and
2 taking action on. Is it the same ratio as the public
3 market TCR ratio, or how different is it in your
4 experience so far?

5 MS. CAIN: Those are great questions. I think
6 to answer your second question first, I would say because
7 the activity has been pretty slow in this area, that the
8 TCRs in this space have been less than overall just
9 general TCRs. I mean, I can say that of the cases, we
10 have seen an evolution in this space.

11 So initially, for instance, we saw most of the
12 TCRs that kind of implicated this area really dealt with
13 a failure to comply with the exemption requirements. So,
14 you know, not taking reasonable steps or failing to take
15 any kind of step or selling to an accredited investor.
16 And then we saw that kind of evolve over time to
17 increasingly implicating potentially unregistered broker
18 dealer activity, you know, where you're having a platform
19 that's set up and they're taking funds based on how much
20 money is raised. They are not putting those funds into
21 escrow. They might be providing investor advice.

22 And then the final kind of evolution is fraud.

23 And, you know, of the cases that have been filed since
24 June of last year, there have been five. All of them
25 have been private offerings and all of them have involved

1 fraud.

2 So in terms of geography, nothing really stands
3 out. I mean, it's nationwide.

4 MR. GRAHAM: What about the demographic?

5 MS. CAIN: Again, it kind of runs the gamut. I
6 mean, you have, you know, potential victims from all
7 walks of life, from all socioeconomic walks of life. In
8 fact, one of the cases that was filed recently, the
9 victim essentially was an issuer. You had, in the Steven
10 J. Muehler, et al., case that was filed in September of
11 last year, the Staff is alleging that Steven Muehler
12 through two organizations offered assistance to
13 companies, putting himself out there and his companies
14 out there as we can help you structure a Regulation A
15 Plus offering, we can get it through the review process
16 with the Commission and then we can market it to
17 potential investors. And that was -- well, it's still in
18 litigation, but our allegations are that they made false
19 statements to the issuers. And they were not a
20 registered broker dealer, neither Mr. Muehler nor his
21 organization. So from my sense, what we're seeing is,
22 you know, a strong need to protect not just investors but
23 also issuers that are new to this space and just still
24 learning, like everyone is, kind of the ins and outs of
25 this area.

1 MR. GRAHAM: Greg, you had something?
 2 MR. YADLEY: Yeah. I think I misunderstood
 3 something you said. I did hear you say that you're
 4 seeing more fraud in the private offering space than
 5 public. But then you were talking about eight cases.
 6 Those were from the TCRs relating to 506(c)?
 7 MS. CAIN: Right. So since we -- I'm sorry,
 8 let me clarify.
 9 Since we started, since post-JOBS Act, we've
 10 had eight cases that implicate potential -- certain
 11 aspects of the JOBS Act, so either 506(c) or the
 12 crowdfunding rules. I mean, obviously, until Monday, the
 13 crowdfunding rules, you couldn't violate them. But we
 14 had activity that, you know, presented itself as, you
 15 know, a crowdfunding platform or what have you, or
 16 Regulation A Plus.
 17 MR. YADLEY: Okay. I think our question was
 18 broader, as we've looked at 506 offerings in general and
 19 private placements. If you're seeing more fraud in the
 20 private area, that means there's only six cases in the
 21 public area in the same time period? Or less than six?
 22 I missed something.
 23 MS. TIERNEY: Her cases are only JOBS Act
 24 related, not overall enforcement.
 25 MR. YADLEY: Okay. I guess that -- okay.

1 MS. CAIN: Yeah, there are very general
 2 statements. I am talking specifically about cases that
 3 are post-JOBS Act that are implicating certain aspects of
 4 the JOBS Act.
 5 MR. YADLEY: Okay. So that means there have
 6 been fewer than six cases related to emerging growth
 7 companies, right? Since that's the only public -- real
 8 public aspect of the JOBS Act. Which is good. Because
 9 so many of the public offerings have been emerging growth
 10 companies. We want them to be successful.
 11 We are interested then in the question that you
 12 were not addressing and maybe, you know, you don't know.
 13 But when we were -- what Steve was alluding to in our
 14 discussion this morning, which was about the accredited
 15 investor definition, we are unaware of fraud really being
 16 a huge issue that is affected by the wrong people or too
 17 many people being able to invest in private offerings.
 18 And so we were wondering if the division has seen more
 19 fraud in private placements generally that would inform
 20 us as we try and wrestle with the issues that are in our
 21 mandate?
 22 MS. CAIN: Yeah. And I think, as the Chair
 23 said this morning, just data like that is very difficult
 24 to come by. It's a little, I think, a little premature
 25 to really be able to say with any kind of certainty how

1 this is going to play out because the -- the industry has
 2 just been very slow to utilize 506(c) and some of these
 3 other exemptions. I mean, obviously, crowdfunding, that
 4 just want effective on Monday.
 5 MR. YADLEY: And I'm not pressing against you
 6 individually. But let's go back to pre-April 2012.
 7 What's the division's experience been with fraud in
 8 private placements under old 506?
 9 MS. CAIN: I can't answer that with any kind of
 10 certainty. Maybe we can --
 11 MR. YADLEY: Would that be something that maybe
 12 if you could get with your colleagues and then let Julie
 13 know, we are very interested in that. Because that falls
 14 squarely within what we're supposed to try and be talking
 15 about.
 16 MS. CAIN: We will endeavor to get that
 17 information. I can't make any promises on that, on that
 18 issue.
 19 MR. GRAHAM: Michael?
 20 MR. PIECIAK: Just to assist with Margaret, not
 21 that our information is all that much more accurate or
 22 better. But from the state perspective, as I mentioned
 23 earlier this morning, that when we conduct our state
 24 enforcement surveys and, you know, the response rate is
 25 somewhere north of, you know, somewhere around 40 states

1 or so that provide data and we specifically ask, you
 2 know, what are the top five types of frauds that you are
 3 seeing? Ponzi schemes, 506 offerings, affinity frauds.
 4 Sometimes they fall in the multiple of those categories.
 5 But 506 offerings generally, not differentiating between
 6 (b) or (c), are frequently in the top five, at least for
 7 the last, you know, five or six years.
 8 Again, that's not -- the survey is not mandated
 9 by the states. We don't have a hundred percent
 10 participation. And we can't, to Annemarie's earlier
 11 point, quantify whether it's more risky or less risky
 12 than the public markets. But we can just say that there
 13 is --
 14 MS. TIERNEY: Well, my question was going to
 15 be, on that, are those points issues that states are
 16 seeing that are state law? Or that states are seeing in
 17 companies in their state? So would that include public
 18 company issues? Or is it just state-covered
 19 transactions, like intrastate offerings or --
 20 MR. PIECIAK: The 506 would the states' general
 21 antifraud authority. So the issuer would have utilized
 22 506.
 23 MS. TIERNEY: But, I mean, is your survey
 24 looking also at public company fraud? Or --
 25 MR. PIECIAK: Oh, I see. Yeah. Yeah, we would

1 be looking at anything in which the states had antifraud
 2 authority over.
 3 MS. HANKS: Michael, any chance of -- any idea
 4 of whether that's changed over the last five years?
 5 MR. PIECIAK: In terms of --
 6 MS. HANKS: Since the JOBS Act went into
 7 effect?
 8 MR. PIECIAK: I know the last -- I don't want
 9 to overstate it, but I want to say the last five years,
 10 the -- in terms of the top five, you know, most frequent
 11 frauds, the 506 offering has consistently been in there.
 12 Whether it's number one, two, you know, three or four,
 13 it does seem to be sort of a reoccurring element that
 14 states see.
 15 MR. GRAHAM: What again are the numbers?
 16 MR. PIECIAK: Yes, the numbers are where it
 17 gets tricky, because they fall into multiple sort of
 18 categories, whether it's Ponzi scheme, you know, affinity
 19 fraud and 506 offerings. And sometimes it can fall into
 20 each of those. And it's a bit about categorizing, how
 21 the state provides us the information. The enforcement
 22 survey that was passed out was sort of asked on an
 23 aggregate level, in terms of, you know, what are the top
 24 10 or five -- actually, I think it's the top five that
 25 you see every year. So we don't necessarily have that

1 specific number data that we can provide. And again,
 2 it's not mandated by all of the states.
 3 But it's more than -- you know, I think it's
 4 safe to say it's in the hundreds, not in the tens. You
 5 know, it's a significant number, even though we can't
 6 provide the specific number now.
 7 MR. GRAHAM: Patrick?
 8 MR. REARDON: This may be unfair, but I'm going
 9 to state it anyway. And I live in Fort Worth, where you
 10 have an office. There's a perception that the SEC only
 11 brings the big cases, the cases that get a lot of
 12 publicity are at the top of the list. And the small
 13 fraud cases are at the bottom. Or the small,
 14 unregistered broker dealers. Now, that's a perception,
 15 and it can be wrong. And feel free to tell me I'm wrong.
 16
 17 I would just encourage you to file cases,
 18 whatever, fraud or unregistered broker dealers or
 19 whatever, to file all size cases.
 20 I'm sure you've got some young lawyers who have
 21 been hired. And on these little cases, cut them loose if
 22 they're fraud. Or give them to the states.
 23 But, you know, the compliance -- it helps us on
 24 compliance if people have a perception that there will be
 25 consequences for failing to comply with the securities

1 laws. Everybody feels that way about tax law. Everybody
 2 knows if you take your dog as a dependent, you're going
 3 to get in trouble with the IRS. But, for some reason,
 4 there are a lot of people in the business community who
 5 think that complying with the securities laws is
 6 optional. And I've heard people as investment advisers
 7 functioning out there and saying, I'm going to get my RIA
 8 one day, like it's something to wear on his hat or
 9 something and it was not a condition precedent to being
 10 in the business.
 11 So -- and there are people in the -- I have not
 12 heard of unregistered broker cases in Texas until the
 13 recent kind of well noted case that was filed in Texas.
 14 So I haven't heard of those in a while. Maybe I'm not
 15 keeping up the way I should be.
 16 But, I mean, if I'm unfair, I'm sorry and I'll
 17 apologize if you tell me I'm unfair in saying that you
 18 bring the big cases. But get down on those little cases
 19 and bring them. Because nothing is going to make
 20 somebody want to comply with the securities law than
 21 having a guy at his country club who's got in trouble
 22 with the SEC over something. So that's my comment.
 23 MS. CAIN: Thank you for your honesty and your
 24 feedback. I think Chair White and the other
 25 commissioners have certainly spoken very publicly about a

1 broken windows concept, if you will, and looking for what
 2 some people may characterize as smaller infractions. And
 3 I think that the Commission has been much more aggressive
 4 in bringing those types of cases.
 5 As I mentioned before, I work very closely with
 6 the Microcap Fraud Task Force. And an initiative out of
 7 that group and out of my group in OMI has been to be more
 8 -- to recommend more frequently trading suspensions
 9 against companies that are putting out false information
 10 or misleading information or omitting material
 11 information. And over the last five years, we've
 12 probably brought approximately 800 trading suspensions.
 13 And we're seeing that that is having a real deterrent
 14 effect in that specific kind of space, the microcap fraud
 15 space.
 16 So, you know, those smaller companies that are
 17 quoted on the over-the-counter market, they're not listed
 18 securities on a national exchange, and historically have
 19 preyed upon our most vulnerable of victims in terms of
 20 elderly or unsophisticated investors. And so I certainly
 21 take your point, and I think it is something that we try
 22 to be mindful of. And so I do appreciate that feedback.
 23 MR. GRAHAM: Okay, any other comments,
 24 questions?
 25 Thank you, Margaret.

1 MS. CAIN: Thank you.
 2 MR. GRAHAM: Well, we've been efficient. We're
 3 running about 30 minutes ahead of time.
 4 So again, thank you everyone for today. As I
 5 said earlier, I will get a draft recommendation relating
 6 to the accredited investor definition to folks within the
 7 next few weeks. And either we'll take it up again at the
 8 -- at a telephonic meeting or at the July meeting.
 9 And for those of you who have forgotten, the
 10 next meeting is slated for July 19. Right? I think it
 11 is. Telephonic if we need it. If we need it.
 12 If we make enough progress with the
 13 recommendation to call a meeting prior to the July
 14 meeting, we'll know one up.
 15 Yes, Mark?
 16 MR. WALSH: I just want to compliment the team
 17 on today. I thought it was very well organized. Julie,
 18 thank you for many, many e-mails to make sure this
 19 happened. It's my first rodeo here. I think it's
 20 wonderful to have an open forum like this and to have a
 21 full exchange of views, compliments to all involved.
 22 MR. GRAHAM: Okay, thank you.
 23 MR. GOMEZ ABERO: And just to confirm for
 24 everyone, it is the 19th. Thank you.
 25 MR. GRAHAM: Okay. So we are adjourned. Thank

1 PROOFREADER'S CERTIFICATE
 2
 3 In The Matter of: ADVISORY COMMITTEE ON SMALL AND
 4 EMERGING COMPANIES MEETING
 5 File Number: OS-0518
 6 Date: May 18, 2016
 7 Location: Washington, D.C.
 8
 9 This is to certify that I, Nicholas Wagner,
 10 (the undersigned), do hereby swear and affirm that the
 11 attached proceedings before the U.S. Securities and
 12 Exchange Commission were held according to the record and
 13 that this is the original, complete, true and accurate
 14 transcript that has been compared to the reporting or
 15 recording accomplished at the hearing.
 16
 17 _____
 18 (Proofreader's Name) (Date)
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 25

1 you.
 2 (Whereupon, at 2:57 p.m., the above-entitled
 3 matter was adjourned.)
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a.m 1:15	accountant	123:1 124:20	actors 125:17	adversely 41:8
ABERO 108:14	51:12 124:7,11	125:5 130:6	acts 56:10	advertising
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