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ON
SMALL BUSINESS CAPITAL FORMATION PROGRAM

RECORD OF PROCEEDINGS

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1 PROCEEDINGS

2 MR. LAPORTE: Good morning, everyone, both those
3 here physically in Washington, D.C. in the auditorium of the
4 Securities and Exchange Commission headquarters and those
5 here virtually because they're listening to the webcast over
6 the Internet.

7 My name is Gerry Laporte. I'm Chief of the Office
8 of Small Business Policy in the SEC's Division of Corporation
9 Finance. I'm here this morning to call to order the 27th
10 Annual Government Business Forum on Small Business Capital
11 Formation on behalf of the Securities and Exchange
12 Commission. This event is being conducted under the mandate
13 of Section 503 of the Omnibus Small Business Capital
14 Formation Act of 1980.

15 We thank you, all of you for taking time to
16 participate today, both those here and those on-line. We at
17 the SEC learn a great deal from the discussions at these
18 forums from the insights and experiences that you share with
19 us and we look forward to receiving the recommendations that
20 will come out of today's proceedings.

21 In recent years, these forums have focused
22 primarily on improvements in securities regulation to
23 facilitate small business capital formation. But when
24 Congress in 1980 passed a statute requiring the SEC to
25 conduct the forum on small business capital formation

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1 annually, they clearly had more than securities regulation in
2 mind. They intended this to be a joint effort among the SEC,
3 the Small Business Administration, the Treasury Department
4 and the Federal Reserve Board. All of these agencies are
5 mentioned in the statute that calls for this meeting.

6 Recent events in the credit and financial markets
7 have taken us back to the roots of that statute and shown
8 that the cooperation of all these agencies is essential to
9 ensure robust small business capital formation in our
10 country. Each of these agencies has been active in
11 formulating today's agenda. We thank them for their
12 cooperation and for participating in today's panels.

13 My first official duty today is to introduce the
14 Chairman of the SEC Christopher Cox. Chairman Cox became
15 Chairman of the SEC a little over three years ago after
16 having served 17 years in Congress, three years in the White
17 House as Senior Associate Counsel to the President, several
18 years as a securities lawyer specializing in venture capital
19 and corporate finance, and several years as a small business
20 owner. He knows the world of small business and knows the
21 world of securities laws well, perhaps better than any SEC
22 chairman of recent memory.

23 During today's proceedings, we will talk about
24 several of the rulemakings that the SEC has finalized during
25 Mr. Cox's tenure as Chairman; but, perhaps, most important,

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1 Chairman Cox's willingness to tackle some of the intractable
2 problems that never seem to get resolved because they are so
3 hard to make progress on, problems that no one ever seems to
4 know how to solve, problems that seem to bedevil our
5 securities markets year after year, but areas where we could
6 have dramatic, long-term, beneficial benefits if someone took
7 the lead to make some progress. And Chairman Cox has made
8 dramatic progress in several of these areas.

9 One example of the type of initiative Chairman Cox
10 has had of this type is with an impact on small business are
11 his championing the transforming the SEC's mandated
12 disclosure system from a static form-based system to one that
13 taps the power, interactive data, to give investors
14 qualitatively better information about their investments,
15 including their investments in smaller companies.

16 I could go on and on about the difficult,
17 intractable issues that Chairman Cox has undertaken, but I'm
18 sure you'd rather hear from him yourself. So here I give you
19 SEC Chairman Charles Cox.

20 CHAIRMAN COX: Christopher.

21 MR. LAPORTE: Christopher Cox.

22 (Applause.)

23 OPENING STATEMENT

24 CHAIRMAN COX: Thank you Gerry, very much, for that
25 very generous introduction. And your slip there with Charles

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1 Cox is actually technically correct. That's my first name,
2 and we as you know have had a commissioner here at the SEC
3 before named Charles Cox with whom I had a discussion about
4 our potential relation when I was working in the White House
5 at the time. So you're right on both counts.

6 This is a splendid panel that we've assembled here
7 this morning. I am delighted to join with Gerry in greeting
8 all of you and welcoming you to what as he noted is the 27th
9 Annual Form on Small Business Capital Formation here at the
10 SEC. It's something that each year we take very, very
11 seriously. We think it's very important and in fact our
12 devotion to small business capital formation imbues a great
13 deal of the work that goes on in all of the divisions and
14 offices here at the Securities and Exchange Commission.

15 I think Gerry also mentioned that in addition to
16 those of us who are right here in the auditorium, we've got
17 people participating on the web. We've got people
18 participating on the web with us through "Twitter," and if
19 you are one of those, I encourage you to submit your
20 questions by e-mail and we'll try to get to as many of
21 those as we can. The SEC's mission, very formally, is to
22 protect investors, to maintain orderly markets, and to
23 promote capital formation. It's that third leg of our
24 mission that calls us together here today. The economic
25 crisis has centered on a lot of the largest players in the

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1 financial world, Fannie and Freddie, AIG, Lehman, WaMu, and
2 now the big three carmakers. The big players are getting a
3 great deal of attention, but this crisis is affecting the
4 entire economy including small business. I don't need to
5 tell you how rapid and severe the impact of recent events has
6 been, for at least the past two decades small businesses
7 which are 99% of all businesses, have bailed us out of every
8 recession and we are looking to small business to fulfill
9 that role once more.

10 You have generated between two-thirds and three-
11 quarters of all net new jobs, year-end and year-out, and that
12 is in relation to your overall size, your relative size,
13 truly over performing. In 2001, which was probably the most
14 extreme example of this, following the burst of the dot com
15 bubble, small business generated 100% of net new jobs in the
16 United States of America. Small business is backed up like
17 statistics such as that, is the engine of growth in America,
18 and America as always is counting on you. While the credit
19 crunch is making it difficult for small businesses to get
20 loans for inventory. Operations and expansion, your customers
21 at the same time are also feeling the pinch, and yet even
22 today according to the small business administration with
23 whom we are delighted to be partnering in this event, small
24 firms employ about half of all private sector workers.

25 You are responsible for 45% of total U.S. payroll

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1 and you've generated, as I said, the lions share of net new
2 jobs in the United States with that fraction of total
3 resources. Our success as a country and as an economy is
4 therefore inextricably tied to the success of small business,
5 and that's why we here at the SEC are dedicated to ensuring
6 that small businesses continue to have access to capital. If
7 we expect to exit this downturn and re-energize our economy's
8 growth as quickly as possible, we've got to smooth the way
9 for the men and women who are continuing to work, sweat, and
10 take risks and make payroll every week, every month, and
11 every year. While that fashion lately seems to be robbing
12 Peter to pay Paul, we thought it was high time someone
13 started listening to Paul for a change. We're delighted you
14 could all be here. We recognize the financial burden on
15 small business from government is even more serious than it
16 is for larger companies. The smaller the business, the more
17 true that is. Firms with fewer than 20 employees spend 45%
18 more per employee on complying with federal regulations.

19 We've been reminded once again of the important
20 role that regulation plays in protecting investors and in
21 ensuring a level playing field, and that's particularly
22 important for small business. But that in no way means that
23 the burden of regulation should be allowed to fall
24 disproportionately on small business. So as lawmakers and
25 regulators look to reform the system over the coming months,

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1 we've got to ensure that we do everything possible to
2 support the growth and the capital formation of small
3 business. At the SEC we've recently taken a number of steps
4 to make it easier for small businesses to comply with SEC
5 regulations.

6 Since June of last year we've revised the
7 eligibility requirements for primary securities offerings on
8 forms S3 and F3. We've enacted smaller reporting company
9 regulatory relief and simplification. We've revised rules
10 144 ad 145 with the same objective in mind. We've exempted
11 compensatory employee stock options from registration under
12 Section 12(g) of the '34 Act, and we've offered relief and
13 tailored guidance for smaller companies regarding
14 management's report on internal controls.

15 As you know, our partners at the SBA have also
16 taken steps to improve small business access to capital.
17 Some of their work includes an interim final rule earlier
18 this month that allows new SBA loans to be made with an
19 alternative base interest rate. The one-month LIBOR rate in
20 addition to the prime rate, which was previously allowed.
21 That's helping to address the recent disparity between those
22 two rates.

23 Of course there's much more that needs to be done,
24 and I know that you all here have a lot of ideas, and we want
25 to hear them and we want to get business on them right away.

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1 So we're going to turn to that immediately. The morning's
2 agenda features two roundtable panels. The first on small
3 business capital formation and the current credit crisis will
4 be moderated by Karen Kerrigan, the president and CEO of the
5 Small Business and Entrepreneurship Council in Oakton,
6 Virginia, and Chad Moutray, the chief economist and director
7 of economic research at the Office of Advocacy in the U.S.
8 Small Business Administration. They are going to lead seven
9 distinguished panelists in what promises to be an
10 extraordinarily timely discussion.

11 The second panel will be at 11 o'clock devoted to
12 current issues in securities regulation for smaller
13 companies. That will be moderated by our own Gerry Laporte,
14 who is of course Chief of the SEC Office of Small Business
15 Policy in the Division of Corporation Finance, and
16 co-moderated by Steve Bochner, partner at Wilson, Sonsini,
17 Goodrich & Rosati in Palo Alto, California. They will lead
18 another seven distinguished panelists, including our own Bill
19 Lutz, who directs the SEC's 21st Century Disclosure
20 Initiative.

21 After lunch we'll reassemble at 2:15 and divide
22 into more panel discussions and breakout groups to develop
23 recommendations. The moderators will include Brian Bussey,
24 Assistant Chief Counsel in the SEC's Division of Trading and
25 Markets, and Greg Yadley, who is a partner at Shumaker, Loop

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1 & Kendrick in Tama, Florida. Then we'll break at 3:30,
2 following which we will continue discussions until our 4:30
3 plenary session to develop next steps.

4 Then with our work done for the day, I invite you
5 all to join us for a networking reception at B. Smith's
6 Restaurant in Union Station. I would like to thank
7 anticipatorily the moderators and all the panelists, as well
8 as everyone who has traveled here, to take part in today's
9 proceedings; and, I'd also like to express my appreciation to
10 the staff of the Division of Corporation Finance we were able
11 to bring together such an impressive cast for today's
12 production.

13 So thank you to all of you. And now, over to our
14 moderator.

15 SMALL BUSINESS CAPITAL FORMATION AND
16 THE CURRENT CREDIT CRISIS

17 MS. KERRIGAN: Good morning everyone. How are you?
18 My name is Karen Kerrigan. Again, I am president and CEO of
19 the Small Business and Entrepreneurship Council. We are an
20 advocacy and a research and training organization with 70,000
21 members throughout the country. Let me thank Gerry and the
22 office for putting this annual forum together, and certainly
23 Chairman Cox, the work that he's doing in leading the SEC in
24 helping small business and simplifying rules and the general
25 thrust of his work and his recognition that it is the small

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1 business and entrepreneurial sector that is driving this
2 economy.

3 I just returned from the world entrepreneurship
4 forum in Europe where I met with 100 of my peers as well as
5 leading entrepreneurs from around the world, and we met to
6 discuss how to accelerate global entrepreneurship and
7 certainly, this issue, the credit crisis, dominated our
8 discussion. And so it is a global phenomena and we worked to
9 put together some solutions. And I'm really looking forward
10 to hearing from the panel in terms of getting a sense of what
11 is happening in the market, in the economy, and in sharing
12 their expertise and then developing recommendations and
13 solutions to move us forward. So with that let me turn it
14 over to Chad. He'll have some opening remarks. Right, Chad?

15 MR. MOUTRAY: Thank you again. And thank you,
16 Gerry, for inviting me to speak. I'm with the Office of
17 Advocacy at the Small Business Administration and we are an
18 independent office within the SBA that primarily has two
19 roles, the first of which I don't have to go too much into
20 because Chairman Cox already stole all my lines, and that is
21 the importance of small business in the U.S. economy. We put
22 out a number of studies documenting the role of
23 entrepreneurship and also issues of importance to small
24 firms.

25 In addition to that, we enforce the Regulatory

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1 Flexibility Act, and we work very closely with the Securities
2 and Exchange Commission, for instance, in ensuring that the
3 rules of SEC consider small business impacts. Again,
4 Chairman Cox stole all my lines there.

5 MS. KERRIGAN: Mine too.

6 MR. MOUTRAY: The small business community, like
7 the public in general, is quite scared right now, and of
8 course they have every reason to. They turn on the evening
9 news and they continue to hear just the drum beat of bad
10 news. Not only the word recession, which we continue to
11 hear, but the stock market continues to plummet.

12 We were talking earlier about how we don't like to
13 look at our overall assets anymore, at least the returns.
14 also are continuing to hear about falling GDP. We've lost
15 We 1.2 million jobs already this year, and the year's not
16 over with yet. And I suspect that we won't see good news in
17 November or December either. And consumer confidence is at
18 an all-time low. So when you hear these kind of statistics,
19 you as a small business owner you're rightly going to be
20 scared. And if you look at the polls that are out there, the
21 National Federation of Independent Business, for instance,
22 monthly asks their members what their optimism is, and
23 they're not very optimistic right now.

24 They tell you that the next three months is not a
25 good time to expand, to hire workers, or to invest in their

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1 firm. So if you're an economist like me trying to look
2 forward, that certainly is not a good sign for the economy.
3 Likewise, the federal reserve, and I'm sure we'll hear more
4 about it in a minute from Dan Covitz, does a senior loan
5 officer survey. And that has for the last year shown that
6 lending standards have tightened and loan demand is down,
7 quite considerably. And we certainly have seen that at the
8 SBA, and again Eric Zarnikow will talk about that with
9 decreased SBA lending. And so today's session, I think, will
10 be an interesting one, because we can kind of help frame some
11 of these issues regarding the economy, and how it's impacting
12 small firms and banks, and how we can get the economy rolling
13 again. So with that, let' turn over to our first panel.

14 MR. LAPORTE: I guess I didn't talk to Chairman Cox
15 enough about how we were going to hand over the baton here.
16 There's just a couple logistical problems that I wanted to
17 talk about before we got the panel started. First of all,
18 those of you here in Washington got program booklets that
19 we've distributed which contain an agenda and the biographies
20 of all the panelists. So we're not going to spend too much
21 time talking about people's stellar qualifications so that
22 you can read about it in the biographies that you have in the
23 program booklets. Those of you who are listening on the web
24 can get copies of the agenda and their biographies by going
25 to the small business page of the small business forum page

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1 on the SEC website at www.sec.gov.

2 Anybody in the auditorium who wants to submit

3 questions for answer by the panelists can fill out one of the

4 yellow cards that are available in the back of the room.

5 Those of you who are following the proceedings by the web

6 cast and other social media tools can send questions to

7 Roundtable Questions at SEC dot gov. Questions may be sent

8 to that address through the link available on the web page

9 where you accessed this webcast. The address again is

10 Roundtable Questions at SEC dot gov.

11 You can even use that address to submit questions

12 anonymously from your BlackBerry if you're here in Washington

13 in the auditorium. Of course, if you have general comments

14 or suggestions after today's program, you can always contact

15 the SEC's Office of Small Business Policy at small business

16 at SEC dot gov. Thanks. Sorry to interrupt.

17 MR. MOUTRAY: That's fine. So we want to have each

18 of the panelists give a brief remark, some opening

19 statements, so that we can get to some Q and As. And we are

20 going to start off this morning with Andrew Sherman, who's a

21 partner at Dickson Shapiro LLP in Washington. Andrew?

22 MR. SHERMAN: Thank you, Chad. I want to make the

23 most of the 60 minutes that you've allocated to me. It was

24 60, not six, right?

25 Just think. Somewhere, probably within a 100 mile

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1 radius of this room there's a panel that looks a lot like
2 this one and an auditorium that looks a lot like this one,
3 and they're talking about how good things are right now, how
4 the markets are booming. They're busier than they've ever
5 been. Unfortunately, it's a PLI bankruptcy lawyer program,
6 but, you know, that's just a detail, so we'll overlook that.
7 We're certainly all here in relatively somber moods. If your
8 livelihood relies around providing access to the capital
9 markets for small, mid-size enterprises, these are not happy
10 times.

11 Our assessment as a panel, even though we were hit
12 with the same news that Chad talked about on the way in this
13 morning from WTOP -- I turned on the radio just as I pulled
14 out of the driveway -- and the first think I heard was, well,
15 it looks like we're in a deep and long global recession. I
16 thought, oh, boy, they're really inspiring me to get on Mass
17 Avenue and get downtown.

18 My view is that the patient is sick. The patient
19 is a little ugly, but the patient is not dead. We are still
20 doing transactions. I will talk a little bit about the
21 impact of today's markets on transactional capital. Some of
22 the pathways that some small and midsize enterprises have
23 been finding some successes with and where things have
24 ground a little bit to a halt, I have some thoughts during Q
25 and A on the impact on the venture capital markets. But we

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1 have some incredible venture capital speakers here. And I'll
2 save those for Q and A.

3 The first thing, obviously, is that it's time to
4 think outside traditional capital formation, strategic boxes.
5 It's very important to get beyond the traditional thoughts of
6 venture capital, beyond traditional bank loans, look at some
7 of the alternative pathways.

8 I found it interesting that of all the great
9 statistics shared of the SEC's accomplishments, you know,
10 activities under regulation D, private placement offerings
11 under 504 and 505, these are pathways that a lot of our
12 clients are looking at. Some are already actively engaged in
13 who they present the PPM to, once it's complete, and how that
14 PPM will be assessed differently remains to be seen.

15 But certainly, spreading the risk and the burden of
16 capital formation into private placements is one opportunity
17 to rely on single angel financing, which was very robust in
18 the last couple of years until about six months ago, picks up
19 on Chad's point: people are feeling poorer, both literally
20 and figuratively. And angels with significant networks who
21 have seen their networks drop in a lot of ways in the last
22 couple of months, their appetite for risk has really turned
23 to nausea.

24 Relying on them for financing is not a good
25 strategy, though hitting them with a document that maybe

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1 asked them to spread that risk into units, like a PPM does, I
2 think, can be very viable. Many of the venture firms, I
3 think, we'll hear are really focused on tending to their own,
4 tending to companies that are already in their portfolio
5 keeping some powder dry just in case those companies need
6 follow-on financing, and not as anxious to look at new deal
7 flow as they were. Those that are making commitments, those
8 of you who are in this business, you see it. Issues of price
9 versus terms, what kinds of terms are you likely to see, how
10 will that affect both the quantitative and qualitative cost
11 of capital is something that needs to be looked at very
12 carefully.

13 Due diligence, longer, deeper, wider, slower, it's
14 there. People want to really, really, really -- that's
15 triple really -- make sure that the deals that they're
16 looking at doing are viable. Management teams are getting
17 frustrated with the number of presentations that they have to
18 give and repeat the same stuff over and over again to
19 different sets of due diligence teams and different advisors
20 to the source of capital.

21 The IPO market, I don't think we've had an IPO in
22 12 months, nine months. It's been a good run. It doesn't
23 appear to be changing anytime soon. That's clearly not a
24 path. Some of the strategic investors, overseas investors,
25 sovereign funds, some of them are more active. But if this

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1 is truly a global recession relying on the influx of foreign
2 capital, particularly from the Pacific Rim, is not going to
3 be as viable as it was, even relying on some of the middle
4 eastern oil money to come in and invest in small emerging
5 growth companies with barrel prices down to where they are,
6 not that I'm upset about that in filling up my SUV, have
7 really had a hit. There's still a lot of cash sitting there,
8 obviously, but accessing that, even Dubai, probably, the
9 fastest growing market out there has slowed down a bit.

10 I'll wrap up just with a quick thought. You know,
11 one thing that I am intrigued by is the extent of the
12 overhang in private equity, in hedge funds, and some of the
13 larger VC funds, the impact that it has on transactional
14 capital, the ability to get financing to do deals, whether
15 that's acquisitions, management buyouts. The overhang has
16 not been removed.

17 That capital is still sitting out there to the tune
18 of anywhere from 600 to 800 billion or more. But the capital
19 is not moving. And so the analogy that my wife gave me last
20 night when we were talking about it was it's a little bit
21 like someone who's overweight and doing nothing about it. I
22 don't think she was talking directly at me in making that
23 analogy, but that's how it feels. I mean, you know the
24 capital is there, but the capital is not moving.

25 And so with that diet tip I will turn it over to

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1 our next panelist.

2 MS. KERRIGAN: Great, thank you, Andrew.

3 And now to get a little bit of a banking
4 perspective we're going to hear from Tom Burke who is senior
5 vice president, National Program Director/Compliance Manager,
6 SBA Lending, Wells Fargo & Company. He wears a lot of hats.

7 Tom?

8 MR. BURKE: Good morning. I am Tom Burke with
9 Wells Fargo. Thank you for inviting me.

10 Wells Fargo is one of the larger institutions in
11 the country that offers business loans to small business.
12 We've been the number one small business lender based on CRA
13 data for the last five years. And the last counting in 2006
14 we had done \$21 billion in small business loans. That's
15 about 820,000 loans across the country. We cover 23 states
16 in small business. That's our banking footprint, which is
17 basically everything west of the Mississippi.

18 Included in that number is also SBA loans. I
19 happen to work in the SBA Division, but I was also a business
20 banker for about 15 years, so I was one of those folks that
21 was pounding the turf, looking for customers, having
22 relations with small business, whether they be a professional
23 business, a gas station or whatever.

24 For me and for our business I think this has been
25 probably one of the slower times that we've seen in the last

1 ten years. We're seeing less loan demand. The loan requests
2 that are coming in to our bank, folks are impacted by the
3 personal side of their lives when you'll be getting an SBA
4 loan or even a small conventional loan; and, I say small,
5 probably up to about \$5 to 6 million. You are looking at
6 people for their personal credit.

7 You are looking at what their situation is in terms
8 of their credit bureaus, how they're handling the personal
9 credit, their payments up to date, etcetera. And what we're
10 seeing generally is that the personal credit situation for
11 people is deteriorating. It depends obviously on what part
12 of the country you are in, but overall you're seeing people
13 who see their values and their homes drop significantly. And
14 that's where a lot of times they get the equity that they
15 need to come to the bank and put money into a transaction and
16 get a loan.

17 You're seeing commercial properties where we got
18 appraisals a year ago and we're still waiting for other
19 reasons, perhaps environmental, to close a deal. And in that
20 year's time that property is diminished in value by 2,
21 sometimes \$300,000. And so you're seeing erosion in values
22 that people can't keep up with. The first speaker talked
23 about psychology. And there is definitely a psychology out
24 there. You talk to our customers and they're looking at the
25 paper. They're watching what's going on on TV. They share

1 what's going on. And we tell people we've got money and we
2 do. We have money to lend and we're out there with their
3 sales people trying to convince people to get loans, but a
4 lot of folks are staying by that side.

5 They're waiting to see what's going to happen.
6 They're not willing to take a chance right now to expand,
7 because they're not sure what's going to happen in the next
8 30 days, the next 90 days. It's almost as if everyone's
9 waiting for the new administration to come in or something to
10 kind of save the day. And that's unfortunate, because there
11 are opportunities. Recently, in Minneapolis, there was an
12 article in the local paper that talked about the fact that
13 actually small business in Minnesota, for example, was
14 actually seeing an uptick in business in certain sectors.

15 Obviously, the foreclosure market is doing very
16 well, and attorneys and accountants that work with that. But
17 they're actually seeing an influx in companies that have
18 trade overseas, so that's a positive sign. But again it
19 depends on what part of the country you're in. Overall, we
20 are seeing a tightening of credit, Wells Fargo, with small
21 business customers. And I'll call small business customers
22 basically \$0 to \$20 million in revenue. We're a relationship
23 organization. What we do is we sell customers loans. If you
24 own deposit accounts, we sell them other products. We want
25 to build a relationship with them. That makes it a lot

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1 easier for us to do credit for small business.

2 On the SBA side we're transactional. We'll do
3 loans for customers whether they're with the bank or not with
4 the bank, but we'll try to get them in and make them a
5 relationship customer, because for us it's easier to lend
6 money to a customer when we know them and understand them
7 rather than just on a transactional basis. And I think
8 that's the challenge right now for small business, is being
9 able to maintain that relationship. Because they're seeing,
10 no matter what size institution their banking with, they're
11 seeing that institution perhaps vacillate about what they're
12 willing to do or not do today, whether it's to reapprove
13 their line of credit, to give them a term loan to buy a
14 building, or whatever.

15 So there's a general, almost like a quicksand out
16 there of inability of people that really feel that they're
17 firm enough to apply for credit. So it is a challenge out
18 there. We are still out there beating the bushes, looking
19 for business. We have money to lend. What we need is for
20 people, I think, to realize that there is opportunity, but
21 there's a macro piece of this that we, by ourselves, cannot
22 get through.

23 MR. MOUTRAY: Thank you.

24 Our next panelist is Kenneth Pelowski, founder and
25 managing partner for Pinnacle Ventures in Palo Alto,

1 California.

2 MR. PELOWSKI: Thank you very much.

3 Just a brief background on my experience, and I
4 think maybe applicable, I really had three legs in my career.
5 I started out working for some large technology companies,
6 firms like Intel and some Microsystems and General
7 Instruments. And I was on the executive staff of several of
8 those companies. And then I was actually on the operator
9 side for start-ups. I was involved in four start-ups, three
10 of which we were fortunate enough to take public and the last
11 one we sold for a little over a half billion.

12 So I'm familiar from the operator's side the
13 challenges of raising capital. And in the last seven years,
14 I've been involved in venture capital out in the bay area.
15 We do both venture equity which most folks are familiar with,
16 but also venture debt lending to start-up companies.
17 Pinnacle has investment capacity of just over a billion
18 dollars, and I would say that if I look at the venture
19 capital community today, which I share the Chairman's
20 comments that small business is the engine of growth of the
21 economy. Well, venture capital is probably the turbo-charger
22 of that engine, generating significant economic growth in
23 jobs, and many of our large companies today were start-ups at
24 one time; firms like Intel, Cisco, Apple, Hewlett Packard,
25 just to name a few.

1 And so really I believe it's a critical part of the
2 economy and the venture capital community today has a
3 liquidity crisis of its own, and that's really driven by a
4 variety of factors. First, the inflow of capital, venture
5 capital was typically pension funds and endowments. They
6 have what we call denominator effect today. That's to say
7 unless they allocate a part of their capital to alternative
8 investments, which venture capital flows in to, and that's
9 based on their total portfolio, and they are allowed to
10 allocate some percentage number, as a result of marking to
11 market, there are public equities. They are out of whack
12 with that allocation and so many are struggling to figure out
13 how to get back into that percentage basis.

14 So although capital is flowing, I don't want to say
15 that it's stopped, it's just significantly less capital is
16 flowing into the marketplace. If we look at Venture Capital
17 flowing out to start-up companies, I think you see, again,
18 capital flowing but less capital flowing. Most of the firms
19 we work with on the equity side, you know, historically you
20 would fund your good companies. You would shut down the ones
21 that the business models don't merit, and then there's a
22 third of the companies that kind of are struggling, but the
23 business model still looks attractive. Historically, most of
24 those companies are still funded.

25 I would say in today's environment less and less of

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1 those companies are funded. Many are still, but less and
2 less. With regards to venture debt loans to these companies.
3 Less of that is available as well. Most of our competitors,
4 we don't do this. But most of our competitors leverage their
5 fund. They go get LP capital and then go to a bank and get
6 leverage. Those lines have largely gone, so that access to
7 capital has slowed significantly.

8 Then in the later stage, venture marketplace, which
9 is typically funded by late stage venture firms, hedge funds
10 have historically come into that the last several years as
11 well as strategic. A large part of that capital is dried up
12 as well, so we do have a liquidity crisis across the board in
13 venture capital. In-flows from the endowments and pension
14 funds, outflows to the start-up companies, again, capital is
15 flowing, but less capital is flowing.

16 I would encourage, you know, the government and the
17 SEC to consider three things as I look at the issue. One is
18 there is going to be regulation as a result of all this
19 activity and certainly we prefer less regulation. So we're
20 cautious and concerned that we don't get over-regulated in
21 this environment and I know there's been some proposals by
22 folks to do that.

23 Secondly, I would encourage people to look at some
24 of the tax issues. For example, in our debt business because
25 we can be deemed a U.S. trader business, we have no access to

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1 foreign capital. So although lots of pension funds in Europe
2 would like to invest in us, that has limited involvement
3 with our capacity in that part of our asset class.

4 And then finally anything that can stabilize the
5 economy and banking, any stimulus package I think will help
6 everybody overall. So those are the three things that I
7 would encourage the government to look at with regards to the
8 venture capital community and how you could be helpful
9 bringing capital in, and then capital out to the start-up
10 companies that really historically and, I believe,
11 continually will drive a large part of our growth and jobs in
12 the future.

13 Thank you very much.

14 MS. KERRIGAN: Thank you, Ken.

15 Our next panelist is David Bochnowski, Chairman and
16 Chief Executive Officer of People's Bank, Northwest Indiana
17 Bancorp, Munster, Indiana.

18 MR. BOCHNOWSKI: Thank you. It's a pleasure to be
19 here this morning and I appreciate the opportunity to
20 represent the American Banker's Association.

21 I'm from Munster, Indiana, which is about 25 miles
22 from Chicago. We're a \$675 million bank. I would note for
23 the record that our public reports show that we had earnings
24 up 9% for the last quarter and that the corporate plane I
25 flew in looked remarkably like a United Airlines jet.

1 ABA has worked very hard to enhance the
2 competitiveness of the nation's banking industry, and I would
3 point out that we are by definition the industry itself by
4 and large small business. The majority of our banks have
5 less than \$125 million in assets, but yet ABA itself
6 represents over 95% of the industry's 13.3 trillion in assets
7 and combined, we employ 2.2 million men and women who serve
8 the commercial and consumer business lines that we're in.

9 I spend a lot of time these days talking about the
10 fact that we are not a national bank. We do not have the
11 Wall Street issues. We have Main Street issues; and from
12 that perspective we agree with Chairman Cox that basically
13 small business is the employer of choice in America. We,
14 ourselves have fit that measure. The Small Business
15 Administration says that if you are a small business if you
16 have less than 500 employees. By that measure, we have 8100
17 banks, 97% of our industry that would be classified as small
18 business, and even more telling we have 3500 banks that have
19 fewer I should say than 30 employees.

20 On the panel today, I want to give some insight,
21 and later on in the question and answer period with respect
22 to where we are as an industry on capital formation,
23 specifically, the TARP program and the capital purchase
24 program and how it affects banks like myself that are
25 considered small business. At the same time, we do fund in

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1 our commercial lending, not only in our community but in the
2 aggregate across the country, small businesses, what we find
3 in today's market is that fear has seized the markets.

4 We would not believe, would not agree, that there
5 is a credit crisis from the standpoint of community banks.

6 We in fact have funds to lend. What we note in two areas of
7 our business, one would be on the consumer side, our personal
8 experience in my bank is that home mortgage lending is down
9 about 40% from where it was at this same time a year ago.

10 And that number is confirmed and reflected by the title
11 companies in our community who say that they see the same
12 thing, and I think that, talking to my colleagues around the
13 country that that's a number that is probably consistent
14 across all regions of the country.

15 Part of the region, we believe at least, on the
16 home mortgage side why lending is down is that there's a
17 psychology that prices are going down and that the borrower
18 and buyer does not want to get into the market until the low
19 is reached. Those are individuals who rightfully from their
20 own perspective want to time the market and buy low, so that
21 they can appreciate high. At the same time, housing prices
22 are falling and we're seeing assessments on the tax side
23 moving down across the country. And I think all of that
24 psychology is impacting buyers.

25 On the commercial lending side, this is far

1 different. Again, we are I think the financier of choice of
2 small business. Our experience and our bank, and I think
3 again from talking to my colleagues around the country is
4 that we are prepared, ready, willing and able to lend from
5 our perspective, both on the home lending side and on the
6 commercial side, credit does not necessarily tightening
7 because most community banks did not get into subprime
8 lending. Most community banks stuck to the sound principles
9 of banking that it came to underwriting credits for small
10 business. I would suspect that the sweet spot for most
11 community banks is a credit that would run from a couple of
12 thousand dollars up to 5 or 10 million dollars, and funds
13 are available for that purpose.

14 We note, and again, it's our experience. But I
15 think this is reasonably true around the country that our
16 book of business on the commercial lending side has not
17 fallen off, but we don't know if the reason for that is new
18 economic activity which we think is not the case or the
19 migration of small business owners from large national banks
20 or from large regional banks back to the community level
21 where they may have been a long time ago and they're
22 returning back to what has been the tradition of community
23 banking.

24 We're actually seeing that our book of business,
25 going through the fourth quarter and the first part of '09 on

1 the commercial side is pretty strong, and again we're not
2 sure if we should feel good about that because we don't know
3 if there's going to be an impact on new economic activity.

4 From the standpoint of the commercial borrowers and
5 their capital formation, obviously, we do fund in large
6 measure working capital for small businesses. Small
7 businesses that might have 50 to 500,000 or less in sales.
8 Much of what they do financially, and I would reflect what
9 Tom has said on this issue, you know, they don't have real
10 financial statements. They might have compilations, but they
11 don't have audited statements.

12 What they are seeing is that the bulk of what they
13 have put into their business, be it the building that they're
14 in or perhaps taking some of their profitability and putting
15 it into the market, they're saying that those values are
16 coming down so they are frozen. And when we look at those
17 companies that might have a million plus in sales where their
18 businesses are a little bit more formal in the way they
19 conduct themselves, they too are swimming in the same water
20 that all of us are in.

21 They're unsure of the future, and the way the
22 current crisis has been teed up has led them to pull back and
23 to not to want to move forward with plans to expand because
24 of uncertainty. So from that standpoint I believe that the
25 community banking industry is prepared to provide liquidity

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1 to the markets, ready and willing to end, but there is a
2 crisis of confidence that is holding back moving forward.
3 And I'll save my remarks on TARP for the question and answer.

4 MR. MOUTRAY: Thanks David.

5 Next up is my colleague, Eric Zarnikow from the
6 SBA. He is the associate administrator for the Office of
7 Capital Access. Thanks.

8 MR. ZARNIKOW: Thanks, Chad.

9 As Chad mentioned, I head up the Office of Capital
10 Access at the SBA, so one of my functions is I oversee our
11 loan guarantee programs. So I'm going to talk a little bit
12 about what we've been seeing in our programs and then also
13 what are the actions that we're taking to address some of the
14 things that are going on in the marketplace today.

15 The SBA on the small business side doesn't actually
16 make direct loans. We provide a partial government guarantee
17 of a loan that's made by a lending partner that might be a
18 bank, a small business lending company, a credit union or
19 community development company. And we spend a lot of time
20 talking and listening to our lending partners to understand
21 what's going on out in the marketplace, and that ranges from
22 the Wells Fargos of the world to the smaller community banks
23 that may only do a handful of SBA loans a year.

24 And we've really over the past year heard three
25 common themes that we've heard throughout the year and really

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1 throughout the country. One is the demand for small business
2 loans has been down and there's been particularly an
3 acceleration of decline and demand over the last 60 to 90
4 days. Secondly, that the borrowers in general that are
5 coming in to apply for a loan are less credit worthy as it
6 was mentioned earlier in many cases the finances of a small
7 business are closely tied to the finances of the small
8 business owner.

9 In a lot of cases, their credit worthiness is down.
10 They may have less equity in their home, or their credit
11 scores may have been negatively impacted; and, then, thirdly,
12 lenders have been tightening credit standards. We've
13 definitely seen that and heard that as well, and that's been
14 supported by the Federal Reserve Senior Loan Officer survey
15 which shows that lenders have been tightening credit
16 standards. The most recent survey indicated that about 75%
17 of the surveyed lenders indicated they tightened credit
18 standards for small businesses, and the survey also supports
19 the decline in demand.

20 That's had an impact on our program for fiscal 2008
21 and we're on a September 30 fiscal year. We did about \$18
22 billion of loan guarantees. That was down about 30% in
23 number of loan guarantees and about 13% in the dollar amount
24 of guarantees coming off of a record 2007, so a pretty
25 significant decline.

1 We've seen an even greater acceleration into the
2 decline of demand really since mid-September, and that was
3 really at the height of the credit crisis and there was a
4 couple things that happened in the marketplace. One is there
5 became a disconnect between the prime rate and the LIBOR
6 rate, the London Inter Bank Offered Rate; and, where that's
7 important is that in our programs, historically, lenders
8 would make loans based on a prime rate spread over a floating
9 rate prime.

10 So basically, the return they earned on the loan
11 was on a prime rate. Many lenders though, their cost of
12 funds either partially or entirely is based upon the lended
13 inter-bank offered rate, the LIBOR rate; and, traditionally,
14 there's been about a 300 basis point spread between prime and
15 LIBOR with prime rate being higher than the LIBOR rate. In
16 mid-September we saw a disconnect where LIBOR moved up
17 dramatically, while the prime rate actually came down as the
18 Fed cut interest rates. So we saw that spread actually
19 compressed to the point where LIBOR exceeded prime.

20 So if you think about the lenders who their cost of
21 goods sold, if you will, is money, they basically sell money
22 or rent money to people, so their costs went up dramatically
23 where their income actually went down, and that compressed
24 profitability for lenders and in many cases they cut back on
25 SBA lending. The second impact the credit market disconnect

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1 had was for the secondary market for SBA loans. About 40 to
2 50% of the loan guarantees each year, the lending partner
3 takes the government guaranteed portion and they sell it in a
4 secondary market. And what that does is it provides
5 liquidity, particularly for the non-depository lenders.

6 That's a very important source of liquidity for
7 them, although many of our banking lending partners sell the
8 loans in the secondary market as well, because the buyers in
9 the secondary market in many cases have a cost of funds
10 that's LIBOR based. They felt the same pinch and basically
11 the secondary market for SBA loans froze up.

12 Most recently, since October, the beginning of our
13 fiscal year, we've seen the number of loans down year-to-date
14 about 50% and the dollar amount of loans year-to-date is down
15 about 38%. So decline in lending has accelerated over the
16 last month and a half or so. So the question is what actions
17 are we doing. What are we doing at the SBA?

18 Well, Chairman Cox mentioned that we last week
19 passed an emergency interim final rule that was effective
20 immediately; and, that did two things. It allowed LIBOR as a
21 base rate in our programs and also made some changes in our
22 secondary market, as well. From start to finish this
23 emergency rule took about 30 to 45 days, which, if you're
24 familiar at all with government regulation, it has to be a
25 world record time, and the years of government typically

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1 grind very slowly. By adding LIBOR as a base rate in our
2 program, in addition to prime, lenders can match up their
3 cost of funds with the income that they get on the loan,
4 thereby reducing the risk in making SBA loans which we think
5 will help free up the market and also help support the
6 secondary market.

7 We also allowed what are called weighted average
8 coupon pools, WAC pools, which historically in the secondary
9 market we only allowed loans with exactly the same interest
10 rate to be pooled together to be sold in the secondary market
11 and by allowing weighted average coupon pools it allows
12 loans with different interest rates to be pooled together,
13 which we think will also help support the secondary market.

14 We've gotten very positive responses from the
15 industry on both of these changes; however, I would say the
16 secondary market for SBA loans is still challenged. You see
17 that in many of the secondary markets for government
18 guaranteed loans right now or other securitizations. There
19 still is disruption in the marketplace. Investors are still
20 hoarding cash, very concerned about liquidity, and there's
21 also issues about relative returns and values, so we're still
22 working on trying to determine ways to help support or free
23 up the secondary market.

24 My final message really would be that the SBA is
25 open for business. We're here to help support our lending

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1 partners in giving capital to America's small businesses. We
2 spend a lot of time getting out talking with our lending
3 partners, talking with small businesses to make sure that
4 they understand and know about the benefits of the SBA loan
5 programs. And we are open for business to help support the
6 capital needs of small businesses.

7 Thanks.

8 MS. KERRIGAN: Thank you, Eric.

9 Up next we have Ned Pollack. He is the Deputy
10 Comptroller for Credit and Market Risk, Office of Comptroller
11 of the Currency, U.S. Department of the Treasury.

12 MR. POLLACK: So thank you. Good morning.

13 I am a bank examiner and the OCC is the Bureau of
14 Treasury Department, as you just heard, and we regulate
15 national banks. We regulate banks like Wells Fargo, for
16 example, that Tom Burke is representing here this morning.
17 We regulate J.P. Morgan Chase, Bank of America. We also
18 regulate about 1800 community banks, so all these banks of
19 course have a lot of business with small business lending.
20 When you talk about small business lending, as I talked to
21 the people that I worked with, there are different
22 definitions.

23 Tom was mentioning loans that go up from 9 to I
24 think \$20 million. Some people would say \$10 million,
25 suffice to say it's a broad category and you would get a

1 different answer from the largest banks than you might from
2 our community banks. You know, what are we seeing broadly in
3 the markets and what are we seeing in small business lending?

4 The problems that we're seeing in the credit
5 markets very clearly you saw problems in the housing markets
6 and they were led by liberal underwriting. And there was a
7 big liquidity factor there, which you've already heard about
8 this morning. You also had that driving the construction
9 development residential lending market, which just had a lot
10 of problems, and similar issues at the higher end for the
11 largest banks that are engaged in leveraged finance.

12 So it tended to be sort of isolated into different
13 loan products and it's sort of a consequence of liberal
14 underwriting, which many cases was driven by an awful lot of
15 liquidity. We hadn't seen that more broadly, but now we are
16 seeing things more broadly, so you're starting to see the
17 kinds of things, the problems that we see in those particular
18 asset classes, spreading more broadly, and that would include
19 spreading into small business lending.

20 What do we see kind of in our metrics? Banks
21 report quarterly their financial results in what they call
22 call reports, and in the second quarter for call reports we
23 have seen increases in past-due loans, increases in
24 non-performing more broadly, that includes small business
25 lending and particularly the smaller of the small business

1 loans is where we're seeing the more rapid deterioration.

2 In terms of outstanding banks, again, it gets the
3 definition and what do you really call a small business loan?

4 Banks have to report once a year, and that's in the second
5 quarter, their volume of small business lending. At the
6 second quarter of this year, the total was \$287 billion, and
7 that's defined by size. So that would be loans from zero to
8 a million dollars. That's up from 237 billion. So from 237
9 billion and 287 billion in the past year, what does that
10 really mean? It's hard to interpret that.

11 There are bank mergers. It may be that bank
12 balance sheets are being used where some other methods of
13 financing aren't being used, but there's certainly at least a
14 net growth in small business lending in the national banks.
15 We do an underwriting survey. The Fed does an underwriting
16 survey. We do one where we actually ask our examiners what
17 they're seeing and we are seeing tightening. You're not
18 seeing the dramatic tightening in small business lending
19 where you're doing some other areas where there really were
20 some of the parts from sound lending principles.

21 The small business lending and commercial
22 industrial lending, generally, we didn't see the departures
23 from sound underwriting the way we did in some other areas.
24 Nevertheless, having said that with what's going on with what
25 we're seeing in the economy, I think there was some mention

1 before of declining asset values to the extent that lenders
2 would look at someone's home, and they see the home price
3 depreciating, particularly in certain markets like Southern
4 California and South Florida, and you look at not just the
5 value of the home today, but what's it going to be worth in
6 three months or six months or a year.

7 We are seeing banks tighten that way. We are also
8 seeing a decline in demand so borrowers are not coming to
9 banks and looking for loans. It may be that they are just
10 being careful about taking on more debt in this market. It
11 may also be that as they look at their own financial
12 situation, they realize that it's not likely that they may be
13 approved. But to the extent that borrowers are coming into
14 banks, the approval rate seems to be stable. So it seems to
15 be both a demand and a supply side, particularly of course it
16 would be in the more sensitive industries, industries that
17 are businesses more closely related to the housing industry
18 and retail industries. That's where you're seeing less
19 demand.

20 One thing you do see in a market like this is
21 increase in asset-based lending. They would tend to be your
22 larger loans. Let's say, 20 million, 10 million, 20
23 million-dollar loans, but that is actually an area where
24 we're seeing growth in the national banking system. And I'll
25 just talk quickly about small business loans versus graded

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1 small business loans. So in our largest banks, the banks
2 depending on the loan size, let's say, a loan up to \$100,000.
3 It may be higher than that in some banks, maybe \$250,000,
4 banks may use a scorecard underwriting methodology versus
5 actually grading the borrower, looking at the sort of
6 traditional look at a borrower's financial condition.

7 In this market, in particular, we are seeing as you
8 might expect that the graded loans are doing better than the
9 scored loans and Tom Burke from Wells was talking about the
10 importance of relationship banking. Those loans where there
11 is a deposit relationship with a bank have been performing
12 better than those loans where there haven't been a deposit
13 relationship. That goes for both categories, but
14 particularly for scored loans where there is no deposit
15 relationship, the performance has been particularly bad. And
16 that's been especially true where banks have used a stated
17 income approach.

18 So how do we view small business loans, bank
19 examiners? I mean, we understand the purpose of a bank is to
20 serve the community and we are for that, so we would be for
21 banks, making small business loans. But we would look at
22 them like any other loan and expect banks would be prudent in
23 a way that they underwrite and advance loans. And you would
24 expect that banks would be especially taking that point of
25 view in the markets that were in. We are not broadly saying

1 you need to tighten your underwriting standards.

2 Really, we don't have to say that across any asset
3 class. Banks are doing that on their own. We certainly have
4 that authority. We would do it in individual banks if we
5 felt that that was necessary and I could comment too on some
6 of the TARP program issues, but I think I'll save that for Q
7 and A.

8 MR. MOUTRAY: Thank you.

9 Last but certainly not least, especially in a very
10 active market for the Federal Reserve is Daniel Covitz from
11 the Board of Governors. He serves as the Assistant Director
12 for the Division of Research and Statistics.

13 MR. COVITZ: First I want to thank Gerry for
14 inviting me here to participate in this discussion of the
15 credit crisis and the impact on small business capital
16 formation. I must admit up front that my expertise as an
17 economist in the Division of Research and Statistics that the
18 board is in broader capital markets as a result almost
19 certainly learn more from you and the other panelists than
20 perhaps you will learn from me. So I will apologize in
21 advance.

22 I should also remind everyone that to the extent
23 that I do offer opinions this morning, they're absolutely my
24 own and not necessarily those of the Federal Reserve Board or
25 its staff. With respect to broader markets, I believe we are

1 all acutely aware that strained conditions have deteriorated
2 further over the past few months. Of particular concern, I
3 would say in mid-September were the redemptions from prime
4 money market mutual funds, which in turn seem to coincide or
5 perhaps lead to sharp declines in the liquidity of the
6 commercial paper market. Perhaps more directly relevant for
7 small businesses was the slow down in securitization
8 activity, including but not limited to that four SBA loans.

9 In addition to some of the specific issues relating
10 to SBA securitizations that have been already discussed, some
11 argued that the broader difficulties and securitizations
12 reflect either the absence of traditional investors and
13 triple A tranches of these securities. Others point to
14 increased concerns about very poor economic scenarios,
15 rationally boosting risk premiums, which you might think
16 would be compensation for a correlation of asset returns with
17 very poor states of the economy. Both explanations seemed
18 plausible.

19 In any case I'm also seeing tighter credit
20 conditions for small businesses and survey data, not just the
21 ones that have already been mentioned, but others as well.
22 Another theme in most surveys that I've looked at that's
23 notable and it's also been mentioned already on the panel
24 is that when asked to rank concerns, credit conditions for
25 some reason come in well behind sales or consumer demand as

1 the top concern for CFOs and small business owners.

2 At this point I'll end my very brief remarks with
3 two questions. First, I'd be very interested in learning to
4 what extent disruptions to securitization markets have
5 affected the ability of firms or the perceived ability of
6 firms to obtain SBA loans. And, second, I'd be also very
7 interested in how small businesses changed the manner in
8 which they fund themselves due to any credit constraints.
9 Thank you.

10 MS. KERRIGAN: Thank you.

11 It's question time, right? Gerry, are we
12 collecting? If you have questions they will come here from
13 the audience. So please if you have any questions do fill
14 out your cards and we'd love to have your involvement in this
15 session this morning. But I guess we can get going. I had a
16 general question maybe I'll throw out to the panel.

17 I mean, certainly, the credit situation in the
18 economy was deteriorating prior to the election, but now that
19 the elections are over, you know, we're in this transition
20 period. To what degree do you think that maybe policy
21 questions or policy uncertainty may be affecting or
22 exacerbating the current situation. You know, in that where
23 the new administration may be moving on issues with respect
24 to taxes and regulations and things of that nature. Anyone
25 care to comment on that?

1 MR. BURKE: Well, in terms of regulation, one of
2 the things from an SBA perspective is an SBA lender, and I
3 think I'm on the national association, the guaranteed lenders
4 board, which represents the SBA lending industry. Some of
5 the things that we think need to be done, first of all, is
6 raise the loan limit on 7A loans, term loans. Right now the
7 loan limit is \$2 million and I think it would be very helpful
8 to be able to raise it to \$3 million. That would give us an
9 opportunity to offer more lending opportunities for business
10 acquisitions in commercial real estate financing.

11 We only ask for 10% down, for example, in
12 commercial real estate. You've got a sizeable government
13 guarantee behind the loan, you've got a better shot of
14 getting that loan done for that customer in a structure that
15 will help them because they've got a 25-year amortization.
16 Another thing we'd love to see is we'd like to see some
17 relief on fees. We can finance the guarantee fees.
18 Customers pay a guarantee fee to us to pass through the SBA
19 for the money that they get it was guaranteed. And even
20 though we can finance it, there's still a psychological
21 barrier there for folks to be paying those fees. To see a
22 fee reduction, even a temporary fee reduction for all of
23 o'nine, or something of that nature, would certainly, I
24 think, help incent people to look at getting an SB loan. And
25 then some of the things around regulatory, we'd like to

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1 probably see a different process in which they audit banks,
2 the SBA audits banks.

3 There's a cost there. You know, as a large
4 institution, we're paying a pretty sizeable fee to have the
5 SBA take a look at us about every 18 to 24 months and to
6 manage our portfolio. And we can afford it. I mean, that's
7 fine for us. We can afford it, but the smaller community
8 banks particularly, that could be a pretty hefty charge, and
9 it's one of the barriers that folks in the lending community,
10 especially in the small rural areas urban banks have to be in
11 SBA lending.

12 MR. MOUTRAY: So before we go on to our next
13 question, Eric, do you want to respond to that?

14 MR. ZARNIKOW: Sure, I'll just make a couple comments
15 on that. I think, your original question was are people sort
16 of waiting on the sidelines because of concerns or what's going
17 on as far as policy, and we were talking earlier before the
18 panel started. I think the bigger impact in my mind is just
19 what's going on with the economy in general. There's a lot of
20 fear out there about are we in a recession or are we going into
21 a recession. Is it going to be a deeper recession?

22 It's hard, when you pick up the paper every day and
23 read about banks failing and multi-billion-dollar write-offs,
24 crunches in the credit market, it's hard to feel optimistic
25 about, wanting to start or expand, or acquire a small business.

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1 So I think the big issue right now is overall fear of where the
2 economy is going versus policy changes that may impact a small
3 business. I also think our view is that right now the access
4 to capital is a more important issue for a small business than
5 the cost of capital.

6 If you think about it, most of the SBA back loans
7 are floating rate loans and prime has gone from eight and a
8 quarter to four percent over the last year or so. So the
9 cost of borrowing has gone down dramatically during that time
10 period, so we think it's more of an access issue. If you
11 think about it in the retail sense, there's product in the
12 store. It's on sale. People want to buy it but there's no
13 access. The door is locked and you can't get in, so we think
14 that it's probably more of an access to capital question
15 right now than a cost of capital question for a small
16 business.

17 MS. KERRIGAN: David?

18 MR. BOCHNOLWSKI: Karen, the uncertainty question
19 with respect to TARP is a major issue for community banks and
20 their capital formation. TARP itself, the legislation, has a
21 paragraph in it that says those who take down TARP funds
22 agree that at any time the Treasury can change the rules
23 under which TARP is issued. So that kind of uncertainty
24 suggests to most community bankers that while you might take
25 the money down to help provide capital for your company or

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1 for whatever reason. At this time, you're agreeing that
2 those rules could change, and no one wants to play by rules
3 that could change at any time. And so there's great
4 uncertainty, I believe, on the part of community banks, my
5 bank being included, as to whether or not we want to enter
6 into a program that while on its face would grow our capital
7 at a price.

8 And when we get into some discussion, perhaps later
9 on in this panel, the price of the TARP funds when measured
10 against what it might cost to raise money on the outside
11 through public offerings, it needs to be weighed off because
12 the public offering doesn't carry the uncertainty that would
13 be accompanied by the TARP funds.

14 MR. MOUTRAY: I have a question from one of the
15 audience members. Business and personal credit cards are
16 becoming a very important source of financing to business
17 owners. We heard about reducing credit line limits by
18 lenders in 2008. Do we have statistics on the amount of
19 credit limits, i.e. home equity lines, credit cards,
20 etcetera, relative to credit card balances? So do you have
21 any comments about credit cards as a source of financing for
22 small firms?

23 MR. POLLOCK: I'll just make some general comments.
24 Banks that offer credit cards to individuals or that offer
25 credit cards to businesses do have the ability to make

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1 changes in the credit lines that they offer at any time, and
2 banks do things under credit card account management that are
3 very statistically based and to the extent that a bank would
4 have some indication that a card would be used for expenses
5 that may be sort of a last resort, then we probably are
6 seeing banks being more active in line management or in
7 reducing the availability of credit through credit cards.

8 Banks may also be more attentive to the extent that
9 a borrower may have several credit cards and not be using a
10 certain credit card. Once activity starts on that credit
11 card, that is unusual, and then combined with maybe some
12 other information that may be available in the credit bureau
13 and so forth. They may take some more aggressive actions
14 that way, which is what we're seeing now.

15 MR. ZARNIKOW: I would add just a quick comment as
16 well. When you think about small business, and once again
17 many cases the finances of small business are very closely
18 tied to the finances of the owner of the business. A lot of
19 times, they will use a home equity line of credit or credit
20 cards to help support the financing of the small business to
21 the extent that source has been cut back, it impacts the
22 ability of small businesses to grow. In addition, we're see
23 that borrowers are less credit worthy. In some cases there
24 have been sort of across the board cuts in home equity lines
25 of credit or credit card lines, which means that the

1 individual has a higher amount outstanding versus their
2 available credit, which tends to have a negative impact on
3 their credit score as well.

4 So some cases they've had a double hit where the
5 access to those lines has been cut and it also has a negative
6 impact on their credit score, which hurts their credit
7 worthiness when they go to borrow.

8 MS. KERRIGAN: Andrew?

9 MR. SHERMAN: Let me be the voice of the maverick
10 on this one point. I think that some healthy pullback is a
11 good thing. When you can go to a Redskins game, get a hat,
12 towel, and two credit cards, the market swung. The pendulum
13 swung a little too far.

14 We had clients that were using credit cards like a
15 checkbook, irrespective of whether there was cash in their
16 accounts. And then the 22% bill comes and they realize that
17 cost of capital is awfully high. I think that to the extent
18 that some of the credit standards are being adjusted on the
19 commercial loan side or the credit card side, as long as the
20 pendulum doesn't swing too far, it's actually healthy for the
21 economy in the long-term. We've all been a bit too credit
22 card dependent, and I'm in favor of some pull back there.

23 MS. KERRIGAN: Thank you, Andrew.

24 Next, we have an Internet question and this is from
25 John in New Jersey. Many of the panelists have said that

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1 they are lending. Yet, as a small business owner, we see the
2 credit market seizing up and lending institutions hoarding
3 cash. Can you reconcile this? Anyone want to tackle that
4 one? I mean, certainly, you're speaking from experience
5 obviously in terms of what you're doing.

6 MR. POLLOCK: From a regulator's perspective, you
7 know, if you look at the banking population and it does vary,
8 there are many community banks that are doing just fine, that
9 we'll say and mean it very honestly they don't need the TARP
10 funds. There are a lot of banks that are not doing just
11 fine. But in the environment that we're in, you know, with
12 the economy where it is right now, what we're seeing in asset
13 values, there's a lot of pressure on banks to keep capital at
14 high levels and to keep the allowance for loan loss at good
15 high levels so that banks don't want to jeopardize that.

16 And they can see into the future that those
17 pressures may become greater. So when you're seeing that,
18 you're very jealous, or you're kind of hoarding your balance
19 sheet. And then when you extend new credit, banks want to
20 extend new credit, but if you're looking down the road at the
21 situation as I was saying earlier in particular in certain
22 industries, in housing and things like that, you may not
23 really change your fundamental underwriting standards if you
24 have certain financial information, cash flow that you want,
25 coverage if you have collateral.

1 But you're in a world where the collateral values
2 may be changing and cash flows may be changing, so there'd be
3 an extra layer of kind of conservative applied under the
4 traditional underwriting standard, so that may be what some
5 borrowers are experiencing that they're thinking banks are
6 tightening, and they are tightening because of what they're
7 seeing sort of trans-financially, but they're basic
8 underwriting criteria probably hasn't changed that much. I
9 don't know if the other bankers may have.

10 MR. PELOWSKI: So just the perspective from our
11 standpoint, we have increased the bar in terms of the quality
12 that we're looking at when we do lending to start-up
13 companies. You know, we'd deem it as a flight to quality in
14 this environment, and so yes, we're still providing loans to
15 start-up companies, but the bar is certainly higher than it
16 was -- not that it was that low, but it's certainly higher at
17 this point. I would say the other thing too is that I don't
18 think people are hoarding as much. Our perspective is that
19 there's been a bit of a run on the bank in terms of anybody
20 that had lines that weren't drawn over the last three or four
21 months, most of those folks have run in to draw those lines
22 down, which typically you would have had drawn down in a more
23 normal timeframe over the next year or so. We are all drawn
24 down relatively quickly, so I think that's impacted folks as
25 well.

1 MR. BOCHNOWSKI: The reconciliation question is a
2 very good one and it may depend on the nature of the
3 borrowing and the nature of the borrower. I believe that in
4 our case and perhaps Ned would agree with this from the
5 regulators point of view, banks are not real anxious right
6 now as an example of one sector to engage in development
7 lending. There's an over supply.

8 So from that standpoint, I wouldn't say that banks
9 are hoarding cash. I would say that there's a business
10 decision that there's a lot of that product in the market, so
11 therefore we're pulling back from that area until there's
12 some absorption. And so not knowing the specific situation
13 with respect to the person who's written in or called in, I
14 should say, it's really hard to answer that question.

15 The other observation I would make is that in this
16 current environment, one of the things that's happening is
17 that bankers are getting cash flowing into the bank, simply
18 because it's coming from other sources where it might have
19 been in finding it's way in a flight to quality or a flight
20 to safety into the banking industry. That poses a particular
21 dilemma for banks and bankers, because our job is to lend it
22 back out. So we have to fulfill our commitment with respect
23 to our charter and I think that generally speaking, most
24 bankers are pretty serious about making credit available.

25 MR. MOUTRAY: Okay. Changing over to the topic of

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1 venture capital or equity capital, I'm going to combine two
2 questions here, because we're getting several of them. The
3 first one is since banks are rolling back their loan activity
4 to small businesses, isn't it appropriate to drill down and
5 look outside the box for outside the box ways to lower the
6 artificial barriers, regulatory or otherwise, to equity
7 capital formation.

8 And the second question, could Mr. Pelowski
9 elaborate on his second recommendation regarding foreign
10 sources and investors for venture capital funds. So I guess
11 one of them honestly was to see about that.

12 MR. PELOWSKI: Sure. Well, this is largely for our
13 debt product. Our debt product has an interesting component
14 and we can be deemed a U.S. trading business which results in
15 taxes, ECI tax for foreigners, EBTI tax for pension funds.
16 And so most of those folks don't like to pay taxes, so
17 they've chosen not to.

18 In essence, that lowers their returns for their
19 investments, so they chose not to participate, even though we
20 would have an interest, especially for folks that have very
21 high tax structures such as Germany, which normally would
22 have come in and really likes the asset class, but typically
23 can't get over the hurdle because of the tax implication. So
24 that has impacted our venture debt business which retards
25 access to foreign capital and certainly that would be

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1 something we would be supportive of, people taking a look at
2 changing that legislation.

3 MS. KERRIGAN: Andrew?

4 MR. SHERMAN: Let me pick up on the part of the
5 question that's about thinking outside the box, and I'll
6 address it from both the equity side and the credit side.
7 The e-mail or the combined questions that you got are exactly
8 on point. I mean, traditional solutions to capital formation
9 problems are not going to work in this environment. So
10 thinking outside the box, not going traditional lender
11 looking at community banks, the credit union is on the credit
12 side. On the equity side, as I mentioned in my opening
13 remarks, private placements under regulation D, looking at
14 strategic investors, some companies, not withstanding their
15 stock price, are still sitting on a lot of cash, have
16 pipeline issues, R&D and innovation issues. They're looking
17 to partner with small companies and provide either cash or
18 non-cash resources.

19 On the quasi credit side, things like leasing,
20 factoring, consortiums and federations, I mean, there's a lot
21 of non-traditional sources of access to resources that we've
22 not talked about yet this morning, we're probably going to
23 run out of time on but these are not the time to be thinking
24 the only two buckets of capital are on the debt side, a
25 traditional commercial bank, on the equity side, a

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1 traditional venture capital firm. There's a lot of other
2 buckets out there and those buckets are going to have to be
3 explored in this environment.

4 MS. KERRIGAN: Okay, the next question comes from
5 our audience. There has been a lot of discussion surrounding
6 the deployment of real investment versus what has come to be
7 known as phantom investment, which doesn't really mobilize
8 labor, goods and services. What policy measures should be
9 implemented to curb leveraged hedge fund activity and
10 encourage more real investment into the job creating economy?

11 MR. PELOWSKI: Again, I go back to a variety of
12 activities that I think can be helpful here in terms of the
13 formation. Other areas like, you know, appreciation of tax
14 credits, R&D credits that recently were passed were very
15 helpful to anybody investing in technology. There's also,
16 for example, the clean tech world, largely a stalled venture
17 capital formation over the last 30, 90 days, because they're
18 waiting, as he's talked about earlier, to figure out what
19 kind of DOE grant programs are going to be available for some
20 of these clean tech investments. And until that's sorted
21 out, people are not going to be taking that inherent risk of
22 an investment. And so I think anything where there's
23 government support in those areas for R&D, grant programs
24 such as for DOE for clean tech, I think, would stimulate and
25 accelerate investment in the area.

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1 MR. BOCHNOWSKI: We come from the manufacturing
2 sector of the country, and in Northwest Indiana at least I
3 think we manufactured more steel, at least in recent years,
4 than any other place in the country. And so I think if we're
5 talking about government stimulus, and that seems to be where
6 we're going.

7 I don't, personal opinion and I think most bankers
8 would probably agree, we don't need to put more cash in the
9 hands of citizens. What we need to do is have true stimulus
10 packages that create jobs, that is to say, to improve our
11 infrastructure. And if we were to do that we would shift
12 from an economy that seems to be manufacturing financial
13 paper back to what we used to do best, which was to put our
14 smokestacks to work and show that America was back to work.
15 And I think that repairing infrastructure would be a big help
16 to the manufacturing sector with any stimulus package we
17 would consider.

18 MR. MOUTRAY: Okay, this next question from one of
19 our audience members: foreclosures versus bank capital.
20 This individual does not want people to lose their homes.
21 What is the effect on bank profits to capital when there is a
22 call for massive forbearance or rewriting of the long-term
23 loans? What is the impact of the MBS to CDO prices due to
24 this uncertainty?

25 MS. KERRIGAN: And what is MBS CDO?

1 MR. POLLOCK: Well, on the first question, and
2 there's an awful lot of discussion as everyone knows about
3 forbearance on mortgages and different types of programs and
4 what works best, and what should banks be doing. Most of
5 what banks have been doing in terms of mortgage modifications
6 and forbearance has been to extend terms to lower interest
7 rates; you know, extend the amortization period.

8 There hasn't been a whole lot of debt forgiveness,
9 although there have been some programs where there's been
10 debt forgiveness and there's been a lot of discussion around
11 whether or not there ought to be debt forgiveness. What it
12 does to a bank's capital when loans are modified and the
13 interest rate is lowered, of course, that lowers the income
14 that comes to a bank or the parties that the bank is
15 servicing for to the extent that banks would actually forgive
16 principal.

17 If a bank were to go and actually forgive
18 principal, then the bank would be obligated to recognize that
19 principal forgiveness as not going to be collected and so
20 that would be a loss. So that would reduce the banks
21 allowance for loan losses and ultimately reduce their
22 capital. So there is a reluctance on the part of banks to
23 make mortgage modifications. I'm speaking generally in that
24 situation. It's varied.

25 That would include some principal forgiveness if

1 there's some other way out that can be, you know, that the
2 bank and the borrower can come up with. As far as the MBS
3 CDO, I'm not quite sure what the question is there. I mean,
4 there's certainly the secondary markets where mortgages are
5 very much strained and it's very difficult to issue mortgages
6 to the secondary market, particularly in the private market.
7 That's pretty much frozen right now, so maybe that's what the
8 concern is.

9 MR. MOUTRAY: Well, the question was simply what
10 was the impact on prices for those securities, was the
11 question.

12 MS. KERRIGAN: Another question from our audience.
13 Has any thought been given to modifying the government's
14 commercial paper program to give first-time issuers the
15 ability to participate? David?

16 MR. BOCHNOWSKI: Karen, I'd just like to go back to
17 the prior question. I'm sorry.

18 MS. KERRIGAN: Absolutely.

19 MR. BOCHNOWSKI: A great secret among community
20 bankers, which is fairly, widely known is the last thing a
21 community banker wants to do is own the real estate. We just
22 don't do it. In my community, back in 1981 when I didn't
23 have any gray hair and I was about 6'2, we lost 25,000 direct
24 steel jobs and 75,000 indirect steel jobs.

25 When we did that, we created a forbearance program

1 that worked incredibly well and we still do that today. I
2 would agree with Ned's observation that the bank, generally
3 speaking, does not want to reduce principal, because that
4 causes other disruptions within the community.

5 It would suggest if you do that for one borrower
6 and you do it for one neighbor, why won't you do it for
7 another neighbor? And perhaps one of the answers here is for
8 us to go back as a nation to seeing that there's equity in
9 properties when we make loans, because the equity has always
10 been there in the past to absorb the downturns. The
11 difficulty we all have is that within at least the last
12 generation, there's never been a downturn in housing.

13 MR. COVITZ: At this point I think the pros and
14 cons of many possibilities are being considered; however,
15 it's important to note, and I guess recent policy actions
16 into some kind of perspective. The Federal Reserve actions
17 over the past year, the aggressive monetary easing the
18 additional liquidity provided to inter bank funding markets,
19 and then as the Internet question mentions, the recent
20 programs designed to inject liquidity into the commercial
21 paper market were all aimed at markets and not sectors.

22 In addition, the Federal Reserve is mandated by
23 statute to be secured, and part of achieving or satisfying
24 that legal requirement has required the program to be
25 restricted to highly rated commercial paper programs.

1 MS. KERRIGAN: Any other thoughts on commercial
2 paper?

3 MR. MOUTRAY: Eric, I have two questions on SBA.
4 So the first one is what are the specifics of SBA guarantees
5 on loan losses? How does this relate percentage wise to the
6 fees that are generated, and what are the specific loan loss
7 guarantee stats, how many, how much, what industries,
8 etcetera, just more community banks or national bank leaders?
9 So those are the questions on losses.

10 The second one is in the 1960s, SBA made direct
11 loans. Recently, I assisted a client in obtaining a small,
12 \$400,000 loan which the SBA preferred lender reduced to
13 \$150,000 in their commitment letter. Question: Should the
14 SBA now consider it direct loan since many lenders have found
15 that the financial resources have greatly diminished there
16 greatly?

17 MR. ZARNIKOW: There was a lot of questions there,
18 so let me try and answer them.

19 Basically, once again, the SBA provides a partial
20 government guarantee of a loan made by a private lender, so
21 if the borrower defaults and they don't repay the lender can
22 come to the SBA and collect on the guarantee. So it's really
23 a back-end guarantee of the obligation by the borrower.

24 Overall, as we look at our loan portfolio, we see
25 that about six percent of our loans default over the life of

1 the loan. Typically, a lot of these loans are
2 collateralized, so our net loss rate is about three percent.
3 We do have, I think, there's a couple things that are
4 important to know about our loan programs. One is we have a
5 credit elsewhere test, so basically we're not trying to
6 compete with the private sector on our loans. So if the
7 traditional credit markets will provide capital to the small
8 business, then the SBA does not get involved.

9 What we're trying to do is expand the credit box a
10 bit and get capital to small businesses that wouldn't
11 otherwise be supported by the conventional market. So the
12 lender really has to represent to us they wouldn't make the
13 loan on the same terms without the SBA guarantee. We do
14 charge fees for our loans, so there's an up-front initiation
15 or up-front guarantee fee, and there's also an ongoing
16 guarantee fee that's paid by the lender in order to have the
17 government guarantee and our programs currently are on what's
18 called zero subsidy. So basically the fees that we charge
19 pay over time on a net present value basis for the losses
20 that we see in our loan programs.

21 The SBA many years ago did have direct loan
22 programs for commercial small business loans. We still do
23 direct lending on the disaster side, but only for physical
24 disaster loans, either to home owners or to small businesses.
25 There have been a number of proposals that have been stated

1 out there publicly about utilizing the SBA disaster loan
2 program to make direct loans, in essence, economic loans.
3 There are some challenges with that.

4 Our disaster loan program, which is really our
5 direct loan vehicle, is really a fraction of the size of our
6 commercial loan program. I mentioned earlier that we
7 guarantee about \$18 billion of loans a year, and on an
8 average year on the disaster side, we do less than a billion
9 dollars of loans. And the vast majority of those loans, both
10 in dollar and amount in number of loans are the homeowners to
11 help them with physical repair damage that's uninsured
12 related to a disaster.

13 So we don't really have a group of people that is
14 experienced in making commercial loans to small businesses in
15 our disaster loan program. Also if you think about it, if
16 you think about the network of banks that we work through,
17 our lending partners, you know, literally, we work with
18 thousands of banks to do our SBA program, so any sort of
19 direct lending program that we would do would have a fraction
20 of the network that we have through our current lending
21 partners and would take a significant period of time and
22 resources to be able to ramp-up staffing people, space and
23 experience to really be able to do a direct lending program.
24 So there's a number of barriers and hurdles to be able to do
25 a direct lending program. I don't know if that answered all

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1 the questions we were asked.

2 I don't know if that answered all the questions
3 that were asked.

4 MR. BURKE: I just want to reinforce what Eric
5 said. I think the private sector does a better job in
6 delivering capital through the SBA program than relying on a
7 government agency to actually do it directly. The SBA in the
8 last 10 to 15 years has been cut almost in half in terms of
9 staffing and budget, because the private sector was able to
10 take on that responsibility much more efficiently and much
11 more effectively.

12 Eric's right. I mean, we have something like 4,000
13 banking stores within our footprint. We are in every
14 community within 23 states that we do business, so we have an
15 opportunity to touch more customers than the SBA ever could
16 on their own. I think it would be kind of crazy to go back
17 to having the government try and do it directly, because they
18 lacked expertise, so it would take quite a bit of time for
19 them to ramp up to do it. And so I think the way the program
20 has developed today, it's much more effective and much more
21 positive in the community, because bankers are working with
22 existing customers or with prospects that come in for
23 referrals. So there's a one to one relationship there that's
24 already been built if you will and it would be difficult.
25 People already have an issue around a government program

1 anyway. I mean, one of the first issues borrowers often have
2 with an SBA loan is getting over the fact that they've got to
3 fill out a whole lot of paperwork. They've got to answer a
4 lot of personal questions, and it seems very intrusive. I
5 think it would be even more intrusive if they had to go back
6 to dealing with "bureaucrats" to do that.

7 MS. KERRIGAN: Another question. Would modifying
8 the mark to market accounting standard tend to free-up credit
9 markets?

10 Anyone want to tackle that? I know we'll be that
11 addressing that this afternoon, I think, right? Or in the
12 next panel?

13 MR. LAPORTE: Yeah, I think the next panel plans to
14 address that a little bit, so maybe we can save that question
15 for the next panel.

16 MS. KERRIGAN: Okay, so stand by on that.

17 MR. MOUTRAY: We have five minutes, and I suspect
18 that there are things that each of you wanted to say that you
19 didn't, and so I'll pose a question here, since I guess the
20 bottom line of today's meeting really is. If federal
21 policymakers could do one or two things to get the capital
22 markets flowing, what would you expect out of the federal
23 policymakers, whether that be the SEC, the SBA, or the OCC,
24 anyone at the federal level. If they could do one or two
25 things, what would you want those to be? And that could be

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1 opened for anybody.

2 MR. SHERMAN: I'll give you a policy and a
3 non-policy answer if it's okay. From a policy perspective, I
4 think, to the extent we are dealing with uncertainty and
5 that's what's bugging folks, the faster that the incoming
6 administration could name the rest of their appointments,
7 articulate their tax policy. If you have business owners
8 confused right now, should they be selling their businesses
9 before capital gains, uptick, but at a time when even
10 multiples are horrible. I mean, that's a pretty confusing
11 time to operate in. So any clarity a new administration can
12 provide to people who are influenced by the uncertainty and
13 try to remove it. My non-policy response is the exact
14 opposite of what I just said, and that is we are here
15 speaking on behalf of small businesses and entrepreneurs in
16 our country, and I've been teaching entrepreneurship at
17 Maryland for 21 years. And the first lecture that I give to
18 the students, I'll reiterate here. And that is entrepreneurs
19 thrive in times of uncertainty. This is the backbone of our
20 country. So throwing up the uncertainty excuse is not
21 working for me, at least not for our nation's entrepreneurs.
22 I think we need to get busy in developing game plans and in
23 getting more creative and access to the capital markets, and
24 stop letting uncertainty be the cloud that's getting in the
25 way of our productivity and our competitiveness.

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1 Because somebody is going to step up, and if it's
2 not us, it will be another country that takes advantage of
3 the uncertainty and moves far ahead of us, so.

4 MS. KERRIGAN: Eric?

5 MR. ZARNIKOW: You know, I think that I would add,
6 also, is you think about the things that have been done in
7 the financial markets. I think they're critically important,
8 and the press likes to call them bail-outs or other sort of
9 negative terms.

10 I really think of them as being investments that
11 are being made in supporting our financial sectors and
12 keeping access to capital and capital markets open at a very
13 critical time. The bulk of the money is really money that's
14 being invested or loaned that the government expects to get
15 paid back. And you heard from the panelists and you read in
16 the paper there's a substantial number of markets that have
17 been disrupted, whether it's the lending markets, the
18 commercial paper markets, the student loan markets. You're
19 hearing now about credit card and other markets.

20 Clearly the SBA secondary market is still disrupted
21 as well. I think continuing support in making those
22 investments in the financial sector is really critical in
23 supporting the capital markets in making sure the capital
24 continues to be available.

25 MR. POLLOCK: And I would just say broadly, I'm a

1 bank examiner and I don't set policy. And I couldn't speak
2 for our organization on policy issues, but it does get back
3 to this issue of uncertainty and confidence in the system. I
4 mean, once there's more confidence in the system, then more
5 capital will be invested in small businesses and banks. And
6 when capital is invested, and people are feeling more free
7 and you'll see more loans being made.

8 I do think if you look at the banking system,
9 certainly in the largest banks, there's a lag between the
10 time that banks tighten the lending standards. When you
11 start to see the results, just like there is a lag between
12 when the underwriting was poor and the poor results show,
13 right now you're seeing high loan loss provisions which are
14 a consequence of higher delinquencies, higher charge-offs.
15 You know, but I do think not too far in the future you're
16 going to see those numbers looking better, because credit is
17 being underwritten more prudently now, and once that starts
18 getting going and there's more confidence, there are a lot
19 of investors that are waiting to come in investment in banks.

20 I mean, we know that. They visit us because
21 they're trying to get a sense of the condition of the banks.
22 Once you start to see some manifestation of these positive
23 things that are happening, so whatever the policymakers can
24 do to move that along, and I think probably the TARP program
25 does that.

1 MR. BOCHNOWSKI: I would just reiterate what I said
2 in my opening remarks, which is agreeing with Ned. The
3 uncertainty in the market has been caused in many respects by
4 the fact we started out with one program for TARP, moved to
5 another and moved to another, and I think the public is very
6 confused by that.

7 I think consumers are confused by that. I think
8 small business owners are confused by that, so I think the
9 more we can do to study issues and be sure that we're
10 announcing the track that we're on, that there is some
11 certainty and that there are results that can be made would
12 be terrific. The other thing under mark to market, which I
13 know we're going to talk about in the last panel, I think
14 resolving that issue was critical as far as banks are
15 concerned to capital formation going forward.

16 MR. BURKE: I don't want to reiterate what everyone
17 else has just said other than I have an opportunity from the
18 entrepreneur classes at local colleges in the town that I
19 live in and those classes are still full. So there are still
20 people out there in their 20s, early 30s, that think that the
21 American dream is alive. And my concern is that we over
22 regulate and do something to disturb what I think is the
23 basic germ of what is so important about small business is
24 that people are still willing to take the risk. And we have
25 to be able to allow banks, venture capital, etcetera, to have

1 the flexibility to help those people meet their dreams.

2 MR. SHERMAN: I've just got to strongly agree with
3 what you just said. It was very well said and agree 100%.

4 MR. PELOWSKI: Again, I'll reiterate what I said I
5 think in my opening statements, and I echo that three things
6 that I think are important. One is just articulated. You
7 know, regulations are going to occur because of what's
8 happened. And certainly, they may be prudent for large
9 companies, but they could strangle starved companies, so be
10 very cautious on that.

11 Two is that there are certain tax policies that I
12 think hinder capital in-flows to parts of venture capital
13 community, especially from foreign investors who are
14 interested. And anything that could help resolve that, I
15 think would help flow more capital into the venture capital
16 community. And then finally, you know, obviously, we have to
17 live in a healthy ecosystem for venture capital or start-ups
18 to thrive. So anything that can be done to enhance overall
19 economic growth and stability, obviously, will thrive that
20 ecosystem.

21 MS. KERRIGAN: Thank you. And I believe our time
22 is up, isn't it?

23 MR. LAPORTE: Yes. Before I get a chance, I want
24 to thank the panel, but a couple of logistical announcements
25 before people start clapping and leaving.

1 If you leave the SEC building, for lunch for
2 instance, please bring your name badge with you. The
3 security officers at the door will recognize your name badge
4 as security credential to get back in the building so you
5 won't have to go through security again.

6 Secondly, if you want to go to Union Station for
7 lunch or for any other purpose and you don't want to go
8 outside in the cold, there is an indoor bridge to Union
9 Station which is to your right as you exit up the escalator
10 after you go through the exit gates on the ground floor of
11 the building. If you can't find it, just ask one of the
12 security officers down there and they'll be able to help you.

13 Lastly, unless the moderators want to say anything
14 I would like to thank both the moderators and the members of
15 the panel for an extremely informative discussion. I think
16 we all owe them a lot of gratitude for coming. I was very
17 impressed and I think that we got a lot of good suggestions
18 to improve small business capital formation. I want to give
19 them all a round of applause.

20 (Applause.)

21 MS. KERRIGAN: I also thank the audience for their
22 terrific questions. That added greatly to the discussion, so
23 thank you.

24 (A brief recess was taken.)

25 MR. LAPORTE: It's about five after eleven, so I

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1 think we should probably get to the second panel. If those
2 who are in the bank could take their seats, we can go ahead
3 and get started.

4 Before we start the second panel, I'd like to
5 recognize the staff of the office of small business policy
6 who are in the room here. I think they're in the room, at
7 least. These are the people who work in the office that I
8 had. First of all, is Tony Barone here? I don't see Tony
9 back there. But if he's not here, I'd at least like to
10 recognize him, and Corey Jennings. These two guys are the
11 people who are primarily responsible for this form and a lot
12 of the good work that gets done in our office. Kevin O'Neil
13 and Joanna Lossert. I don't know if they're here. I think
14 they're probably busy doing other things.

15 Last but not least, although she's not on our
16 office, I'd like to recognize Maurie Osheroff who's sitting
17 in the third row here. She's the associate director who
18 oversees the work of our office. And, lastly, so he doesn't
19 feel left out, I'm going to recognize Brian Breheny who I
20 will introduce in a few minutes, who is the deputy director
21 to whom all of us report.

22 A couple more logistical things; the federal law
23 under which the SEC conducts this forum envisions that
24 recommendations will result from the forum to improve small
25 business capital formation. We're going to try to start

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1 developing the recommendations starting at 2:15 this
2 afternoon in break-out groups that will meet in this
3 building. The details are in the program booklets that you
4 have.

5 Those of you here in Washington who want to
6 participate in the break-out groups should reassemble in this
7 room at 2:15 after lunch and we'll discuss at that time how
8 the break-out groups will work. You will need an SEC staff
9 member to take you to the conference rooms on the upper
10 floors of this building where the break-out group sessions
11 will be held, so if you're too late, you might have trouble
12 getting up to those rooms.

13 After the break-out groups, as you can see in the
14 program, we will reassemble again in this room this
15 afternoon, develop a plan or next steps as to how the
16 recommendations will be delivered to the groups or agencies
17 to whom they're addressed. I think most of you were here
18 before heard my remarks about how you submit questions.
19 There are yellow question cards in the back for those of you
20 who are here in Washington.

21 Those of you who are listening following the
22 proceedings by webcast or other social media tools may send
23 the questions to Roundtable Questions at SEC dot gov. That's
24 R-o-u-n-d-t-a-b-l-e, Q-u-e-s-t-i-o-n-s, at SEC dot gov.
25 Questions may also be sent to that address on the link

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1 available at the web page on which you access this webcast.
2 If you have general comments about what's being said today or
3 follow-up suggestions, you could always send us comments and
4 suggestions.

5 Send comments and suggestions to the SEC Office of
6 Small Business Policy at Small Business at SEC dot gov. As
7 we begin our second panel, I'd like to say that any opinions
8 that are expressed by Brian or myself are our own opinions
9 and don't necessarily represent the views of the SEC or any
10 of the individual commissioners or members of the Commission
11 staff. Chairman Cox, this morning, reviewed some of the
12 initiatives that the SEC has undertaken in recent years that
13 relate directly to small business capital formation.

14 I won't go over the things that he mentioned this
15 morning. The one thing he did mention last year on May 23,
16 2007, I believe it was, we had a major meeting of the
17 Commission in this room in which they voted to issue six
18 releases that directly related to small business capital
19 formation and regulation of smaller companies by the SEC.
20 Five of those releases were favorably acted upon at the end
21 of last year by the Commission.

22 The only release that hasn't been acted upon was
23 the one revising regulation D for limited offerings. The SEC
24 has had a lot on its plate, recently, and hasn't gotten to
25 the Reg D release yet. So we're now thinking that perhaps

1 our new Chairman or Chairwoman will decide what the SEC
2 should do to follow-up on that release.

3 Starting the introductions by the panelists, I'd
4 like to ask the panelists to please make sure to turn off the
5 microphones when you're not speaking, because I'm told if we
6 leave the microphones on it creates a lot of static on the
7 web cast and people can't understand. I'd also like to say
8 that similar to the last panel, towards the end of this
9 panel, I'd like to go around to all the panelists, especially
10 those from the private sector, and ask you if there were one
11 or two things that you think the government agencies could do
12 to facilitate small business capital formation, what would
13 that be. So we'll give you a chance to think about that.

14 If you're not going to say that in your opening
15 remarks, you can say it at the end, or maybe you can save
16 something from your opening remarks. At the beginning, most
17 of the panelists will have a few minutes, five to seven
18 minutes or so to make a presentation with the exception of
19 Bill Lutz, and we're going to give him a little bit of extra
20 time. But before we get to the other panelists, I'd like to
21 introduce my co-moderator, Steve Bochner, who is a partner at
22 Wilson Sonsini Goodrich & Rosati, working out of Palo Alto,
23 California. As most of you know, Wilson Sonsini, was the
24 top-ranked firm in number of IPOs of any law firm in the
25 country for the many years in which we had an IPO market.

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1 Now that we haven't had IPOs for a while, I don't know what
2 the people that issue those rankings are going to do. But
3 that firm has very many good lawyers expert in small business
4 capital formation. And from what I know, Steve is one of the
5 best people at that firm. I got to know Steve and admire his
6 work when he served as a member of the SEC advisory committee
7 on small or public companies from 2005 to 2006 and we're very
8 pleased that he's come back to the SEC today to serve as a
9 moderator of this panel.

10 CURRENT ISSUES IN SECURITIES

11 REGULATION FOR SMALLER COMPANIES

12 MR. BOCHNER: Great. Thanks a lot Gerry. That was
13 a nice introduction.

14 I would also like to welcome and thank this
15 terrific panel that we've got up here before you. And I'd
16 like to thank the SEC for having me here today. I'm also not
17 going to go through the various things that the SEC has
18 adopted in the form of rule changes and rule proposals, but
19 you've got in your book the recommendations of the SEC
20 advisory committee. And actually the recommendations coming
21 out of this forum last year and at least as I flip through
22 them, I am pretty impressed by how responsive the SEC has
23 been to both sets of recommendations, you know, ranging from
24 404 relief to capital formation to making S-3s easier, and
25 that incorporation by reference flexibility available to a

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1 larger percentage of companies, E-Proxy and the list is
2 pretty long, so I think that's great. More work to do.
3 You're going to be hearing from Bill Lutz in just a minute
4 about a proposal to modernize the disclosure system and this
5 promises to further reduce costs. And when we're talking
6 about smaller public companies, these companies bear the cost
7 disproportionately of compliance, and so anything that is
8 able to reduce those costs and take advantage at the Internet
9 and so on, I think is terrific for the small business
10 community.

11 The other thing I'll point you to is the
12 recommendations of the committee on improvements to financial
13 reporting which came up with some recommendations, including
14 recommendations in the area of materiality and perhaps making
15 restatements easier for smaller public companies who are
16 subject to the tyranny of small numbers. Little errors are
17 sometimes magnified and restatements can be difficult for
18 those companies. So I think some of those recommendations
19 are important and I think we'll also help reduce costs of
20 compliance.

21 So as Gerry mentioned, I was on the SEC advisory
22 committee for smaller public companies. I'd like to kick
23 this off before we dive into the panel with some observations
24 on issues affecting smaller, private companies; and, in
25 particular, I'd like to talk about the venture capital area

1 which is one I'm close to. Chairman Cox referred to the
2 venture capital community and business as an engine of
3 growth, and it certainly is. It's created some very
4 important companies, Google, GenTech, and AutoDesk. The list
5 is very impressive.

6 Right now, that business and that community is in
7 stress mode, and some of that stress is coming out of the
8 credit crisis, but some of it isn't. You know, venture
9 financings are down, mergers are down, all liquidity events
10 are down. IPOs as Gerry noted are way down, and while I
11 think financings and mergers will resume to some normal level
12 once the credit crisis has passed, the dearth of IPOs is not
13 a credit crisis phenomenon.

14 That is something that has kind of come out of the
15 more discerning public market. It's also come out of higher
16 compliance costs. And based on, if you look at data from Dow
17 Jones Venture Source, Venture One, you'll see that it now
18 takes eight plus years to get a venture backed company
19 public. In 2007, one out of ten of those companies fortunate
20 enough to achieve a liquidity event were IPOs. The rest were
21 mergers.

22 And so without a healthy IPO market, the venture
23 community is in trouble, because if you have to rely on
24 mergers to get liquidity events, you are relying on what I
25 like to say is the kindness of strangers as opposed to being

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1 a master of your own destiny and being able to take a company
2 public.

3 And so what's happened, and I wish I had a graphic
4 up here, but the picture I'd like to paint is an environment
5 in the old days where you used to see the venture community
6 support an A, B, C round financing. And then at some point a
7 company around 30 or 40 million in revenue could go public
8 and access the public capital markets. Today, there's a big
9 gap being created between middle and late-stage venture and
10 the IPO -- eight plus years, lots of financing, sometimes
11 bridging multiple funds -- and that's created a capital gap,
12 a problem in that middle market.

13 And so what I'd like to kick off with three
14 thoughts, maybe for the panel and maybe for all of you is
15 perhaps a way to address this, which is sort of looking at
16 that middle market and asking the question, can we improve
17 capital formation and can we approve liquidity in that
18 market. And before the credit crisis, you saw foreign
19 markets trying to take advantage of that capital gap.

20 I think a good question is could we take advantage
21 of that by improving capital formation and liquidity among
22 investors, like a credit investor or large credit investors
23 that perhaps don't need the protections of the '34 Act. So
24 here my three thoughts of things to consider is we sort of
25 balance capital formation with investor protection. One is

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1 500 shareholder limit, which is if you imagine taking
2 advantage of liquidity in a closed, electronic trading system
3 that only accredited, or large accredited or QUIBS or
4 whatever the community is, that 500 shareholder limit has
5 become a barrier because once you reach 500 shareholders you
6 have to register.

7 And so we now have an exemption for options, which
8 I think is a good thing. It's taken longer to get public and
9 the companies have to hire more employees in therefore
10 options, but could we have an exemption that would eliminate
11 from the 500 shareholder account investors who can protect
12 themselves like QUIBS or large accredited or accredited.

13 So something to think about and that would
14 facilitate capital formation above that limit, and we can
15 issue stock to investors under the '33 Act without
16 registration, so I think it does make some sense to eliminate
17 from that count investors who can fend for themselves.

18 Secondly, under the Reg D proposals, there's a general
19 solicitation, relaxation, sort of the same policy theory on
20 investors. Does it really matter how investors are solicited
21 as long as the ultimate purchasers can fend for themselves.

22 They meet certain standards, and I think I would
23 encourage the SEC to continue to look at that and maybe even
24 expanding that beyond the large accredited level, and then
25 thirdly, taking a look at 144A and transferability and

1 considering whether to lower the skirts from qualified
2 institutional buyers being able to take advantage of easier
3 transferability to something below that level, maybe large
4 accredited, maybe accredited investors.

5 And if you were to do those things, you then could
6 imagine that it would free some of these efforts that the
7 National Venture Capital Association is looking at and some
8 of the SROs looking at to actually help create a middle
9 market that addresses this capital gap that's being created
10 where qualified investors that meet whatever standard we
11 decide we ought to meet can go and raise capital, have some
12 limited trading, and perhaps start to address this growing
13 capital gap. So with those remarks, Gerry, I think we're
14 ready for our panel.

15 MR. LAPORTE: As the first panelist I'd like to
16 introduce the director of the SEC's 21st Century Disclosure
17 Initiative. If this is probably a title that doesn't mean a
18 whole lot to a whole lot of people, and I think that Bill
19 Lutz is very good at explaining what he does. Bill came to
20 us about six months ago, so maybe less than a year ago, I
21 think, he's been an English professor. He's both, I think, a
22 PhD in English and a lawyer. He has unique qualifications to
23 be able to suggest, make recommendations to the SEC as to how
24 we should make our disclosure more understandable to
25 investors. And, Bill, why don't you tell us what you're

1 doing in the 21st Century Disclosure initiative.

2 MR. LUTZ: Thank you. Terrible name. I didn't
3 choose it.

4 Basically in the sound byte description, my charge
5 is directly from Chairman Cox to develop a high level plan
6 that will move the SEC from a forms based disclosure system
7 to an electronically based disclosure system; and the
8 implications from that are significant. Basically, all of
9 the required filings are forms that are uploaded
10 electronically in either HTML word, whatever format that you
11 used.

12 And while that can be significantly improved, it's
13 the other side of the filing process that is important and
14 that is the accessing the data. Right now, the data is
15 static. That means it's locked into that form. You cannot
16 now go to Edgar and say I want to look at the earnings per
17 share of these five companies all together at once on one
18 screen. You cannot do that.

19 So ultimately the system that we would recommend
20 for the Commission to consider would empower both filers and
21 investors to have easier filing and much easier access to the
22 financial disclosure that the SEC houses. Clearly, there
23 would be a significant reduction in filing costs once such a
24 system was in place. For the small firms where filing can be
25 a real financial burden, not just the 10K, but the 8Ks, the

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1 Qs, if you could reduce any of those filing costs, that money
2 goes directly to the bottom line and our goal is to reduce
3 that as much as possible to make filing quick, easy,
4 seamless, and just as reliable as it is now.

5 The benefits besides cost savings are far greater
6 than that. When the data is in what we can an interactive
7 format and can be easily accessed and used, and manipulated
8 any which way, you have democratized data. You no longer
9 have to have sophisticated software, or you don't have to go
10 to a financial intermediary to purchase that data. You can
11 do it yourself, and that means that more people will have
12 access and that means greater coverage for companies.

13 I think the significant drop in coverage of
14 companies by analysts would be addressed, because anyone
15 would be able to easily access data on one company, groups of
16 companies, profile any groups they want. And, suddenly, I
17 think, a lot of companies would get coverage that aren't
18 covered now, because there wouldn't be the barrier that there
19 is to accessing the data and trying to assemble it. So in
20 addition to lowering the filing cost, I think it is more
21 important that the company's data is out there and accessible
22 by investors, and this has to, I think, help capital
23 formation. Also, to repeat a cliché, this is the Internet
24 world, which means that financial data, financial disclosure,
25 financial information has no boundaries in time or space. As

1 the chairman said in his speech in New York just the other
2 day, an investor in Boise can affect and purchase stock in
3 Bangkok, and I'm sure you've seen the television ads where
4 the person says, with a click of the mouse I just bought
5 shares in -- name of the country. So we are moving into
6 international markets. Such markets are not based on
7 forms-based financial data, particularly static data.

8 If you check with Japan, India, China, 20 countries
9 have already moved to interactive financial disclosure, so we
10 live in a world capital market. It's no longer just a
11 capital market in individual countries, and more and more
12 investors assume that they can get the information they want
13 from just about any country in the world on any company that
14 is a public company. So our initiative is to give to the
15 Commission a plan for their consideration on how to move
16 towards such a disclosure system. Part of what we are
17 mandated to do, of course, is a cost-benefit analysis and we
18 think it will be significant in savings, and particularly for
19 the small businesses where filing costs are a real burden.
20 And the more that we can reduce that, it certainly, as I
21 said, goes to the bottom line.

22 But more importantly, I think in the long term that
23 you may be a small business, but you're working in the world
24 capital markets and you need to get your information out
25 there for the investors around the world. And I think that

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1 can only help capital formation for smaller companies.

2 MR. BOCHNER: Terrific; thanks a lot, Bill.

3 Next, doing double duty today we're going to hear
4 again from David Bochnowski, who has previously been
5 introduced to you.

6 David?

7 MR. BOCHNOWSKI: Thank you.

8 I'm sorry I was late joining the panel. I was out.

9 I had to return a few phone calls. I am David Bochnowski and
10 I am the Chairman of the Northwest Indiana Bancorp which is a
11 public company. We are located about 25 miles from Chicago
12 in the Northwest corner of Indiana.

13 We have 10 locations, and about 181 full-time
14 employees, and I am very pleased to have the opportunity to
15 participate today. I'd like to specifically discuss the 500
16 shareholder rule and the impediments that it poses to
17 community banks' ability to raise capital and impact our
18 operations and our profitability. Let me tell you first a
19 little bit about our bank.

20 We are basically locally owned. We have 400
21 shareholders and about a quarter of those are insiders. 75%
22 of our shareholders are all Indiana residents. Our revenue
23 is \$23 million. Market cap is about 70 million, and we
24 employ, as I said, 181 full-time employees. We trade in the
25 bulletin board. Our average share volume over the last three

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1 months is 308 shares a day, and if you do the math that's
2 154, I believe, because you do the buy and the sell side. So
3 we're not very actively traded. We would be considered
4 illiquid.

5 We have the occasional analyst who calls, and I
6 think just because we're at the bottom of the list, he's got
7 to call somebody, or she does. And as you can see, we're a
8 small business and I think we're typical as I will explain of
9 community banks and their structure as public companies. We
10 are clearly on Main Street and as I said earlier today, most
11 community banks, 97% of our industry, would be classified as
12 small business. But I think there is a telling statistic
13 that I would take from the time perhaps that Steve, you were
14 with the small company study. And back in 2006, the SEC
15 found that 726 banks filed periodic reports with the SEC. Of
16 those 425 or 58% had a market cap below 128 million, 203 or
17 27% had a market cap below 787 million; and, only 98 or 13%
18 had a market cap above that 787 million-dollar hurdle.

19 Yet, for SEC purposes my company competes with the
20 largest lender in the United States, G.E. Capital. We have
21 followed the same rules. It seems that there is a question
22 of proportionality in balance that needs to be brought into
23 play as we look at small companies and their registration
24 with the SEC. The SEC requires that a company with 10
25 million in assets and 500 shareholders register, and I think

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1 we know those facts, and that you cannot deregister unless
2 you fall below 300.

3 Once you do that, of course, there is always the
4 risk that more shareholders would come on board and you could
5 push above the 500. All of this inhibits the ability of
6 capital raising in small banks, and so I think we have to
7 look at whether or not there need to be changes made at this
8 point in the middle of this crisis that would help us
9 specifically with raising capital.

10 While the TARP funds are available and we talked
11 about that on the first panel, the preference, I think, that
12 all Americans I have is the bank's not -- I don't want to use
13 the word rescued, but that's what the public thinks is
14 happening that banks have the ability to raise funds
15 privately. And I think that the shareholder limit does
16 impact that, and hopefully we'll have a chance to get into
17 that a little bit in the question and answer session.

18 Let me just add in a few more thoughts here in the
19 opening statement. The \$10 million asset limit was
20 originally 1 million and it's been increased 10-fold since
21 1964 when it was first put in place, but the shareholder
22 provision has not. I was explaining all of what I was doing
23 today to our youngest son who is 17-years-old, and of course,
24 everybody wants to give a community banker advice, so he gave
25 me his advice.

1 And his advice was that "Dad, you were a sophomore
2 in college then and the world of investing has changed in the
3 last 24 years. But beyond that, it's changed in the last
4 month." So I guess even he had some understanding that the
5 world is changing around us. The inability of that threshold
6 number to be updated I don't think in this day and age
7 represents at least for banks the true nature of them as a
8 public company. And so I would hope that the SEC would
9 seriously consider relief that is needed.

10 Clearly, there is operational impact and cost
11 impacts, and I will save those comments for the discussion
12 later. Thank you.

13 MR. LAPORTE: Thanks David.

14 Our next panelist is Brian Breheny, who is the
15 deputy director to whom our office reports at the SEC.

16 Brian?

17 MR. BREHENY: Thanks, Gerry.

18 Well, good morning. As Gerry mentioned, my current
19 job is the deputy director for legal and regulatory policy
20 here at the SEC. I've been in that position for about a year
21 now, but before that I joined the Commission in July 2003 to
22 run the Commission's mergers and acquisitions office. And,
23 before that, I practiced law in New York and London, and
24 before that I was a CPA. But probably more important for
25 today's purposes, in addition to representing the Commission

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1 on this panel, is also I'm a small business owner. I started
2 a company with a number of friends back in 1998, and
3 thankfully those business which focuses on the law school
4 education market have been quite successful. They've grown
5 to about \$3 million in revenue and about five full-time
6 employees. We have not had to access the public markets for
7 investors or for credit, but I certainly understand the
8 start-up, small business issues that many people throughout
9 the country are dealing with. In my current position, I have
10 the pleasure of working closely with Gerry and members of his
11 office of small business policy. I think you all know we
12 looked at that office to be the face of the SEC, two smaller
13 companies, and I think that this program and the other
14 programs that Gerry and his office organize and attend are
15 very helpful for us as we set an agenda and work through that
16 agenda to address issues that are important to U.S. small
17 business capital formation.

18 I also want to thank Gerry and the members of his
19 office for putting the forum together today. You know, as we
20 gather here today, we are in the midst of tremendous change
21 in this country. The capital markets continue to change. I
22 think you probably all know the Dow Jones Industrial Average
23 all know the Dow Jones Industrial Average fell to its lowest
24 levels in 5-1/2 years yesterday and then I checked this
25 morning.

1 Unfortunately, the markets were declining again
2 today. Hopefully, that's changed. Of course, you are also
3 visiting Washington, D.C. during the transition to the Obama
4 administration. This transition will impact the SEC.
5 Chairman Cox has already publicly announced that he intends
6 to leave the Commission at the end of the current
7 administration. And most recently John White, the director
8 of the Division of Corporation Finance has announced that he
9 will leave the Commission at the end of this year.

10 With this change, I believe, comes tremendous
11 opportunity for us to consider what the Commission and its
12 staff should focus on in the new term. Before we propose a
13 new agenda of action items, however, as we talk about today,
14 I think it would be helpful for us to sort of recap the
15 recent successes that I think we've all enjoyed.

16 Since we gathered last year at this forum, which
17 was held in September, the Commission approved five of the
18 six proposals that had at issue to address small business
19 capital raising and private offering reform. These proposals
20 have been referred to earlier today and I want to stress how
21 very important they were for us in the division and ones that
22 we devote a tremendous amount of time and thought and
23 resources in order to get them right.

24 In putting the proposals together, we looked to the
25 advice of the small business community. Certainly this forum

1 and the members have participated in the past as well as our
2 advisory committee on smaller public companies were extremely
3 helpful. We also took very seriously the comments that we
4 received during the comment process, and I hope that you
5 realize that those comments were reflected in the final
6 products that were adopted by the Commission.

7 So just briefly, the five proposals: the first,
8 the smaller reporting company regulatory relief and
9 simplification proposal. In that release, the Commission
10 expanded eligibility for our scaled disclosure and reporting
11 requirements for smaller companies by making the scaled
12 requirements available to all companies of up to 75 million
13 in public float. We now refer to those companies as smaller
14 reporting companies. We also simplified the reporting
15 requirements for these smaller companies.

16 Next was the revision to the eligibility
17 requirements for the primary security offerings on forms
18 S-3 and F-3. In this release, the Commission revised the
19 eligibility requirements of those forms to allow companies
20 that do not meet the requirements of the forms for the \$75
21 million in public float to nevertheless register primary
22 offerings of the securities. This was the first time that
23 that could happen, however, those folks were subject to
24 restrictions in the amount of securities that they may sell
25 pursuant to the eligibility standards over a one-year

1 period.

2 Next up, the exemption of compensatory employee
3 stock options from registration under 12g of the Exchange
4 Act, and Steve mentioned this earlier. In this release, the
5 Commission adopted the two new exemptions from Section 12g
6 including exemption, subject to several conditions from
7 registration for private, non-reporting companies issuing
8 options to employees, directors and others provided for under
9 Rule 701.

10 The revisions to Rule 144 and Rule 145 to shorten
11 the holding periods for affiliates and non-affiliates was
12 another release the Commission adopted. This release
13 shortened the holding period for the free resale of
14 restricted securities by non-affiliates from two years to six
15 months for reporting companies and to 12 months for
16 non-reporting companies. The amendments also raised the form
17 144 filing thresholds and eliminated the presumptive
18 underwriter provisions in Rule 145, except with respect to
19 transactions involving shell companies.

20 Finally, the electronic filing and simplification
21 of form D was something the Commission adopted recently, and
22 in that release the Commission mandated the electronic filing
23 of information required by form D. But it also revised and
24 updated the form D information requirements and simplified
25 and restructured form D itself. By the way, voluntary,

1 electronic filings began on September 14, just two months ago
2 now. To date we received approximately 250 electronic
3 filings. That number represents approximately six percent of
4 the form D filings in the total, both paper and electronic.
5 Mandatory electronic form D filings will be required in March
6 of next, so hopefully, people are getting used to this system
7 during the six-month phase-in period.

8 Of course, one of the key proposals that continues
9 to remain outstanding -- remember, there were six proposals
10 that the Commission proposed, and we've adopted five at this
11 point -- that proposal is the revisions of the limited
12 offering exemptions in Regulation D by the way, it generally
13 happens to be the most popular one that we get most questions
14 about. I noticed by the way Gerry punted on the answer as
15 to when we're going to get that done. But in that release
16 the Commission proposed, I don't blame him by the way, a new
17 exemption from the Securities Act registration process for
18 offers and sales of securities to large, accredited investors.
19 This is a new category of folks that we would be recognizing
20 with respect to which the issuer could engage in limited
21 advertising.

22 The proposals also would address the standards for
23 qualifying as an accredited investor, the current definition
24 under Reg D. It would also shorten the timing required by
25 the integration safe harbor and Regulation D and apply

1 uniformed disqualification provisions to all offerings
2 seeking to rely on Reg D. In addition, the release provided
3 guidance regarding integration of concurrent public and
4 private offerings. With the proposed changes to Reg D
5 clearly on our mind, and please know that we are working
6 tirelessly behind the scenes to get those proposals adopted,
7 if you look at the timeframe of the Commission and the
8 changes and make-up of the Commission, you'll note that as of
9 August of this past year we finally had five Commissioners, a
10 full compliment of commissioners.

11 At that point, we immediately moved in the Division
12 of Corporation Finance. And by the way, our colleagues in
13 all the other divisions had similar ideas and moved on their
14 proposals as well. On August 27 of this past year, we had
15 four CorpFin proposals that were approved by the Commission.
16 cross-border tender rules; two, foreign private issuer
17 releases and the IFRS proposal and then once those were
18 done, as you know, half the proposals are approved by the
19 Commission, there is some time it takes for us to clear and
20 to finalize the releases.

21 That happened over a period of time. In fact, one
22 of those releases, the IFRS release, was just this past
23 Friday published by the Commission. So August 27 goes into,
24 as you probably all know what happened in September and
25 October diverted all of our attention. And now that we're

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1 back in November after an election, I'm not going to make any
2 guarantees as Gerry did as well. I'm not sure what's going
3 to happen with the Reg D, but I think Gerry was probably
4 accurate in saying it's something that we'll probably have to
5 wait to see our new chairperson comes in. But let me know
6 a few of the areas that perhaps we might see from the
7 Division of Corporation Finance in 2009.

8 First, as you probably were following closely, in
9 June of this past year, the Commission extended for another
10 year the starting date for smaller public companies to begin
11 filing their auditors reports on internal controls under
12 Section 409 B of the Sarbanes Oxley Act. That starting date
13 for smaller public companies to begin compliance with Section
14 4 or 4B is for fiscal years ending or after December 15,
15 2009.

16 Let me note also that that means that that
17 extension only applied to 404B, not to 404A, which is the
18 management report on internal controls over financial
19 reporting. Those reports on 404A were required to be filed
20 and I remind people that they do that. It has come to our
21 attention that there have been a number of smaller companies
22 that had missed the requirement on 404A, so please remind
23 them. They are your clients. And if you are one of those,
24 you should no. No further action is needed by the Commission
25 for the 404B compliance to apply to smaller reporting

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1 companies.

2 That's not a statement. That's something that may
3 or may not happen, but I'm just telling you that if no
4 further action is taken, the 404B compliance will
5 automatically be required by small reporting companies for
6 fiscal years ending after December 15, 2009.

7 I'll also suggested that you pay close attention to
8 the Commission's interactive data initiative. Bill Lutz
9 talked a little bit about the importance of that. This has
10 certainly been a key focus of Chairman Cox. Under this
11 proposal, SEC registrants would be required to file a
12 document with the SEC where data points were tagged. This
13 would be in addition to the compliance of filing of a form 10
14 or a form 10-Q.

15 They would also have to file another document that
16 would have certain financial information tagged. These rules
17 are designed in part to help investors. Certainly, investors
18 in all companies, including smaller companies understand
19 their investments better and to reduce research costs,
20 potentially increasing the analyst coverage of smaller
21 companies. That's the thinking.

22 The proposal that went out would require that
23 smaller reporting companies begin filing these interactive
24 data filings for fiscal years ending on or after December 15,
25 2010. So there's a phase-in period for smaller companies.

1 We also, of course, in the Division of Corporation
2 Finance await the recommendations from the Commission's 21st
3 Century Disclosure Initiative, which Bill has already talked
4 about this morning. I think those recommendations will play
5 an important role in setting the rulemaking policy agenda for
6 the Division of Corporation Finance.

7 We are also busy considering and responding to the
8 recommendations that the Commission has already received from
9 its advisory committee on improvements to financial
10 reporting. This past August the Commission published an
11 interpretive release to provide guidance regarding the use of
12 company websites under the Exchange Act and the anti-fraud
13 provisions of the federal securities laws. This guidance was
14 requested by the CIFR Committee.

15 Steve has already mentioned that some of the other
16 recommendations that the CIFR Committee had dealt with
17 restatements by public companies and also the definition of
18 materiality. We are busy working on those matters as well in
19 the hopes to address those recommendations.

20 Let me also note that when the Commission adopted
21 changes to its proxy rules to facilitate the use of Internet
22 to deliver proxy materials, the Commission hoped that that
23 would reduce costs for all companies including smaller
24 reporting companies that many times, it has been noted this
25 morning, bear a larger percentage of these costs than their

1 larger competitors. Our understanding to date is that while
2 the costs had been reduced, the response in retail investors
3 has been low.

4 We will also hear the timing for filing and
5 distributing the proxy materials, which are currently, the
6 timing is set in the rules, impact whether companies will use
7 the e-proxy mode. So we are considering ways and
8 recommendations that he can make to the Commission to rectify
9 some of these noted problems in the e-proxy rules. For
10 instance, we had been told that certain shareholders, when
11 receiving the notice, because currently under this model you
12 can only send a notice. You cannot send the proxy card
13 itself, and when they received the notice they are confused
14 and intending from time to time to actually try to vote the
15 notice.

16 So perhaps what we need to do is amend the rules to
17 allow companies to improve educational materials along with
18 the notice so shareholders better understand this new model
19 that is allowed. We have also, as I mentioned, the timing
20 requirements requiring companies to file the e-proxy
21 materials forty days before the meeting in such a tight
22 timeframe has caused some problems, so we are busy working on
23 that and developing recommendations to the Commission to
24 change some of those rules.

25 So what other items can you expect from us in the

1 upcoming term? I don't know. Will we take up the points
2 that have been mentioned this morning about re-thinking the
3 500 shareholder? I'll say yes, because the person next to me
4 brought it up. So I don't want them to hit me during the
5 thing. I don't know. When we looked at that, we are office
6 of economic analysis is considering a study of this issue.

7 Where will that go, I don't know. I think it's one
8 that's worth thinking about. Will we rethink the 144A
9 threshold limits, like Steve has suggested this morning? I'm
10 not sure about that either. We are certainly interested in
11 hearing from you today, and that's why I think this
12 conference is extremely important. I encourage you all to
13 consider by the way both long and short-term projects.

14 If there are matters that we can be doing on a
15 short-term basis, and my fellow panelist to my left mentioned
16 this morning, are there certain things that we should be
17 doing to address the current market crisis? I'll mention to
18 you to you that we were approached by members of the industry
19 about potentially eliminating some of the restrictions that
20 are included in the Commission's Section 5 communication
21 rules under Securities Act Rule 163. These are rules that
22 limit the communications that can be made on behalf of
23 well-known, seasoned issuers, so these are your larger
24 companies.

25 And we were approached to say that those

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1 restrictions, because of the potential filing of registration
2 and indicating to the market that you need to raise capital
3 in this very tight liquidity market could result in a
4 decrease in the company's market share. So we were
5 approached to say, would you entertain the possibility that
6 the commission could adopt a sort of interim rules that may
7 only last for a certain period of time that would give the
8 companies more flexibility.

9 We are considering that. I'm not saying something
10 will definitely happen on that, but it is something that we
11 brought to the highest levels within the Commission and this
12 certainly is an appetite in today's market to do something
13 like that. That may not be the way back in 2003 when the
14 Commission amended the '33 Act to change the communication
15 structure that was allowed that that was clearly thought
16 about and at the time didn't think that that was the way the
17 permanent rule should read. But perhaps in this market when
18 companies are faced with such a stringent access to capital,
19 that may be something the Commission will think about. I
20 throw that out only as an example of something that we're
21 thinking about. So hopefully, when you're thinking about
22 these matters today, keep that in mind that maybe something
23 we may be able to get done by the Commission in a short-term.

24 Thanks.

25 MR. BOCHNER: Thanks a lot, Brian.

1 Okay, next up to Brian's right is Erin Gurewitz.
2 Erin is the head of equity capital markets at Roth Capital
3 Partners in Newport Beach, California.

4 Erin?

5 MR. GUREWITZ: Great. Thank, you very much, and I
6 want to thank Jerry and the SEC for inviting me here to
7 present just a little perspective. Roth Capital Partners
8 focuses on the 50 to billion-dollar market cap companies, so
9 we are truly in the small company. Most of what we do is on
10 the public side, and over the last 15 years, we've really
11 focused on IPOs, follow-ons, PIPEs and RTOs, and we have
12 raised about 10 billion for those types of companies.

13 From my perspective, there's been some discussion
14 this morning on IPOs. To put that in perspective, actually,
15 it's been over 100 days, until today. The first IPO had
16 priced, and if you look at that marketplace as compared to
17 the small cap or microcap companies, it's probably even worse
18 than this and it's even going to continue to be bad going
19 forward.

20 What Steve talked about this morning was
21 liquidity, and so what we're seeing in our market place is
22 funds, hedge funds, getting redemptions. They're all looking
23 for ways to get liquidity in this marketplace. Historically,
24 these types of funds I have invested in PIPEs, and we've been
25 a very active PIPE player in this marketplace. What we've

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1 seen over the past several months and due to this credit
2 crisis is the PIPE market is drying up.

3 The investors are looking for liquidity. They're
4 sitting on the sidelines and they're just not interested in
5 putting money into illiquid securities, hence PIPEs. The SEC
6 did, I think, a great thing a year ago where they allowed
7 these Microcap companies with non-affiliated floats of less
8 than 75 million to file shells, and that has really helped a
9 lot of companies in our space and a lot of the smaller
10 companies.

11 What's happened though is I think that that has
12 left behind a lot of companies that are not listed on
13 exchanges, and so what we're seeing in this marketplace is
14 investors are shifting out of PIPEs and looking to do
15 register directs or looking to invest in companies where they
16 get registered securities, whether a follow-on or a cross
17 between a registered director follow-on where the underwriter
18 will actually underwrite the securities.

19 And so the thing I'd like the SEC to consider is
20 looking at the guidelines that they've put in place and take
21 a firm look at whether it makes sense to allow these
22 companies that are not in exchanges to file an S3.

23 So thank you.

24 MR. LAPORTE: Our next speaker to Aaron's right is
25 Jack Hogoboom, who is a partner at Lowenstein Sandler in

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1 Roseland, New Jersey.

2 Jack?

3 MR. HOGOBOOM: Good morning. Gerry, thanks for
4 including me in the Roundtable. It's always nice to get an
5 invitation from the SEC rather than a subpoena.

6 I, like Aaron, work primarily in the public company
7 space and so most of my practice involves representing
8 issuers, placement agents like Aaron's firm, and investors in
9 this marketplace trying to provide capital to smaller public
10 companies. From my perspective the SEC has done a lot to
11 help people in my space, but I think there are some steps
12 that can be safely taken to make the world an even easier
13 place for these companies. Steve pointed out at the
14 beginning that the cost of compliance with the securities
15 laws are disproportionately high for these smaller companies
16 and it's extremely difficult for an entity that's raising
17 several million dollars to struggle with costs that can be
18 half a million dollars to try to register securities for
19 resale or to try to meet mandated reporting requirements for
20 a significant period of time.

21 I agree with Aaron, and without talking about the
22 history of how it happened, practitioners like me were quite
23 surprised when the SEC finalized its S3 revision proposal and
24 for the first time included a requirement that the companies
25 be listed on a national securities exchange. Frankly, from

1 my perspective that didn't make much sense because it was
2 companies that weren't listed that had the hardest time A,
3 raising capital, and B, complying with the reporting
4 requirements that would be created in light of that capital
5 raise.

6 I don't know exactly why that happened. It's never
7 been explained and it's not really relevant. But in this
8 marketplace, especially if the SEC is interested in leveling
9 the playing field and making access to information, something
10 that doesn't create advantages for some market participants
11 over others, it's hard for me to understand what the
12 continuing rationale would be for limiting the use of a short
13 form registration statement to a company that's listed on an
14 exchange. I mean, frankly, any company that's been public
15 for some period of time and is current in its Exchange Act
16 reporting requirements ought to be able to take advantage of
17 an integrated disclosure system that allows them to basically
18 report once and once only information that's relevant to
19 security holders.

20 From my own personal perspective, the impact of
21 that rule has been to substantially limit the ability of
22 smaller public companies to compete for capital because as
23 Aaron points out in a difficult marketplace investors who
24 have capital are going up-market and seeking returns that are
25 available in investing in more liquid, more reputable -- I'm

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1 sorry, reputable is not the right word -- more established
2 companies and the result is that it's become an
3 extraordinarily tough market for smaller public companies to
4 raise capital and the staff really needs to adjust its rules
5 to level that playing field.

6 There are a couple of other areas that I think the
7 staff should be focusing on. One is that even for companies
8 that are unable to take advantage of short-form registration,
9 there's still a limitation on the ability of smaller public
10 companies to use forward incorporation by reference in an S1
11 registration statement. Again, in a world where filings are
12 instantaneously available in electronic form on Edgar, a
13 restriction like that is wholly artificial in my view and
14 only makes things more difficult for smaller companies
15 without any regulatory justification that I can see.

16 I think where we should be heading, and, hopefully,
17 where the SEC would like to go is some notion of a company
18 registration along the lines of what was proposed in the
19 aircraft carrier release, at least, gosh, maybe 10 years or
20 so now. Honestly, I knew it was a good proposal because it
21 immediately made me start to worry about what I was going to
22 do for a living if it got adopted. Again, there doesn't
23 appear to be any reason to discriminate between a smaller
24 public company and a larger public company in a world where
25 information freely flows and where the costs of compliance

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1 are so disproportionately felt by smaller companies. And I
2 would ask the SEC to look at whether justifications or
3 purported justifications for distinguishing between classes
4 of issuers really makes sense in the kind of environment that
5 we're facing to day and that we've honestly faced for a long
6 time.

7 The absence of an IPO market, especially for
8 smaller public companies, makes it that much more important
9 that people be able to intermediate and provide financing for
10 these companies. And the PIPEs market has honestly grown
11 because of the fact that there isn't another alternative for
12 smaller public companies. And while we might all wish that
13 that wasn't the world we were in, that's where we find
14 ourselves and that's where we need to focus our attention to
15 make sure that that continues to happen.

16 A more esoteric area where I think that the staff
17 needs to refocus some analytical insight is on the issue of
18 the staff's interpretation of Rule 415 without boring people
19 to whom this isn't relevant, suffice it to say that the staff
20 will frequently comment that somebody is inappropriately
21 using a short form registration statement for an offering,
22 merely because of the number of shares that are being
23 registered for offering. It's just not the most relevant
24 criteria to make the decision. The staff's supposed to use
25 the facts and circumstances approach to making that

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1 determination.

2 In a lot of these cases the people who were buying
3 this stock have no intention of reselling it, and really
4 wouldn't be able to sell it even if they wanted to, given the
5 flow to some of these smaller companies. They want
6 registration, primarily because otherwise they have to take a
7 liquidity discount when they mark their portfolios to market.
8 And the staff needs to understand more clearly why
9 registration rights continue to exist in these types of
10 transactions and to focus more on the realities of the
11 situation and what's likely to happen to those securities,
12 rather than have the equivalent of a knee jerk reaction that
13 once you get over some artificial threshold, you're
14 potentially dealing with an illegal distribution.

15 Another area that I think needs to be addressed is
16 some strange, last-minute problems that were introduced into
17 Rule 144 as a result of the staff's adoption of the
18 amendments last year. I believe that the staff has a request
19 for rulemaking from a number of prominent firms in the small
20 cap space, asking the staff to address an issue under Rule
21 144I that has the impact of basically punishing any company
22 that was ever a shell company in perpetuity and more
23 importantly, really, the investors who were investors in
24 those companies.

25 I mean, frankly, I've seen at least one situation

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1 where an issuer, where there was nobody at the issuer who
2 could determine definitively whether the company had ever
3 been a shell. There just wasn't any way to find out that
4 information. And, again, maybe some waiting period for shell
5 companies makes sense, but to have a perpetual difference in
6 the way that companies are treated just doesn't make sense in
7 my mind in light of any rational, regulatory purpose of the
8 staff.

9 Just one final thing before I exit here is that a
10 more strange request would be the idea of hopefully one day
11 getting Congress to repeal 16B. If ever there was a statute
12 that's an anachronism whose time is past it's 16B. 16B was
13 passed in 1934 in a world where access to information was not
14 what it is today. The staff and government have plenty of
15 arrows in their regulatory quiver to combat insider trading.

16 Today, people like me spend a tremendous amount of
17 time counseling investors, whether or not they can provide
18 capital to a portfolio company and what impacts it will have
19 on them from a 16B perspective, and that's just not helpful.
20 There are too many times when an investor who would otherwise
21 be willing to invest in a deal has to pass, because of the
22 potential impacts of Section 16B, and that's a bad thing for
23 smaller, public companies.

24 MR. BOCHNER: Thanks. It sounds like you at least
25 made a case for shortening the holding period, if not

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1 eliminating it, given the flow of information.

2 I think both you and Aaron, Jack, have also

3 inadvertently done a commercial for Bill on modernizing the

4 disclosure system, because I think a big piece of what he's

5 doing, if I understand it correctly, is helping the

6 Commission figure out how we move from a paper-based world to

7 an electronic world. And I think some of the issues relating

8 to S3s are sort of caught up in that conversion, if you will.

9 So I'm sure his initiative will be addressing those kinds of

10 issues.

11 Okay, next, Kara Jenny; Kara is the chief financial

12 officer of Bluefly in New York City. Kara?

13 MS. JENNY: Good morning. I would like to thank

14 Gerry and the Commission for providing a form where the needs

15 of small businesses are considered and addressed as part of

16 regulatory decision-making process. A roundtable discussion

17 such as this one has always been important for the small

18 reporting company. However, given these challenging times it

19 seems critical to our survival.

20 The Securities Act of 1933 was an act to protect

21 new investors in public companies, and the act has gone far

22 to ensure that among other things the protection of the

23 individual investor both large and small. And as a result

24 it's promoted economic growth in all industries across this

25 country, however, these changing times give us cause for

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1 concern.

2 Even before October of this year we small reporting
3 companies had a lot weighing heavily on our minds. We still
4 spend a lot of time concerned with SOX compliance. In
5 general, I believe that most small reporting companies share
6 the opinion that the first year of compliance was somewhat
7 painful and costly. We enter our second year feeling a
8 little wiser. We have intimate knowledge of our business
9 processes and were comfortable with our controls, but our
10 concern has shifted towards managing the process. We still
11 need to ensure that the process remains efficient, but that
12 it's less costly than the preceding year.

13 We look to streamline and to reengineer the
14 internal testing to manage the cost without ever compromising
15 the results. Until recently, top of mind for many of us was
16 how we could manage the incremental costs associated with the
17 attestation requirement of 404. Knowledge that the related
18 fees would be at least half of our audit fees leaves a
19 company looking for ways to absorb those costs and make them
20 transparent to the bottom line. For small companies, as has
21 been said this morning many times, these costs are
22 meaningful.

23 So when we're not focusing on 404 compliance, we
24 tend to worry about the transition to XBRL and IFRS. Lessons
25 that we've learned from SOX are fresh, and what we know is

1 although the dates of compliance for both of these
2 initiatives are not within the next 18 months for smaller
3 reporting companies. Time passes quickly, and they will
4 require both significant attention of our already stretched
5 teams. So even before the worsening market conditions, we
6 small reporting companies spent a lot of time trying to
7 assess how we'd manage the current aspects of compliance.

8 The events of the past few months have forced us to
9 wonder what is next. Take capital and debt markets coupled
10 with the fact that existing lines of credit do not provide
11 the comfort that perhaps they once did as we've seen them
12 either pair down or their use severely restricted. Small
13 companies need liquidity and the markets are not able to
14 provide it right now. Like everyone else, they would not
15 hazard a guess to know how long it will take for the capital
16 markets to rebound, but we know that they will. And when
17 they do it's clear that the small companies will need them to
18 help them grow their businesses.

19 The question is that we as small companies have to
20 ask ourselves aside from how we weather the storm is what the
21 regulatory environment will look like after the storm. The
22 following are a couple of initiatives or areas that we as
23 representative of smaller reporting companies would
24 respectfully suggest that the Commission would consider to
25 assist small business community during this time and then

1 afterwards.

2 So first, from a capital markets perspective,
3 things that could help small reporting companies include, and
4 I know this has been discussed before, the commissioning or
5 sponsoring of analyst research and the coverage of smaller
6 reporting companies would provide exposure not currently
7 available to smaller reporting companies. Liquidity is a
8 hurdle that many small companies face due to lack of analyst
9 coverage, and their liquid market forces more small
10 businesses to search for financing in an already strained
11 capital market.

12 Allowing companies to pool funds for
13 company-sponsored analyst research would enable companies to
14 at least be exposed to the investing community. Now in
15 October 2008 NASDAQ temporarily suspended the enforcement of
16 the rules requiring a minimum one-dollar closing bid price.
17 In addition to that, NASDAQ also suspended the enforcement of
18 the rules requiring a minimum market value of publicly-held
19 shares. These proactive measures, not to delist any security
20 for these concerns, shows the responsiveness of the
21 regulatory agencies. These initiatives helped a lot of
22 small, reporting companies rest a little better at night.

23 Another similar role that would certainly help
24 smaller NASDAQ companies in the capital raising process would
25 be to obtain some relief from the future price securities

1 interpretations to the NASDAQ stockholder approval rules. So
2 NASDAQ current requires stockholder approval for most
3 issuances of 20% or more of a companies equity at less than
4 fair market value. While few would dispute the underlying
5 rationale for this rule, it is has been interpreted to
6 require shareholder approval of any transaction that includes
7 securities that had anti-dilutive protection, which include
8 most preferred stock and warrant deals.

9 Thus, companies are often required to obtain
10 shareholder approval, even when raising capital at above
11 market rates. This often slows down the deal process,
12 becomes a bargaining chip with investors, and increases the
13 cost of the annual shareholder meeting. So there's now
14 another matter put before them for their consideration.

15 Secondly, from a reporting side, with the
16 assistance of the Commission, there have been more simplified
17 rules in the disclosure such as the ones put into effect in
18 February of 2008. While simplifying the regulatory
19 disclosure requirements is a first step, there are still many
20 resources that smaller companies have to employ in order to
21 meet the disclosure requirements. These resources include
22 the hiring of additional qualified employees and maintaining
23 or upgrading technological infrastructures for filing
24 requirements like reporting software, Edgar, XBRL.

25 We worry these days that the economic crisis will

1 be blamed on presumed financial reporting weaknesses and not
2 risk-taking or poor judgment, potentially requiring small
3 reporting companies to perform fair value audits or appraisal
4 of balance sheet items would be even more costly than what we
5 live with today, and we fear that investors, shareholder and
6 management would not receive any additional benefit from the
7 information. For small businesses, providing web-based,
8 direct filing technology format would allow us to update
9 current information while preserving prior historical data.
10 This also would allow smaller companies the ability to reduce
11 resources in preparing the information as it would eliminate
12 the need to go through an intermediary such as a third party,
13 Edgar service provider.

14 With respect to international financial reporting
15 standards, many companies, including smaller reporting
16 companies, face the challenge of this transition. Among the
17 challenges that small companies need to adapt include
18 relearning, implementing new processes, and building an
19 integrated new technology infrastructure. Based on a study
20 provided by the Commission just last week, it's estimated
21 that U.S. companies will spend approximately .13% of their
22 revenue on making the transition to IFRS during the first
23 year of filing.

24 While we recognize and appreciate that the
25 international accounting standard settings body have begun to

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1 provide assistance with the initiatives to simplify IFRS
2 rules for smaller reporting companies, we worry that the
3 incremental cost will outweigh the immediate benefit that the
4 investors and shareholder would realize, and this would just
5 be one more cost that we have to sort of absorb in our
6 financials. Another area is that 8K rules have not really
7 been loosened for smaller reporting companies, and they're an
8 incremental cost to just getting business done on a
9 day-to-day basis.

10 Finally, from a corporate governance perspective,
11 another thing I'd like to mention is that small reporting
12 companies are required to have all the same committee
13 meetings that much large companies do. So nominating
14 committees, compensation committees, audit committee
15 requirements are often burdensome and time intensive for
16 management as well as their board members. So while the
17 Commission has made significant improvements in assisting to
18 ease the burden that the smaller reporting companies face,
19 the existing environment has caused the small reporting
20 company to wonder if their needs will be lost in the shuffle.
21 Our fear is that the response to the current crisis could
22 inadvertently penalize small companies who have little
23 culpability, but may end up paying a large price in the
24 fall-out.

25 MR. LAPORTE: Thanks, Kara, for those excellent

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1 comments.

2 Our last panelist to make an initial presentation
3 this morning is Roger Novak, who is a general and one of the
4 founding partners of Novak Biddle Venture Partners, which is
5 a very active venture capital firm in the mid-Atlantic area
6 and perhaps nationwide. I'll let Roger tell you what he
7 does.

8 MR. NOVAK: Okay, Gerry, thank you for inviting me.
9 I appreciate the opportunity. When you're the last speaker
10 you sort of sit here and 'x' through the comments that you
11 were going to make because the panel hit a lot of them. I
12 feel I'm coming at this from a fairly unique basis.

13 My venture firm is an early stage information
14 technology only venture capital firm. Our investors tend to
15 be endowments and foundations, and yet I currently serve on
16 the executive committee of the National Venture Capital
17 Association and am also lead director of a public company and
18 sitting on an audit committee. So I sort of see the whole
19 gamut from absolutely two guys in a garage to a public
20 entity.

21 This year the National Venture Capital Association,
22 the NVCA in honor of its 35th anniversary commissioned a
23 study on the impact of venture capital in the U.S. economy.
24 And out of it came some pretty startling statistics. This
25 35-year study showed the U.S. companies that received VC

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1 account for approximately 10 million jobs and 2.1 trillion of
2 revenue. And this was done on an investment amount that was
3 approximately .2% of GDP and yet the companies now account
4 for almost 17% of GDP.

5 So this is an asset class, which is in alternative
6 assets that is very efficient and has a big impact on U.S.
7 productivity, and really, I believe, national security. When
8 you look at what's been created by venture capital, the
9 hi-tech industry, you can look and go Intel, Cisco, Google,
10 E-Bay. The biotech industry was really started by venture
11 capital. You know, Steve earlier mentioned GenTech, but
12 there's AmGen, GenSyme, a number of others.

13 A lot of the money right now is going into clean
14 tech and new emerging alternate energy. And even when
15 industries aren't created, venture capital has had major
16 impact on changing existing industries, on-line education.
17 There was a company here in D.C. called Blackboard, which is
18 really sort of the father of on-line education. In fact 80%
19 of higher ed now uses Blackboard. You have Starbucks. You
20 have FedEx. So clearly this is a very, very important sector
21 of the financial community. And, yet, Steve alluded to as an
22 industry -- and I apologize I have a little bit of a cold --
23 we're facing systemic challenges. And a lot of this has
24 really arisen post the Internet meltdown and a slew of
25 regulatory actions which have had an impact.

1 If you look, SOX, what I call Spitzer's march
2 through Wall Street where he decoupled investment banking and
3 research, decimalization. All of these have had an impact in
4 that it is redefined what it means to be a public company.
5 And, by that I mean I was having conversations with several
6 portfolio managers at T. Rowe Price recently, and they said,
7 you know, if an IPO doesn't have a 500 million post-money
8 market cap, we're not going to buy it, because it doesn't
9 have the appropriate research coverage that we need.

10 So even before this most recent credit crisis,
11 Steve alluded to the fact that the time from a start-up to go
12 to an IPO had moved from roughly four years, two and a half
13 to three years ago, to where it's now -- assuming you can go
14 public -- it's 8.6 years. So recognizing that we generally
15 have lock-ups when a public goes public of six months, you're
16 in nine years, and most venture capital funds are 10 years.
17 So what that really says is if you are planning how you're
18 going to put out your money, you probably really only invest
19 an early stage in your first or second year. Otherwise,
20 you're going to have liquidity issues and have difficulty
21 figuring out how to return capital when your fund life ends.

22 So what has happened in the venture community as
23 the IPO market moved out, you had a number of people moving
24 what we would call up the food chain. So a lot of the
25 community moved up to what we would call mid expansion. So

1 companies five million and up and later stage where they
2 hoped to get quick returns, figuring that two to three times
3 your money is better than taking the risk of the early stage.
4 So the risk return relationship has really skewed toward the
5 mid to late stage with the result that there's fewer money
6 for early stage investments. And because of the redefinition
7 of what it takes to be a public company now has moved
8 significantly.

9 Buyer's portfolio companies recognize if you are
10 not going to be able to have access to the public equity
11 markets, then we're not going to buy you at a public
12 comparable. So you've actually seen valuations head down
13 even in the mergers and acquisitions. Now, some people would
14 say this is okay, that venture capitalists make outlandish
15 returns, but the fact of the matter is we're nothing more
16 than high risk money managers. Our funds come from
17 endowments, foundations, and pension funds. So the average
18 American is also being penalized in this.

19 You now add the recent credit crisis and the market
20 downturn, and a lot of the angels who provided the start-up
21 capital, in addition to people like ourselves, have
22 disappeared from the scene. So what the outcome of this is,
23 I'm afraid, is we are potentially facing a dearth of early
24 stage money, which can potentially harm innovation. And,
25 again, I go back to ultimately national security. So as I

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1 sit here and have the opportunity to talk to you all, I think
2 what's really needed, particularly now that a new
3 administration is coming on, is we need to revisit all
4 regulation. We need to look at SOX again.

5 We need to reconsider decimalization. We need to
6 work in conjunction with Treasury and tax codes. You need to
7 work with the accounting standards to say what is it that we
8 need to do to make it easier to open capital markets to young
9 companies, and what are the laws that we need to ease. Not
10 to take a protection away from the individual stockholders,
11 but to facilitate innovation, because what you're seeing now
12 is that there's not as many interesting companies being
13 formed. And I think that that translates to problems down
14 the road.

15 Thank you.

16 MR. LAPORTE: Thanks, Roger.

17 First of all, before we get into some of the
18 questions that we've gotten from the Internet, and also the
19 questions that we've gotten from the audience. Mark Story
20 may be able to tell me. He tells me that we were having some
21 problem with the Internet address and he wanted me to talk
22 about sending questions to a new Internet address.

23 Is that still a problem, Mark?

24 MR. STORY: Yes.

25 MR. LAPORTE: Yes, okay. Instead of the address

1 that I gave you before, please send your questions over the
2 Internet to Story M., that's S-t-o-r-y-m at SEC dot gov.
3 Okay. Although we've gotten a few questions that have come
4 through apparently, there were some problems with that
5 previous address that I gave out.

6 We have one question that's left over from the
7 previous panel. It was the question about mark to market
8 accounting, and we had intended to address that subject in
9 this panel, although this may be one of these questions that
10 sort of falls between the gaps of what the other panel was
11 talking about and what we're talking about today. And I'm
12 not sure that anybody on this panel can answer this, because
13 I don't think we necessarily have experts in the credit
14 market. But just in case there's somebody who wants to say
15 something about this, I'll repeat this question.

16 Would modifying the mark to market accounting
17 standard tend to free-up credit markets? Does anybody on
18 this panel have any thoughts about that? Brian?

19 MR. BREHENY: Maybe I'll speak up, although I can't
20 answer that question directly. I just want to note as you
21 probably all know that the Commission has been studying the
22 mark to market accounting issues. There's been a number of
23 roundtables; and, in fact, there's another one tomorrow here
24 in this room, which of course people can participate through
25 the website as well, and is study ongoing on mark to market

1 accounting and our chief accountants office and the
2 Division's Office of Chief Accountant have also been very
3 involved in this process.

4 We've certainly heard lots of suggestions that the
5 FAS 157, which by the way didn't create a new category of
6 assets or liabilities that needed to be covered or carried at
7 fair market value, but instead provided more guidance and
8 disclosure on how fair market value should apply, certain
9 people believe, has created some of the issues that the
10 market is dealing with today. I won't give you an answer as
11 to whether I think that's right or wrong, but we're certainly
12 aware of the issues, and there's been a tremendous amount of
13 study going on. There's a whole part of the SEC's website
14 that's dedicated to the study to the roundtables as to what
15 we're doing to try to get to the bottom of it.

16 And I also will note that our own chief
17 accountant's office, Wayne Carnall, a chief accountant in his
18 staff, has issued letters to financial companies and the CFOs
19 in response to provide them some guidance, and I know that
20 there's been some other letters issued by FASB. So I think
21 there's a number of people thinking about that issue. Again,
22 I don't know the direct answer to the question as to whether
23 if changes were made to FAS 157 that would somehow free up
24 the credit markets. I think some people believe that the
25 guidance that was given in 157 has resulted in companies

1 taking more conservative approaches to marking down the
2 assets that they're carrying certainly with regards to the
3 real estate assets. So I would stay tuned to what comes out
4 of that study and also out of those roundtables.

5 Gerry?

6 MR. LAPORTE: Roger?

7 MR. NOVAK: I'm not going to comment other than
8 anecdotally. I think a lot of the banks and the investment
9 banks would wish FAS 157 wasn't around. But I will tell you
10 one of the issues that we are all facing in the investment
11 community is that the accounting profession is running
12 scared. They're so scared of potential liability.

13 Even though we are private, we have to comply with
14 FAS 157, and it's extremely difficult when you're dealing
15 with young, start-up companies. I mean we could have a
16 company that might have had an offer to sell, say, 100
17 million and turned it down. But the truth of the matter is
18 that company at that stage of development is probably so
19 fragile that Microsoft, if it decided to go into the same
20 business the next day, renders that company virtually
21 worthless.

22 So as we sit there with the accountants, you know,
23 I said, look. Every company in this portfolio is worth
24 somewhere between one and a billion. You pick it, because I
25 certainly can't say with exact science that today this

1 company is worth 10 million or 50 million. So it's a real
2 issue in at least the private, venture-backed world.

3 MR. BOCHNOWSKI: Again, I guess to the question but
4 not the specifics of the question, one of the issues with
5 mark to market accounting and where it does effect banking,
6 we have in our portfolio a trust preferred that is a cash
7 flow of 100%, and yet its market value is not there. Well,
8 because it's temporarily impaired, we have to run that
9 through our equity side. And the equity of a bank is what
10 permits it to lever up to do lending, so it impacts the
11 community. It impacts lending in the middle of this crisis,
12 and I think a lot of banks would probably have for other
13 reasons, but I know that's one of the issues that's been
14 remarked about before, and I think it's germane to the
15 question.

16 MR. LAPORTE: Thanks Dave.

17 Did any of the other panelists want to comment on
18 things that a previous panel has said before we start the
19 questions?

20 MR. BOCHNER: I might just ask Rogers. You know, I
21 guess I posited the opening in a roundabout sort of way
22 whether we have the right market structure. In other words,
23 are the issues you noted where you go, you know, private
24 financing, eight plus nine years IPO, but you've got to be a
25 hundred million in revenue, full 34 act, you know, exposed to

1 the retail investor, and this gap that I noted got created.
2 Is that a market structure issue? In other words, should we
3 have some middle market below the retail investor level as
4 some are trying to create, or do you think it's simply a
5 matter of reducing regulation and solving the current issues
6 with the existing market structure, because I guess it's a
7 bit of a loaded question in the sense that I doubt we're
8 going to have a stomach to actually roll back a lot of the
9 reforms, and I'm dubious about whether we've ever going to
10 get back to a point at which a company with a \$30 million
11 revenue run rate is going to be an IPO candidate. So I'm
12 curious about the market structure point.

13 MR. NOVAK: Well, I think if you go back you can
14 look at Intel. You can look at Oracle. You can look at a
15 lot of the bellwethers. They all went public at less than
16 100 million. So clearly at one point in time, that was
17 attractive. Now, a lot of people postulated that what really
18 happened is after the Internet meltdown, you know, Wall
19 Street probably did bring some companies that should not be
20 public, public, and so there was clearly reaction and
21 investors pulled back. And people became risk averse and you
22 actually saw the four horsemen, Alex Brown, Robbie Stevenson,
23 Hambrecht & Quist, and L.F. Rothschild, go out of business.

24 People postulate that what was really happening at
25 that time though is that the Internet valuations expanded,

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1 the taking companies public and Internet companies became
2 more attractive to the bulge bracket firm who then would go
3 after what had historically been sort of the lower tier,
4 mid-tier investment banks market to where now the Goldmans
5 of the world were coming down and taking that business. As
6 the mid-tier regional banks went out of business, Goldman, et
7 al., the bulge bracket, were in the position to really
8 dictate what can go public, and there has also been a
9 tendency to do away with syndication where the book running
10 manager determines who gets the stock and they put it with
11 the hedge funds who would flip it and that would be the way
12 the game was played with hedge funds going down, with
13 investment banks going in.

14 I think Steve that what we really need to look at
15 is the emergence of a tier of strong sort of mid-investment
16 banks, like the size of Baird, Jeffries, people of that
17 nature. And I think that we can't roll back all the
18 legislation, because I actually think that part of SOX is
19 really good and really put discipline in. But I do think
20 that if there needs to be a market of some nature for these
21 smaller emerging companies. And maybe the buyers are not
22 your individual investor, but a more accredited investor or
23 institution.

24 MR. BOCHNER: Steve, do you have a comment on
25 that?

1 MR. GUREWITZ: Sure. You know, back in the late
2 90s and kind of mid-90s, what we saw was a lot of
3 early-staged IPOs and that took place for a while until, as I
4 mentioned, the Internet days. What happened is all the bulge
5 back and larger firms, this became more attractive to them,
6 and some of the Internet companies and smaller companies kind
7 of moved that stream.

8 I think, and it's not there yet, and it's going to
9 be a while, but one thing that we've talked a lot about our
10 firm is going back to the late 90s is doing these smaller,
11 earlier staged IPOs to give some liquidity to the venture
12 funds or some of the private equity funds where probably the
13 larger firms might not be interested and maybe the deal sizes
14 are only \$10 or 15 million.

15 But at least it gets you guys public, and as I
16 just mentioned, there's a new era of investment banks coming
17 on-line, partially because the Lehmans of the world have
18 shut down. And they're all going to start up new banks at
19 some point that might focus on this smaller cap, microcap
20 company. We're not there yet, but I think that might be a
21 trend that happens when the market does open back up.

22 MR. BREHENY: Not specifically on that point,
23 but some of the panelists made some points I wanted to
24 respond to. Number one, I think somebody brought up, I
25 think, Aaron and John mentioned the point about the

1 Commission's shelf registration ability for companies to
2 use shelf registration and the fact that companies need to
3 have a listed security. I wasn't involved in that project,
4 and I don't know specifically why the Commission ultimately
5 required that. But I just want you to know that we
6 certainly are aware that that is a concern and something
7 that I know Gerry has been tracking that some folks in the
8 small business community have raised that as an issue. So
9 what will happen I'm not sure.

10 On the Rule 144 issue, which I know John brought
11 up, on the unfortunate results of Rule 144I and the fact that
12 if a company was ever being a shell company is being caught
13 up on that, that we're very aware of and we've actually
14 already started to move on that, as well as by way a number
15 of issues that people that brought to our attention with
16 regards to these new rules, so we're sort of cobbling
17 together what we're calling technical amendments, although
18 that one has very perverse results.

19 Remembering, of course, that 144 is a safe harbor
20 provision, so it's not saying that you can't do certain
21 things, but it obviously provides, and I know people rely on
22 it often. But we are aware of that issue. Unfortunately,
23 the way it was drafted and the outcome is if you have a
24 company that is or was ever a shell company they need to
25 follow the provisions that are captured. And I do think that

1 that was probably not something that the Commission intended.
2 So that one I think you could see something sooner rather
3 than later on that. I'm not going to touch the Section 16B
4 issue, though.

5 MR. BOCHNER: Great. We did have a question from
6 the audience on 144I, and I think Brian just addressed that.
7 Here is one on 404. Some of these are written as political
8 statements, not really questions.

9 MR. LAPORTE: That's okay. This is a forum, after
10 all.

11 MR. BOCHNER: 404A provides some benefits to
12 everyone, although at a high cost. 404B, the auditor
13 attestation, may not work for start-ups and very small
14 filers the way it worked for large filers or small filers
15 with a good future, may be impaired by 404B requirements.
16 Small filers, CFOs and CPAs should have input where there's
17 going to be fewer IPOs.

18 I think I'm reading that correctly, so that's not
19 really a question, but I'll do one more Gerry.

20 MR. BREHENY: Can I just jump in there one second,
21 Steve?

22 MR. BOCHNER: Yes.

23 MR. BREHENY: You know, we are doing yet another
24 survey. Our Office of Economic Analysis is already deep into
25 this. This is the survey of the benefits and the costs.

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1 It's actually a two-part survey of 404 compliance. It's
2 something that the Commission announced, and that something
3 is ongoing. So I would encourage you, by the way, if you're
4 interested, to get involved in that survey. We really do
5 want to hear from people about, you know, the new auditing
6 standards, the Commission's guidance that they issued. We've
7 taken a lot of steps in this area in the hopes to try to
8 address some of the concerns that people had with compliance.

9 I know that somebody brought that up earlier on the
10 panel. So please, you know, we're looking for people to
11 weigh-in on that subject. What the results will be of that
12 survey, or if further action will be taken, I don't know.
13 But there's a survey ongoing and we'd appreciate any
14 assistance you could give us with data and input.

15 MR. LAPORTE: Yeah, let me just something about
16 that, Brian. The survey was undertaken by the Commission
17 staff at the same time the Commission approved the last
18 extension of not requiring smaller companies to comply with
19 404B. And if you read at least sort of a condition of the
20 exemption that the staff is going to go back and figure out
21 the cost and benefits for smaller companies, so it is tied
22 to, I mean, there are some people who think there ought to be
23 a further extension.

24 I don't know if there will be or not, but there's
25 an implication that the Commission would have more data on

1 the cost and benefits for smaller companies. That the next
2 time it was called upon to grant an extension, if any further
3 extension would be warranted, which I'm not commenting on at
4 all.

5 MR. BOCHNER: Okay. This is one that's directed at
6 Rogers and Aaron, but you can feel free to not answer it or
7 somebody else can chime in if they want. How would a finder
8 or private placement broker-dealer assist in bringing Angel
9 or other kinds of capital to the start-up world, and how do
10 we overcome the state securities regulators objections or
11 concerns? So dealing with the role of the finder, and I
12 guess that overlapping regulation of finders/broker-dealers by
13 the states, I think, that's the thrust.

14 MR. LAPORTE: I don't know if Roger wants to say
15 anything about this, but we do have a panel specifically on
16 this topic this afternoon, so that if people want an answer
17 to that and Denny Crawford, the Texas State Securities
18 Commissioner is on that panel, so she would be able to
19 address some of the state law issues that are involved. But
20 people on this panel may have some specific things they want
21 to say about that.

22 If you want, Steve, I've been getting some on my
23 BlackBerry. I've been getting some of the questions that
24 have been submitted over the Internet. Steve Bochner talked
25 about amending the 500 investor limit and creating more of a

1 middle market for capital raising and trading for accredited
2 investors. Could he talk more about the value of this to
3 emerging companies and investors?

4 MR. BOCHNER: Sure. I like talking about this. I
5 was worried I was talking too much about this. Well, just
6 briefly, there are various initiatives, but I think some
7 serious groups looking at whether there should be more of a
8 market infrastructure in that middle market.

9 If it takes a hundred million dollars in revenue
10 and eight years to go public, and as the markets recover
11 from the credit crisis, this gap I pointed out, and I think
12 some of our other panelists pointed out are we going to allow
13 foreign markets to fill that gap and have earlier trading and
14 earlier liquidity and earlier capital formation, because
15 we're rightfully so trying to protect retail investors and
16 give them things like auditor attestation and mandated
17 disclosure.

18 Or, is there a place in that market structure for
19 another kind of market participant? I think that's the basic
20 question, and I think you are going to see groups suggest
21 that. I threw out for discussion three changes that from a
22 regulatory point of view could facilitate such a market by
23 allowing -- and maybe using that to kind of follow on what
24 Bill's initiative is all about -- use the Internet in a way
25 to facilitate capital raising and trading more broadly, and

1 some of the existing regulatory constraints that I think from
2 my own position is above my pay grade.

3 Brian and the people in this building are
4 ultimately going to be the arbiters of the investor
5 protection versus capital formation balance. But it seems to
6 me the three things I mentioned, you could get there from a
7 policy perspective as long as the investors were talking
8 about that made the trade, or you raised capital with, met
9 certain standards that we felt as a society resulted in those
10 investors not needing the protections of auditor attestation
11 34 act, and so on. And we indeed have those kinds of
12 provisions under the '33 Act today.

13 That's what 402 and Reg D and some of the Reg D
14 proposals that Brian touched on are considering. So I think
15 another long-winded response, but my own view is there is a
16 gap in the market. The question is if there are groups that
17 address that with a new sort of trading platform and these
18 regulatory constraints could be alleviated to facilitate such
19 a middle market. So AIM and other foreign exchanges didn't,
20 you know, solely address that market.

21 We had a competitive response as a country. If we
22 build it, will they come. I don't know if we can facilitate
23 that sort of trading and capital formation that way, but it
24 certainly is kind of an appealing idea, and I think you'll be
25 hearing more about that.

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1 Does anybody else want to chime in?

2 MR. HOGOBOOM: Just a comment Steve. I think that
3 anything that enhances liquidity in the weeds of these
4 smaller companies in general makes a lot of sense, and the
5 idea of having, I think Gerry refers to it as 144B type of
6 market where institutionally accredited investors can trade
7 freely among themselves is a great thing.

8 I would caution people about pointing to AIM as an
9 example of somehow we're losing a competitive edge, because
10 my understanding is that AIM has been an unmitigated
11 disaster, primarily for the exact reason that it was supposed
12 to be created, which is that it's great for people who issue
13 their securities, and then there's no liquidity for anybody
14 that buys them.

15 So I think the focus really has to be on liquidity
16 and are there ways that we can enhance the tradability of
17 some of these securities without having to necessarily not
18 adequately protect investors.

19 MR. LAPORTE: Another question from Internet, and
20 this reminds me that I think it was Jack that mentioned
21 something about the aircraft carrier release and how it
22 called on company registration as opposed to the
23 transactional registration.

24 I think that's something that Bill is addressing in
25 the 21st century disclosure initiative. But Bill can comment

1 on that if he wants. And, also, I have a question that has
2 come over the Internet for Bill himself. It says can you
3 talk more about how modernization of the financial system
4 will help reduce compliance costs for small businesses? Can
5 you offer some hard numbers? What about the up-front costs.

6 MR. LUTZ: Let's see. I think there's three
7 questions there. The first on cost, we are doing some cost
8 studies. They are companies who have given us some numbers
9 on their already dealing with structured data internally, so
10 they've had hard experience. Also, there is a market out
11 there developing by software developers, for example,
12 Microsoft.

13 You can go to the Microsoft website to their
14 investor relations section where they show you tagged data,
15 structured data of the type that we'll be talking about and a
16 number of companies are developing software programs to make
17 it easy to format your data and file it. Now, my initiative,
18 as I said, is to design a high level plan. That the goes to
19 the Commission for its consideration and action.

20 What we are outlining in that plan is a system. A
21 platform that goes with IDEA, the new system and platform
22 that the SEC is implementing now, and it would be part of
23 that system. What the Commission decides to do with it after
24 that, I think, is open to study and certainly meetings like
25 this. However, what it would give the Commission is a set of

1 tools to really start looking at what is disclosed and how,
2 and what it wants to do.

3 It means much greater flexibility. If you stop to
4 think of it, disclosure today is based on the '33 and '34
5 Acts and of course the 40 Investment Company Act and similar
6 legislation that was in a paper and pencil world. And you
7 looked at information through that lens. There is a
8 significant change to move from thinking about information
9 and data in terms of paper and pencil, and thinking about it
10 in terms of electrons bouncing around in cyberspace.

11 It's just a significant difference on how you think
12 of information and how you deal with it, that is how you
13 gather it, store it, and disseminate it. So it opens up
14 incredible possibilities and flexibility for the Commission
15 to consider its disclosure regime, and what it will do will
16 unfold over time. But back to the cost savings, in terms of
17 actual filing, when a fully developed system, whatever shape
18 that takes form, and you can look at some of the other
19 countries.

20 As I suggested, Israel for example has a very, very
21 dynamic system. You can go on-line to the Israel securities
22 authority and they've got a very nice PowerPoint presentation
23 that you can look at it. Once fully implemented in filing,
24 it will significantly reduce the cost of filing by reducing
25 the amount of time, first of all, as simply that alone.

1 By that I mean the number of billable hours and
2 work hours internally would reduce, and I think there's a
3 possibility for every company if you have an internal
4 auditing system that you could coordinate that system with
5 the SEC system if the Commission chooses to go that way, so
6 you could file automatically that way, something like the IRS
7 system now.

8 The Department of Labor has a similar system.
9 These systems exist. We are not talking new, unproven
10 technology. What we are talking about, taking stuff off the
11 shelf and simply catching up and providing both filers and
12 users with the current tools that they should have available
13 to them.

14 MR. BOCHNER: If Warren Buffett was a regulator, do
15 you think he would be increasing or decreasing regulation
16 requirements in the current environment? That's a rhetorical
17 question, maybe. Is the current market environment an
18 opportunity to take a fresh look without compromising its
19 integrity at the overall regime for smaller businesses and
20 the cost benefit of all the regulatory requirements where
21 alternatives exist. And I guess, Brian and Gerry, I think
22 that was part of the SEC advisory committee.

23 I know you do this on an ongoing basis and have
24 these initiatives going on. Does anybody care to respond to
25 either of those? Yeah, Jack?

1 MR. HOGOBOOM: Just a comment. You know, it's
2 interesting because you could really look into a crystal ball
3 and see a world where everything is different. I was at a
4 SIFMA conference in New York a week ago and Chuck Schumer
5 made a keynote address in which he came out in favor of a
6 system very similar to what's in the U.K. where there is
7 basically one regulator for the entire financial services
8 industry.

9 Clearly, Warren Buffett would regulate credit
10 default swaps and even Alan Greenspan, apparently, would
11 agree now. So it's really kind of an interesting time period
12 and it will be interesting when the new Congress is seated
13 and a new president is inaugurated to see whether or not the
14 landscape really radically changes. I haven't thought
15 through in my mind whether that means that we'll have new
16 securities laws or whether we'll just have a different way of
17 enforcing and regulating them. But honestly it could be a
18 brave new world out there and in 12 months we could be
19 looking at something that's completely different than
20 anybody's contemplating right now.

21 MR. BOCHNOWSKI: Warren Buffett, I guess, is all
22 about shareholder value, apparently, based upon his holdings.
23 And if I just use the example of our cost of complying as an
24 SEC registrant, it's \$200,000 a year, before we get to 404B,
25 which will add a little bit more. And I was really happy to

1 hear Brian say that this whole issue is being reviewed, but
2 that 200,000 a year translates to over five years, a million
3 dollars, that is otherwise in the hands of our shareholders.

4 And if we do it times the current PE ratio, it's
5 about 2.4 million. And so I think when we look at
6 modernization, we want to be sure that we don't become too
7 stringent as we go forward because there is that risk that
8 that will happen, and at the same time to serve the interest
9 of shareholders as we go seems critical. In the middle of
10 this credit crisis, that million dollars over the next five
11 years will not be in the hands of our shareholders,
12 presumably, could also be in equity. And to get back to
13 something I suggested earlier on this panel, that would
14 translate to \$10 or 12 million worth of leveraging that would
15 go into loans, so these issues are all interrelated and I
16 think I would applaud and agree with those on the panel who
17 have suggested that we have to be sure that the costs are
18 proportionate to the benefit of the shareholder.

19 MR. BOCHNER: Here is an interesting one, I think.
20 Brian, you can feel free to tackle this or pass, but given
21 the current cases regarding short-selling prior to a PIPE
22 offering, does the SEC plan any rulemaking to attack the
23 problem?

24 MR. BREHENY: Well, as you know, there's been a
25 number of enforcement cases, which I think this is getting

1 to. There's been one opinion issued. The others were bench
2 opinions so there wasn't anything written on it. We are
3 actively following those cases. And if you see the briefs
4 that the Commission filed on them, I think, we strongly
5 believe in those specific fact patterns the approach that
6 some of these investors have taken is a violation of Section
7 5.

8 It's a longstanding position to the Commission and
9 the Commission staff that what these investors were doing is
10 something that they can't do under Section 5.

11 Will there be rulemaking on the issue? And part of this is
12 some of these matters are still appealable and there's still
13 a litigation process that's ongoing. So I don't know what
14 we'll see in the future. It is something that we're
15 certainly looking about and it is something that we're
16 looking for. You know, we've been dealing with the folks in
17 ABA and other members of the market to get input on it.

18 I think, you know, it may be something to weigh-in
19 on, but I wouldn't sort of fashion a guess as to when that
20 will happen.

21 MR. HOGOBOOM: Steve, could I just add a quick
22 comment?

23 As somebody who's had to advise plenty of clients
24 in light of those cases, I think that everybody in the
25 private securities bar is frankly shocked at what the

1 outcomes of those cases have been; and, while it may be great
2 if you have a client who does something stupid and gets a
3 call from the SEC Enforcement Division to argue that those
4 cases somehow tie the staff's hands.

5 I don't think that anybody who's advising a client
6 prospectively, who's trying to be responsible would advise
7 somebody that it's okay to trade in advance other than
8 announcement of a PIPE. And, you know, it's completely
9 flabbergasting to see some of the decisions that have come
10 down; and, God only knows what the outcome of that will be.
11 But there's something about that activity that just doesn't
12 seem fair, and, therefore, it shouldn't be allowed to
13 continue.

14 MR. BOCHNER: I agree.

15 David, maybe I'll ask you if you want to expand.
16 We both made kind of different comments on the 500
17 shareholder rule requirement and triggering '34 Act
18 registration. But presumably at some level, you've got a
19 mandate '34 Act filing and protections. And is this
20 something that you're advocating be directed at banks, or are
21 you advocating just the numbers increase. How do you kind of
22 balance that, what you're asking for versus the reality that
23 it's some number of shareholders. You actually are a public
24 company, or how are you thinking about that balance?

25 MR. BOCHNOWSKI: The balance is what we're, I

1 assume, trying to strike. And the banking industry itself,
2 unlike I think the panelists here, we're regulated by two
3 banking agencies -- both our state regulator and our federal
4 regulator -- and in our case the FDIC. And we could linger
5 around the fact that we're a holding company under the Fed,
6 so I guess we have three. So we get visited regularly in
7 the 24 years that I've been in banking, plus had one
8 experience for four years as the Chairman of the Indiana
9 Department of Financial Institutions which regulated all
10 state charter banks, thrifts, credit unions and trust
11 companies in Indiana.

12 It is my experience that, as I like to tell my
13 friends, a Reg toting and guidance quoting and bank examiner
14 can make an IRS agent look friendly by comparison. So I
15 think with respect to transparency, if that's one of the
16 issues, are we sure that there are controls. Under
17 fiduciary, as example, our bank must have a CPA on our board.
18 So from the standpoint is the information there and available
19 and is there assurance to the public through those channels,
20 I think the answer is yes. If we were to find ourselves in a
21 perfect world, we would find ourselves, but I'll let that up
22 to Brian and his group. In a situation where we would be
23 considered deregistered because of changes in the
24 requirements in terms of numbers, several things are clear.
25 First, I'm still going to know those 75% of our shareholders

1 face-to-face. That's not going to change. We have looked
2 very carefully at what we would like to do and we know that
3 we would continue to track our SEC reporting system, just as
4 we do now, and make that public. We would make that available
5 to our shareholders. We would do so through both electronic
6 means, posting it on our website, e-mailing directly, mailing
7 directly as we do now. So in that respect, that kind of
8 reporting would not change.

9 I think that over the long haul, what we want to be
10 sure of is that there continues to be a benefit to the
11 shareholders from being a registered company and it's not
12 altogether clear with the kind of cost that we would be
13 incurring whether or not that balance is struck. And I would
14 leave it probably to the other panelists to suggest for their
15 specific industries where they would be on that number.

16 MR. LAPORTE: Thanks, David. I have one question
17 here that really involves a series of questions about the
18 new electronic Form D, and I'm not sure that anybody on this
19 panel really deals in this world as much as I do, so maybe
20 I'll try to answer the question.

21 The first question is we are having problems
22 receiving Edgar Access codes back from the SEC in order to
23 file form Ds on-line. You do not receive, receive too late,
24 to make a timely filing or info trapped in my spam crusher,
25 complicated when attorneys are the person needing the info,

1 yet the client is the authorizes person.

2 Let me say that Brian did mention that we have
3 on-line form D which is scheduled to become mandatory on
4 March 16, 2009. When the Commission past the rule making
5 form D mandatory, some of the individual commissioners
6 expressed concern that the form ID authentication system
7 that's currently used for Edgar may be a bit too complicated
8 for the average smaller company user and the Commission, our
9 Office of Information Technology at the open meeting, said
10 that they would try to do something about that before form D
11 became mandatory.

12 So we are aware that there are issues in processing
13 form IDs and our Office of Information Technology is looking
14 into what options we have in providing an alternative
15 authentication system to the form ID process. And before we
16 go, I did say that I wanted to go around.

17 We don't have very much time, but quite a few of
18 the panelists made specific suggestions. But if you want to
19 take a minute or so to talk about -- especially the people
20 from the private sector -- if you want to talk about specific
21 suggestions you would make if you could do one or two
22 things to improve small business capital formation, I think
23 that might be valuable.

24 Maybe you've already said everything you want to
25 say. Does anybody have anything to add? A thing that they

1 think the highest priority.

2 MR. BOCHNOWSKI: To reiterate, mark-to-market
3 accounting would be a very high priority in making
4 appropriate changes.

5 MR. LAPORTE: Thanks.

6 Steve, did you have any concluding remarks?

7 MR. BOCHNER: No.

8 MR. LAPORTE: Okay, well, if that's it, we'll
9 reconvene at 2:15 in this room for those people who want to
10 take part in the break-out sessions this afternoon. I'll
11 thank all of you for coming. I thank all the panelists for a
12 very informative panel discussion. Sitting up here today, I
13 think, since I've been in this job, which is I think six
14 years now, I think this has been one of the best discussions
15 we've had at any of our forums. And I want to give everybody
16 in the panel a round of applause.

17 (Applause.)

18 (Whereupon, a luncheon recess was taken.)

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

20 MR. BARONE: Good afternoon. I just want to make a
21 few organizational announcements. We have four options right
22 now at the 2:15 program. Those people who want to listen to
23 our third and last panel on private placements and M&A
24 brokers should stay right here in the auditorium. People who
25 want to attend the three other break-out groups on private

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1 security offerings, I will escort you to room 3000 in the
2 building.

3 There is another break-out group option on smaller
4 public companies and Kevin O'Neill will escort that group to
5 Room 4000. And our third break-out group on tax, Johanna
6 Lossert of her office will escort that group to room 5000.

7 At 3:30 this panel will end, and those members who want to
8 participate in the private placement and M&A brokers
9 break-out group should stay right in this room, and we're
10 going to ask if you could all can kind of come down and
11 closer to the stage for that break-out group discussion.

12 We will not use a multi-purpose room. At 3:30 we
13 are going to have a break and anyone who wants to switch
14 break-out groups, an SEC staffer will escort you from one
15 breakout group to another. So for example, if you've spent
16 2:15 to 3:30 in a private security offerings breakout group
17 and then you want to go to the smaller public companies
18 break-out group that starts at 3:45, an SEC staffer will
19 escort you to that other office or other room.

20 Then at 4:45 we'll all reconvene here in the
21 auditorium and we'll go through the recommendations of each
22 break-out group. And at 5:30 I remind everyone that we're
23 having a network reception at B. Smith's restaurant, which is
24 right up the street of the main entrance to the SEC on the
25 right-hand corner of Union Station. So I'll then turn the

1 conference over to Greg Yadley.

2 PRIVATE PLACEMENT AND M&A BROKERS

3 PANEL AND BREAKOUT GROUP DISCUSSION

4 MR. YADLEY: Welcome back and welcome to those of
5 you who are participating by webcast. We appreciate your
6 questions and please continue to submit those as we'll be
7 happy to handle them during the next hour and 15 minutes,
8 which is a private placement brokers and M&A brokers.

9 We spent the morning speaking about balancing
10 capital formation and protection of investors; and,
11 certainly, nowhere is the need for balance more apparent.
12 And to some people's views, the need to rebalance more acute
13 than in this area, because finders and financial
14 intermediaries of various types are gateways to capital,
15 gateways to next stage transactions. And we're going to talk
16 about why we have the regulations we have today, what
17 movement there is, what developments there have been at both
18 the federal level and the state level, and what we might
19 expect in the future.

20 I'm going to introduce the distinguished panel that
21 the securities and exchange commission has assembled for us.
22 And the first time each of them speaks on a substantive
23 matter, they'll identify themselves. So those of you on the
24 webcast can keep track of who's who. And we're going to
25 generally break the discussion into private placement brokers

1 or those who function primarily to help companies raise
2 capital, and M&A brokers, those who assist companies with the
3 sale of businesses or transactions involving a sale.

4 To my right is Christina Fausti. She's a special
5 counsel in the Office of Chief Counsel in the Division of
6 Trading and Markets, the old market regulation division. She
7 specializes in broker-dealer regulation and has been a great
8 assistance to those of us in the private bar and in industry
9 who are attempting to meet the SEC's requirements and meet
10 the concerns that they have as a regulator.

11 Next to Christina is Dennie Crawford. She is
12 widely known as the securities commissioner to the state of
13 Texas. Those of you on the webcast will know who she is
14 because she has a Texas draw. She is also the president
15 elect of the North American Securities Administrator's
16 Association, which is a group made up of the securities
17 regulators of all of the states and Puerto Rico, and the
18 District of Columbia, the Virgin Islands, and Canadian
19 provinces and Mexico.

20 Next to Denny is Faith Colish, counsel to Carter,
21 Ledyard and Milburn in New York. Faith specializes in
22 regulatory advising to broker dealers and other financial
23 securities industry participants. Faith is co-chair with me
24 for the ABA task force on private placement broker-dealers.
25 She's been working at this since about 1999, if not before,

1 and we're glad to have Faith with us.

2 Next is Dennis Roberts, the Chairman of the McLean
3 Group, a middle market investment bank that provides M&A
4 capital formation and business valuation advice and other
5 things that caused him to describe himself as someone who
6 does both things: capital raising and M&A.

7 Next is Michael Ribet, managing director of Focus
8 Capital Advisors, a mid-market M&A advisory firm, very active
9 in this area, also happens to be the president of the
10 Midwest Business Brokers and Intermediaries Association, very
11 knowledgeable and thank you for participating, Michael.

12 Finally, Shane Hansen, partner in the firm of
13 Warner Norcross & Judd in Grand Rapids Michigan. Shane is an
14 experienced practitioner specializing in the financial
15 services regulation and securities area, is quite active in
16 the area, and ladies and gentlemen, this is our line-up. And
17 to get started I would like to ask our regulators on the
18 panel, Christina and Denny, to give us a little bit of a
19 recap of the regulatory environment, what it is and why.

20 MS. FAUSTI: Thank you, Greg.

21 Just to be clear, as Greg said, we're going to be
22 splitting up the private placement issues and the M&A issues.
23 So Denny and I are going to get started, and talking from the
24 perspective of the private placement issues, and later on
25 we'll address the M&A issues.

1 I do have to make my standard disclaimer that my
2 remarks today represent my own views as a staff member of the
3 Commission. They do not necessarily reflect the views of the
4 Commission or my colleagues on the staff, but with that said
5 I have been working in the Division of Trading and Markets
6 for over four years now, and I'm in the office of chief
7 counsel where we do deal primarily with broker-dealer
8 registration issues and the interpretive issues related to
9 that.

10 And on the other side of our office, we also deal a
11 lot with sales practices issues, which in a way tie in to a
12 lot of our considerations, and we are thinking about
13 broker-dealer registration issues. I think everyone has
14 traditionally known this area in terms of talking about
15 "finders." The Commission itself doesn't recognize a
16 category called finders. We are focused on who is a
17 broker-dealer; and, if you are a broker-dealer, you should be
18 registered under our laws. So for us, we're always looking a
19 the definition of a broker-dealer in the Exchange Act, which
20 is a person engaged in the business of affecting transactions
21 in securities.

22 To us, there's two parts of that. There's the
23 affecting transactions in securities and whether you're
24 actually engaged in the business of it. And, I'm sorry. I
25 don't think I said the full definition. It was engaged in

1 the business of affecting transactions and securities for the
2 account of others, so there is a little bit more to it. But
3 in the case law, we draw some from that in terms of what is
4 affecting transactions and securities and it's anything along
5 the chain, all the way from initial solicitation of an
6 investor to the completion of a transaction.

7 On the engaged in business side, the starting is
8 usually the transaction issue, and if it's transaction based
9 compensation, such as a commission, if it's somehow
10 success-based, that has been viewed as getting you to engage
11 in the business. Now, the question comes up a lot when
12 you're talking about fee structures: what if it's not a
13 commission; what if it's a flat fee. Well, another way of
14 looking at engaged in the business is the regularity of
15 participation that could be the regularity of participation
16 in a particular type of transaction and dealing with a lot
17 of different issuers.

18 So we sort of take our start from the case law, and
19 that is where some of that has been defined. But when you
20 get to this category of what we think of as finders, a lot of
21 the guidance in the past has come from no action letters.
22 And for those that aren't as familiar with no action letters,
23 those are the view of the staff here at the Commission. It's
24 an informal way for us to give guidance in this area, and you
25 can rely on it as the views of the Division of Trading and

1 Markets, but is not a formal statement from the Commission.

2 So with that said in this area, the Commission
3 itself is not formally made statements on finders. It has
4 not formally made statements on private placement broker
5 issues. In fact, when we get to the nitty-gritty of talking
6 about proposals that have come forth and a lot of work that
7 has been done, a lot of the work has been done at the staff
8 level versus rising all the way to the level of the
9 Commission. But I think our hope would be that we would be
10 in a position to make recommendations to the Commission so a
11 statement could be made in the future.

12 As far as where we are right now, one no action
13 letter in particular that comes up a lot in the area of
14 finders is Paul Anka, known for his singer ability as well.
15 But known in our world more for this finders no action letter
16 and in that letter he was asking for the ability to refer
17 investors to an issuer. It was a hockey team that would then
18 sell investments to those investors and it's a very unique
19 letter. It's from 1991. And it's unique in the fact that a
20 lot of people think of finders as in some cases a person that
21 would provide introductions.

22 Well, then, introduction talked about, and Paul
23 Anka, actually doesn't really happen. He instead is
24 transferring the names of potential investors that then the
25 issuers, employees, specifically the directors and officers

1 would go out and contact themselves, you would not be
2 involved any way in negotiations; and, in fact, not the
3 introduction as I just mentioned. And there was a sort of
4 commission or transaction based fee there.

5 Ever since Paul Anka has come out, a lot of people
6 in the private bar, a lot of people in the business industry,
7 have felt that that has given some sort of coverage to allow
8 for what is thought of the traditional providing an
9 introduction between investors and an issuer, and being able
10 to receive compensation for that.

11 The truth is, from the staff point of view, there
12 is no progeny of Paul Anka, in fact, and the ways that we
13 look at broker-dealer regulation today, I'm not even sure
14 that we would issue the Paul Anka letter again. And so,
15 really don't think it's something that people out there doing
16 transactions should be relying on. A lot of other letters
17 that have come out where persons have asked to earn some form
18 of transaction-based compensation and when you're talking
19 about capital raising, there is not a lot of relief that is
20 given.

21 And that is because from the definitional point of
22 view of a broker-dealer on the one hand, we look at you as
23 affecting transactions securities. Because if you're
24 providing those introductions, we see that as a form of
25 solicitation and we see it as an implicit recommendation in

1 terms of the issuer and investor. Now, this gets me to the
2 sales practice side of what I do.

3 We have concerns about sales abuses that could
4 happen and that's why we want you under the umbrella of
5 broker-dealer regulation. And then associated with that, if
6 you're getting a transaction-based fee, we consider you
7 engaged in the business. Even if you're getting a flat fee,
8 we generally take the view that some people have thought in
9 the past there might be one bite at the apple or maybe you're
10 only talking about one-time introduction. Staff takes -- I
11 don't want to say a grim view -- but we don't really believe
12 that. We believe that a lot of people are out there to make
13 money and to be in the business. And we just take a much
14 narrower view of what would fit under the definition of a
15 broker-dealer.

16 I know another question that comes up a lot is
17 okay, if we see someone out there and we think they're acting
18 as an unregistered broker-dealer, what are enforcement
19 policies from the Division of Trading and Market standpoint.
20 We are not the enforcers. We make the policies. We do the
21 interpretive work, but we definitely, when we see activity
22 that we think is in violation of the broker-dealer
23 registration requirements referring those issues over to your
24 enforcement staff.

25 There are a couple different ways they can be dealt

1 with. In some cases in the past we have issued what we call
2 early intervention letters which say it appears what you're
3 doing is broker-dealer activity. We advise you to register,
4 or else we'll refer you to enforcement. If it seems like
5 it's been a larger level, and maybe the persons have been
6 unnoticed before that they're in violation of broker-dealer
7 registration issues, we would go ahead and refer to our
8 enforcement staff. Of course, we don't have complete control
9 over the resulting investigation if charges will be made.
10 But it is something that we do take seriously and that would
11 be the role that we would play in terms of referring it for
12 enforcement.

13 So that's basically a snapshot overview where we
14 are in terms of broker-dealers and finders. One more issue I
15 want to mention, because I know it comes up in the private
16 placement area, is also the idea of a finder for a
17 broker-dealer, meaning if you come across a deal and you
18 can't, you don't want to get involved, because you don't want
19 to get the compensation. But maybe, you know, broker-dealer,
20 you can pass it off to. And the question always comes up,
21 well, can we get a referral fee from a broker-dealer.

22 Under NASD rules you cannot share commissions, and
23 so we view that as a broker-dealer activity. Unless you are
24 a registered person associated with the broker-dealer, you
25 cannot receive those fees, and we've actually issued quite a

1 few no-action letters that take that standpoint as well. So
2 that is the view of the staff on those types of fees as well.

3 MS. CRAWFORD: Good afternoon.

4 I am Denny Crawford and I am the Texas Securities
5 Commissioner, and my history with this issue is very long.
6 And it's somewhat frustrating and it's probably been very
7 frustrating for those of you listening this afternoon or in
8 attendance here today. And the reason that it's frustrating
9 is because for purposes of federal and state law, and you've
10 just heard a very fine overview of the federal law from
11 Kristina, but for purposes of both of these laws, this
12 activity really is full-blown dealer activity, which exposes
13 to people that we ordinarily think of as finders or private
14 placement broker dealers to potential liability, both civil
15 liability and in some states criminal liability if they
16 aren't properly registered to engage in the activity.

17 Now, in my state of Texas, if you're engaging in
18 dealer activity and you're not properly registered to do so,
19 you've engaged in a felony. So you can see how serious this
20 question becomes when you start talking about offerings to
21 raise capital, and people involved are getting commissions,
22 are getting referral fees and what-not.

23 Back in 1983, which seems like an awfully long time
24 ago, I was general counsel of the Texas State Securities
25 Board and I was asked by my boss to research the law of

1 finders. And it was a very interesting research project,
2 because what I found is that the case law is extremely
3 inconsistent in terms of how the decisions are rendered,
4 whether somebody is or is not required to be registered as a
5 broker-dealer. And it was my conclusion that despite the
6 black letter law, the judges were really deciding these
7 issues based upon the equities. This particular small
8 business capital formation conference has been going on for a
9 long time and I've had the good fortune to attend many of
10 them through the years, and it's been so interesting to me
11 that year after year almost without fail the number one
12 recommendation that comes out of this conference is to do
13 something about finders. And why is that?

14 Well, the reason is that because it's so incredibly
15 important that small business have access to people who can
16 connect them up with investors in order to raise capital on a
17 micro level and as a state regulator, that's where I see this
18 happening. It becomes incredibly important to be able to tap
19 in to the networks that well-known people have, financiers,
20 people who are well-known in the community.

21 In my own state, a good source of finding activity
22 is from football coaches, and you could see how that would be
23 the case. Well, as a regulator, I think it's very important
24 to try to have a pragmatic point of view. What works in
25 terms of protecting the investors, but what goes too far.

1 And my own feeling about this particular issue has been that
2 the pendulum has swung a little bit too far in terms of over
3 regulation. While there have not been many enforcement
4 cases, in fact, there have been very few enforcement cases,
5 which speaks to the issue of is it of sufficient importance
6 to expend resources on it. And the answer, I would say, most
7 of the time is no. But it's the worrisome factor. Small
8 businesses by and large are trying to raise capital and
9 they're trying to do it legitimately. And they need the
10 ability to reach out to these finders.

11 The states have experimented in this area, and the
12 experiments have resulted in sometimes working pretty well
13 and sometimes not so well. We have four states that have
14 actually tried to do something on the state level about
15 finders. The state of Michigan has had a long-standing rule
16 that actually considers finders to fall within the rubric of
17 investment advisors in some cases. Sometimes it's helpful;
18 sometimes it's not.

19 The state of Texas came up with a full-blown, easy,
20 finders regulation, light-type registration approach, and it
21 has worked pretty well. We've got about 40 individual
22 finders registered with us, but, again, it will only work on
23 an intrastate basis because we have no national rule, a
24 federal rule, and we don't have a coordinating state approach
25 yet.

1 The state of South Dakota sort of gave up entirely
2 and said we don't think that this is all that important and
3 we're just not going to regulate it. They created an
4 exemption, and then the last state was Minnesota, who has
5 tried yet another approach, and they have an exemption from
6 registration in certain circumstances. Well, while the
7 states are the laboratories to experiment, I would have to
8 say that we really do need uniformity.

9 What we fundamentally must have is an SEC approach
10 to this problem that then the states can respond to in a
11 uniform fashion. It ought to be possible to do deals and
12 utilize finders and still protect the public. So what the
13 states have been thinking about and what we've been
14 dialoguing about at every opportunity is this notion that
15 some sort of broker-dealer light registration, something
16 where you would undergo an enforcement check, you would get
17 registered, and with some conditions you would be able to
18 engage in finding activity.

19 You would not be a full-blown broker dealer. You
20 would not have net capital requirements. You might have
21 minimal books and records requirements because that's
22 important, and while we would do the enforcement checks, we
23 would not do this look-back type approach that requires you
24 to sort of own-up to your prior finding activity in a way
25 that could then expose you to enforcement actions on the part

1 of the state. So with all of that in mind, I would have to
2 say that state securities regulators are very sympathetic to
3 the small business community on this particular issue. And
4 we are very interested in working with small business and our
5 fellow regulators, both the SEC and FINRA to the extent that
6 FINRA is involved, in coming up with a uniform scheme that
7 would work.

8 So having said that, I guess we'll move on and I'll
9 come back to you a little bit later with some more
10 observations.

11 MS. COLISH: Thank you very much.

12 I have to say that the words of the two previous
13 speakers, and in particular Denny, are music to my ears,
14 because I think the points that she's made have been what the
15 task force has been working on for almost 10 years now. I
16 think it was mentioned that the task force got started in
17 1999, which was two bubbles ago. At that time, it was the
18 tech bubble, and the actual genesis was lawyers for small
19 issuers in Silicon Valley whose clients needed to raise money
20 but didn't have the track record or the capital or whatever
21 else to attract the attention or be able to afford, but,
22 mainly, to even attract a real broker-dealer. So they needed
23 the money.

24 What would they do? They would go to an
25 unregistered finder and sometimes it worked out fine. And

1 sometimes it worked out terrible, but their lawyers were very
2 nervous, because in addition to the factors that you've heard
3 mentioned about regulatory action, potentially even criminal
4 action, there is what I call the 'R' word, which means
5 rescission. And if you do a transaction at least under
6 federal law that is not in compliance with the Securities
7 Exchange Act, that contract that is void, it's not even
8 voidable. It's void. And so you have finders who may wish
9 to enforce their contracts to get a fee unenforceable.

10 You may have investors who decide they would rather
11 change their minds about an investment and they have
12 rescission rights, and that's really what scares lawyers. So
13 the task force was put together by the ABA, or at least by
14 part of the ABA back in '99, by essentially small business
15 lawyers. They realized that it would be helpful to have
16 somebody on the task force who knew something about
17 broker-dealer work, which is how I came into the picture,
18 because that's been my specialty for 25 years or more. And
19 it was a long and slow process.

20 And I think a lot of credit is due to Shane's
21 senior partner, Hugh Makins, who among other things was for a
22 number of years the chair of the task force and who was I
23 think the driving force in putting together the report that
24 was eventually issued in the spring of 2005. It starts out
25 with essentially a compilation of all of the learning that

1 could be found on what makes a person a broker. And it is
2 admittedly spotty, inconsistent. There are gaps. It talks
3 about Paul Anka.

4 It talks about some of the authorities or no action
5 letters which are almost tantamount to authority and sort of
6 surveys what is the problem and what can be the consequences
7 of doing business as an unregistered broker. And, by the
8 way, the report is called ABA task force on private placement
9 broker-dealers, but since what we're really talking about is
10 brokers who are agents as distinguished from dealers. And I
11 know the terminology varies under state law, but for federal
12 law it's only a broker. So we refer to this category of
13 person as a PPB, a private placement broker. We've dropped
14 the 'D'.

15 The report, as I say, surveys the literature up to
16 that point and made some tentative recommendations. It
17 wasn't actually a rule proposal, but an approach was
18 suggested which I call broker-dealer light, which was to make
19 it easier for finders to get registered and easier for them
20 to live a registered life. And that included some things
21 that Denny mentioned such as replacing the net capital rule,
22 and by the way, the net capital requirement for an
23 SEC-registered broker of this type would be \$5,000.

24 And, frankly, anybody who can't scrape together
25 \$5,000 should try to think of another kind of work, but even

1 that leads to things like books and records requirements and
2 audit requirements, which are going to cost you a lot more
3 than \$5,000 a year. And we thought maybe that could be
4 replaced by something like a fidelity bond, which might
5 actually provide some protection to investors and examination
6 requirements that were more appropriate to the very limited
7 nature of the work and some other suggestions along those
8 lines.

9 We were lucky, I guess, in that the report came out
10 in the spring of '05 just in time to be part of the material
11 looked at by the SEC's advisory committee on smaller business
12 enterprises, which issued its report in the spring of '06.
13 And most or a lot of the issues in that advisory committee
14 report related to things like Sarbanes Oxley and what I call
15 '33 Act issues.

16 But they also looked with favor on the task force
17 report and actually endorsed it. And I used to be able to
18 recite this from memory, but their recommendation was that
19 the SEC spearhead an effort of regulators to address this
20 problem along the lines of the task force's recommendation.
21 That led to dialogue between the task force and SEC and
22 people at the state level, NASA level, individual states, and
23 also as it then was, the NASD. And we were gratified to get
24 a very warm reception from the SEC.

25 First of all they told us we got it right. When I

1 say we, I mean, mainly Hugh had gotten it right in terms of
2 our compilation of the authorities and that we hadn't left
3 anything out or mischaracterized anything. And they asked us
4 to draft a rule that would embody this broker-dealer light
5 approach which we were happy to do. We submitted that and
6 they gave us some helpful comments. And we were about to
7 submit a revised draft when the bright idea of an exemptive
8 approach, based on essentially the same criteria that we were
9 considering as a basis for the broker-dealer light
10 eligibility came, and frankly to me it was like someone
11 turned on a light bulb.

12 I mean, it was so obvious, why hadn't I thought of
13 that? Because among these things, and I mention we'd been in
14 touch with the people at the NASD, I have to tell you they
15 were not enthusiastic about broker-dealer light. They were
16 not enthusiastic about the idea of having thousands of new
17 one-person member organizations. This, as you may remember,
18 was just about the time that they were soliciting proxies for
19 turning themselves into what's now FINRA and small
20 broker-dealers were an issue in those days. So when the
21 notion of an exemptive approach came along, that got some
22 real -- I don't want to say traction -- but at least a much
23 more friendly response along the lines that not only would
24 they be happy to forego the pleasure of regulating these
25 people. But they would also, if necessary, make it explicit

1 that their members could share commissions with people who
2 would qualify under this new concept. It's not even yet a
3 proposed rule, but we're hoping it will soon be.

4 So that's been essentially the trajectory of the
5 task force's work. Once we reach the point of, as I said, by
6 this time it was around six. I guess it was '06 that the
7 notion of an exemptive approach coupled with appropriate
8 state regulation had sort of become the shape of the concept.
9 The SEC let us know that they were taking charge of the
10 project, and since I have been doing this on a pro bono
11 basis, I said, "Wow, this is perfect." No. I don't have to
12 do anymore work and the idea has taken root.

13 So I now am an observer more than an actor in terms
14 of how this rule is actually evolving. But of course we're
15 very interested and we're always available to talk to the
16 SEC, to talk to the states, and to talk to anybody else that
17 will stand still about our views on what would be in the
18 public interest. I think it's interesting that Denny
19 mentioned that this is. I won't lean on you so much, but
20 I'll speak for myself. I think we're in a period where
21 regulation, deregulation is a hot topic. And I think this is
22 regulatory neutral. On the one hand there has always been a
23 law that says, or at least since 1934 there has been a law
24 that says if you want to do this, you have to be registered.
25 So we're not looking to create new laws. We're looking to

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1 create in effect exemptions from laws.

2 On the other hand, there has been an astonishing
3 range of understanding or denial of the fact that there is
4 such a law. I mean, I've talked to the people who have never
5 heard of the '34 Act or who would say, well, everybody does
6 it. It must be okay. Or, yeah, I could get caught but I'll
7 take that chance. Or, gee whiz, rescission, I won't do
8 anything. It runs the gamut.

9 So I think that although there may be people
10 stepping into the regulatory arena, stoplight visibility,
11 which from of course the regulators' standpoint is a good
12 idea. It means that they are not subject to the heavier
13 burden of actually being registered. So I think it's a
14 win-win situation; and I also just wanted to make the
15 observation. It occurred to me recently that the Securities
16 Exchange Act in terms of when it was adopted is closer in
17 time to the Civil War than it is to now. So the fact that
18 things have changed or may need to be changed is not
19 surprising.

20

21 MR. YADLEY: Thank you, Faith.

22 As Denny said, at this forum, the idea of how to
23 deal with this '34 Act definition has been front and center.
24 For the last six years it's been, if not the top
25 recommendation, close to the top, and as Faith said, we got a

1 real push forward with the Small Business Advisory Committee
2 report in April of 2006.

3 Last year, reflecting the fact that in the
4 discussions among practitioners as well with the regulators,
5 a distinction has emerged between the capital-raising side
6 and the transactional side.

7 Three recommendations were contained in the final
8 report of the 2007 forum. The first was a recommendation
9 that the Commission take the lead in adopting rules in
10 coordination with the states to create a limited federal
11 registration exemption and simplified system of state
12 registration and regulation for M&A and business brokers who
13 act as intermediaries and advisors in the purchase and sale
14 of existing businesses.

15 The second was that the Commission adopt rules
16 recommended by the task force that Faith mentioned to
17 facilitate capital raising by small business owners.

18 And then third was to create a private placement
19 broker that would be allowed to raise capital through private
20 placements of an issuer securities with one or more
21 accredited investors only in amounts per issuer up to 10
22 percent of the inventor's net worth, excluding their home,
23 with full written disclosure of the broker's compensation and
24 in aggregate amounts of up to \$10 million per issuer,
25 periodically adjusted for inflation.

1 So that was sort of, it wasn't so much a shot
2 across the bowel as a way to take this issue, which from a
3 regulator's standpoint understandably creates anxieties
4 because it's pretty wide open in its broadest sense and
5 creates lots of opportunity for fraud from people who already
6 operate pretty successfully under the radar, and if you give
7 them a pass to do that, it could get worse.

8 So the idea of the third recommendation that I just
9 read was to indicate that we're not looking for anything that
10 will open the door to more fraud, but directly in a focused
11 manner to help raise capital for small companies from
12 investors who are able to fend for themselves.

13 So perhaps we should now ask the SEC staff
14 representatives and representatives of the states to discuss
15 a little bit about what you're doing about these proposals
16 and what is the appropriate position of the states versus the
17 SEC, and then get some of the views of people from the
18 broker-dealer industry on the panel.

19 MS. FAUSTI: Thank you, Greg.

20 One footnote, I just want to say when Faith was
21 saying, talking to the SEC, she in fact means SEC staff. The
22 Commission itself, as I've already stated, has not taken a
23 position or made any proposals in this area. As an SEC staff
24 member, when anything comes to us in the form of an idea,
25 when we see a regulatory issue and we need to come up with an

1 approach, we need to be doing our due diligence, and that's
2 in considering alternatives.

3 The B/D-lite approach and the ABA Task Force report
4 was something we started mulling over. We started reaching
5 out to NASAA has a finder's group that we started to talking
6 to some of them. We of course talked to the ABA Task Force.
7 We ourselves talked to NASD, now known as FINRA staff, to get
8 their feedback and their input.

9 And I think, you know, we also have to think about
10 obstacles when we're thinking about different approaches. We
11 have to think about, you know, the pragmatic point of view.
12 We have to think about effects on competition overall, the
13 impact on small businesses.

14 I'll say one of the big obstacles that we did face
15 is when we talked to NASD and FINRA staff and no one here is
16 represented, so obviously, you know, we're talking on behalf
17 of people that aren't here. But I think that we were also of
18 the general view that there was a hesitancy to take on an
19 additional registration category from an administrative
20 burden standpoint for them. Also just some concerns of the
21 existing members that we have.

22 And so for that reason we had to start looking at
23 other alternatives. You know, whether it be maybe a notice
24 registration, all the way down to could we come up with an
25 exemptive approach. And I think there are several people in

1 the audience here that have participated in this forum in the
2 past, and know that I have attended as well.

3 And we very much appreciate the feedback that we
4 receive at this forum, and that goes into our consideration
5 as well. And I'm very much looking forward to the breakout
6 after this.

7 With that said, there are additional issues, and I
8 think we really appreciate last year some of the
9 recommendations that came out of the forum, because some of
10 the issues that come up are when you're talking about whether
11 it be a B/D-lite, whether it be an exemptive approach, are
12 there limits that need to be established? Does there need to
13 be a limit on the types of businesses that you're helping?

14 If that is the case, and we say it's a small
15 business, well, how do you define that or should that even be
16 the focus? Should the focus be more on the issuance itself
17 and the transactional side? And you know, last year the \$10
18 million suggestion came out and that's a number that we
19 continue to mull and we continue to get feedback on.

20 Then there's also the issue of the investors
21 themselves that you're dealing with. You know, should it be
22 the accredited investor, or does there need to be some form
23 of sophistication? And if we're going to a pragmatic view of
24 really solving the problem that's out there in terms of
25 providing clarity of who should be registered as a or

1 broker-dealer and who can fit into whether it be a B/D-lite
2 or an exemptive approach are you protecting the right people,
3 and are you providing something that's really going to solve
4 the problem, and that the states will be able to deal with?

5 So those are some of what happens.

6 In terms of just a process point of view as well,
7 as I've mentioned, the staff has been working on it. I'm a
8 staff attorney. We have to vet this internally with our
9 senior staff, and then we would get to a point where we would
10 actually be able to make a recommendation to the Commission.

11 We're not quite at that point yet, because a big
12 point of considering an exemptive approach is in that case,
13 as Faith mentioned, you want to make sure that there is some
14 system, then, at the state level.

15 As Denny mentioned, they're very interested in have
16 uniformity of the B/D-lite, and so we are actually in the
17 process of further reaching out to the NASAA finders group,
18 which Denny also sits on, and I've had the pleasure of
19 working with her for a couple of years now and having
20 conversations with her and her colleagues that also serve
21 with NASAA. And we really want to make sure that we are
22 getting their feedback, that whatever approach we are doing
23 at the federal level is workable, that it's going to allow
24 the states to come up with a uniform approach, if that's what
25 they want.

1 And so any ultimate recommendation that we would
2 make to the Commission will not be taken lightly, and it will
3 not be made without making sure that we have fully vetted at
4 all the different levels that we need to.

5 And so that's a little bit of the process that we
6 are going their right now at this point. And also getting,
7 you know, feedback from the states on some of those issues
8 that I talked about, you know, who should the investors be,
9 who should the businesses be, does there need to be
10 transactional limits. Are there some issues that we should
11 not even be deciding, and we should be getting more input
12 from the states.

13 And of course if this got the level where the
14 Commission is ready to make a proposal, we would be in a
15 position to generate public comment. And so what further
16 comments and questions should we be asking of the public and
17 those in the industry that would be affected.

18 Now the question that always comes up year after
19 year is, okay, the ABA Task Force report came out in 2005;
20 we've now had recommendations for the past couple years from
21 both the small business advisory committee and from this
22 forum. So what is the timing. When is the staff going to
23 have a recommendation. When is the Commission itself going
24 to come out and say something on this issue.

25 I can't speak for the Commission. I can tell you

1 this is an issue high on my priority list I've been working
2 on the entire time I've been on the staff, and I continue to
3 move it forward to the best of my ability. Of course the
4 Commission itself has been focused on other issues going on,
5 but that doesn't mean that other issues go away and are any
6 less important.

7 We also obviously have a transition issue coming
8 up. We are about to gain a new administration in the new
9 year and that is going to affect our agency, and what
10 direction our agency is going in.

11 So I can't necessarily answer those questions, but
12 what I can say is that when the Commission is ready to
13 consider it, we have been engaging in the conversations we
14 need to engage in to inform them on the issue, to answer
15 questions that they have on the issue, and to hopefully make
16 a recommendation that they would be receptive to, and if
17 they're not receptive to it, then, you know, to do the
18 further work that the Chairman and the other Commissioners
19 would want to be done on the issue.

20 And I hope that makes people, you know, at least
21 feel good to know that it's an issue we take very seriously,
22 that we work on. As someone that deals with broker-dealer
23 registration issues, I'm constantly talking to members of our
24 examination staff, to members of our enforcement staff, as
25 well as members of the public.

1 And I'm constantly taking their feedback and
2 learning what's going on, so that that can be taken into
3 consideration. And you know, so the hope is that, yeah, it's
4 been a few years since that 2005 report came out, but a lot
5 of work has been done, and hopefully we'll see some fruition
6 in the not-to-distant future.

7 MS. CRAWFORD: Well, Kristina has given you a very
8 good overview of the process and sort of where we are right
9 now and what the timing might be. And I would just say from
10 the state's perspective, we are greatly enjoying the
11 opportunity to work so closely with the Commission and come
12 up with a collaborative approach.

13 The Commission staff has been terrific on this
14 issue. They have done all the things that Kristina just said
15 that they have been doing, and they've been doing it quite
16 well in my opinion. We're looking forward to having a
17 proposed response to what the Commission ultimately decides
18 to do that is ready to go immediately.

19 We feel like our conversations have been so
20 fruitful that there shouldn't be a big lag time between when
21 the Commission actually makes a decision on this area, how
22 it's going to be dealt with, and the state's proposal for a
23 uniform approach.

24 Now whether it would be an exemption or a
25 broker-dealer lite registration, I can't say for sure. Right

1 now I am of the belief that we're going to be proposing a
2 uniform broker-dealer lite registration for finders, for
3 these private placement, is it dealers?

4 MS. FAUSTI: No, PPBs.

5 MS. CRAWFORD: PPBs, the PPBs. And I think that
6 our goal -- well I know that our goal is to make it workable,
7 do it quickly. And just so that you get comfort on this
8 point, I'm going to repeat something I said earlier. We
9 don't want to have look-back provisions that cause you during
10 the registration process to have to expose yourself to
11 potential enforcement simply by virtue of the fact that
12 you've engaged in this activity previously without the
13 benefit of registration.

14 That's one area that I think we can sort of carve
15 out. Now any other enforcement-related problem, no. That's
16 going to be an issue, because it will be a registration,
17 albeit a B/D-lite registration. And if there are prior
18 enforcement problems, no go.

19 Also we would be very interested in bad person
20 disqualification provisions along the lines of which you've
21 seen in the private placement private offering exemptions.
22 That's going to be very important to the states.

23 We would want to see minimal bookkeeping. We may
24 waive exams that would seem to make sense in this context.
25 But we would want all of those things, because the primary

1 goal for us is to know who out there is engaging in the
2 activity, make sure that they're not people who have violated
3 securities and related laws in the past, and you know , are
4 going to actually help small businesses and not do anything
5 to hurt the capital raising process.

6 So with that said, I'll let you move on, Greg, to
7 the players in the industry.

8 MR. YADLEY: Great. So gentleman, what do you
9 think?

10 MR. ROBERTS: All right. You said it was mine, so
11 I'll take it. And by the way, welcome to Washington. I may
12 be the only actual native of Washington in this room today.
13 I went to grade school two blocks away from here.

14 And I don't know about where you guys are from and
15 what you think of our temperature, but I've given up any
16 longer looking at the temperatures or the stock market
17 reports in the morning. I just look at the obituary columns
18 and the bankruptcy columns. If I'm in not in either one of
19 those, I figure it's probably another good day.

20 My comments are really without axe to grind, just
21 some practical observations from the registered broker-dealer
22 industry.

23 First of all, so you can rate the rater, I too have
24 been a student of this for probably 20 years. The first ten
25 years I operated as an unregistered broker-dealer, and then

1 eventually drank the Kool Aid and became registered and have
2 been a registered broker-dealer for ten years.

3 I think there are a couple of -- I don't want to be
4 too harsh, by suggesting the mythology -- but a couple of
5 premises that I would tend to question here.

6 The first one is, is that -- and I understand this
7 is at least ostensibly somewhat contradictory to the title of
8 the whole-day workshop, which is capital formation for small
9 businesses -- but I've done this for 35 years now, as a bank
10 chairman, and as an investment banker, as a recovering CPA --
11 I first attended one of these sessions I think in 1993 in
12 Providence, Rhode Island, where in fact at that time capital
13 formation for small businesses was more of a problem than it
14 is at this time.

15 We've had in peak years over the last six or seven
16 years, we've had up to \$200 billion a year come into the
17 private equity industry in the venture capital industry.
18 There's no shortage of capital out there for good ideas. Now
19 49 out of 50 ideas are turned down, if not higher. It's not
20 because of the lack of capital, it's because of the lack of
21 quality of the deals.

22 And I think I would encourage our regulators as
23 they, you know, choose the directions they want to go with
24 this stuff. Be very careful that you're not encouraging
25 naive investors and naive investments and low-quality

1 transactions.

2 There's a ton of capital. SBA is among a number of
3 programs out there to deal with small business. I'm not
4 suggesting for a moment that it can't be improved, but I
5 think the situation overall -- as Mark Twain says, "The
6 rumors of my demise are greatly exaggerated." I think this
7 is somewhat exaggerated.

8 The second practical observation from the
9 practitioner I would make is, is that as Faith pointed out,
10 absolutely correctly, the capital costs of setting up a
11 broker-dealer are \$5,000, and if you meet the minimum
12 requirements before you have to supply a reason for not
13 meeting them, it's \$6,000. The actual compliance
14 obligations, including audits and so forth. And once you've
15 done this it really, really de minimis.

16 I've addressed groups of hundreds over the last
17 four or five years who said the same thing. And today I get
18 no fewer than one call every month from someone who is in a
19 audience, or one of my students -- teach the subject as
20 well -- saying, "You know what? We finally did it. And you
21 know what? It wasn't that painful." And it's not.

22 I have a firm right now that's in 31 cities I
23 believe. But when I first made the broker-dealer election, I
24 had fewer than 5 professionals. So this isn't something
25 that's restricted to large affluent founders of broker-dealer

1 firms. It's not that difficult to obtain.

2 I don't object to the private placement approaches,
3 both in M&A and in capital formation that people have spent a
4 good deal of time, some wonderful people, especially on this
5 panel.

6 But I'd say in the meantime, given the fact that,
7 as Faith said, one of us said that we've been at this thing
8 for ten years, that those of you who represent unregistered
9 broker-dealer constituencies, consider going back to your
10 constituencies, and recommending that in the meantime, that
11 it isn't that painful to begin with.

12 In respect to the private placement issues
13 specifically, I've read all the law -- I never liked Paul
14 Anka's music, to be honest with you, and if I ever see his
15 name in a report again, it would be not too soon or not too
16 long -- but it's been murky law.

17 I'm not an attorney, so I'm just going to comment
18 from the point of view of a lay investment banker, if you
19 will. In general, the distinctions that define a finder,
20 which is essentially non-involvement, appear if not well
21 codified, to be pretty darn clear.

22 Secondly, there's another finder rule that I think
23 Kristina observed. And what I find really, really
24 irritating, and that is the inability of a FINRA member to
25 share a fee with non-FINRA member.

1 Even though I'm a FINRA member, I think what that
2 fundamentally accomplishes is keeping the money in the
3 family.

4 And if there is at least a mild restraint of
5 access, you know, for smaller businesses to both capital and
6 to M&A representation -- which the second part of this panel
7 is about, so I'll reserve my comments on that there -- I
8 think that is somewhat of a mild impediment.

9 It's quite frankly a stupid law. I realize it's
10 designed to keep the bad guys out, and maybe keeping the bad
11 guys out can be accomplished either by exempting these
12 referrals or requiring some kind of special qualification.

13 So I don't disapprove in any way of the several
14 directions that are being taken. But by the same token I
15 think we need to look at reality. For those of you who
16 actually represent that constituency, I'm kidding as I say
17 this, but not entirely. Get over it, it's not that big a
18 problem to do it.

19 One thing I like about the unregistered
20 broker-dealers is that as a registered broker-dealer -- in a
21 competition or a beauty contest to get a client, I'm going to
22 win 99 out of 100 times, because they won't put \$5,000 into a
23 bank account and go to some fairly minimal requirements,

24 So that's my story and I'm sticking to it.

25 Mike, I don't know, do you want to speak on this

1 subject?

2 MR. RIBET: I think Shane and I are on for the M&A
3 portion of the program.

4 MR. YADLEY: Okay. Well, thank you Dennis Roberts.
5 Are there any questions from the audience on the topic of
6 private placement brokers?

7 QUESTION: (Away from microphone.)

8 MR. YADLEY: The question from the audience is
9 could regulators on the panel discuss the issue of issuer
10 agents and what that means at the state level employer,
11 employee person.

12 So Kristina and Denny?

13 MS. FAUSTI: At the federal level, there's an
14 exemption for employees of issuers; but we look at it as a
15 safe harbor, it has very specific conditions. In order to
16 meet that, you cannot in fact be associated with the
17 broker-dealer; you cannot be subject to statutory
18 disqualifications, so you can't, you know, have engaged in
19 behavior that would keep you out of the industry right now.

20 If you were the employee of an issuer and also it
21 applies to officers and directors, you can assist the issuer
22 in finding investors.

23 Now the catch is you cannot receive
24 transaction-related compensation. So if you're getting some
25 sort of commission or you're getting some sort of

1 compensation that is tied solely to you bringing in
2 investors, you're out of the safe harbor and you go back to
3 that analysis that we normally do on whether you're a
4 broker-dealer.

5 The other piece of this is there is actually a
6 condition where there's three different ways that you can fit
7 it. The easiest way I think to fit it is if you are a
8 legitimate employee. And what I mean is you're not a
9 consultant in some capacity; you are someone that has a job
10 with the issuer.

11 For example, maybe you're in marketing and that's
12 something that you are going to continue doing in the future
13 in that capacity, and this capital raising is just sort of
14 something that you're doing on the side.

15 There is also some -- I'm not remembering off the
16 top of my head -- but there's also some other limited areas
17 where maybe you're just dealing with broker-dealers or there
18 are certain transactions that the safe harbor also applies
19 to you.

20 If people want to look that up, it's rule 3(a)(4)-1
21 of the Securities and Exchange Act; if people want to contact
22 me afterwards, I'm also happy to direct you to that rule.
23 But there are very specific conditions that you have to fit.

24 I should also mention this is not an area that we
25 will give interpretative guidance on, because it's meant to

1 speak for itself. Either you fit the conditions or you
2 don't. Another condition in there that I don't want to
3 forget to mention is it's one issuance per a 12-month period,
4 so you can't be involved in a lot of transactions and you can
5 be only be involved, you know, with this one issuer.

6 QUESTION: What about discretionary bonus?

7 MS. FAUSTI: Discretionary bonus tied solely to the
8 capital raising? Okay. The question was, what about
9 discretionary bonus?

10 I think that we would probably view that as being
11 transaction-related compensation. I wish I had the rule in
12 front of me. But the language there, a lot of times we say
13 "transaction based compensation" or "commissions," and the
14 language in the rule is a little bit different to be a little
15 bit broader to talk a little bit more about any type of
16 compensation that is tied to that specific issuance and
17 bringing in investors for those transactions.

18 But I'd have to look at the rule specifically to
19 answer that question more concisely. But we probably would
20 view that as a transaction-based compensation that would kick
21 you out of the safe harbor.

22 MS. CRAWFORD: On the state level there is quite a
23 bit of variation. So at the risk of oversimplifying, I will
24 say this. The issuer can only act through human beings. To
25 the extent that somebody is a pre-existing employee with

1 other bona fide duties and is involved in raising capital,
2 that's okay.

3 Somebody that is hired simply to engage in that
4 activity is not okay.

5 And then you've got a range in between.

6 And the very question that you raised, which is
7 what about, you know, this compensation as a bonus, it's
8 going to be a question of fact in most states. So I'm not
9 going to be able to give you a definitive answer yes or no.

10 MR. YADLEY: Other questions?

11 Do we have any web questions that have come in?

12 (No response.)

13 MR. YADLEY: Okay. If we do, we could take them
14 later.

15 But why don't we move now to -- sorry --

16 QUESTION: (Away from microphone.)

17 MS. CRAWFORD: I'll take a stab at that one. I
18 would say with regard to a lot of really small businesses,
19 the answer's yes. Without question, the answer's yes. If
20 you're talking about what we consider to be micro-businesses,
21 that are trying to raise capital, if they have to go to a
22 registered broker-dealer and try to raise capital using that
23 format, it would have a chilling effect and they would not be
24 able to get out there and get the job done.

25 So yes. All the more reason to try to come up with

1 a good collaborative regulatory approach on how to deal with
2 finders, because it creates options, viable options for these
3 small micro-cap type companies.

4 MR. YADLEY: Thank you.

5 We're now going to turn to how the federal
6 securities laws apply to M&A transactions and how
7 intermediaries involved in those transactions come within
8 this broker-dealer regulation.

9 So back to Kristina, please.

10 MS. FAUSTI: Thank you.

11 Well, here we are boxed in because of the 1985 U.S.
12 Supreme Court case called Landreth Timber. And that case
13 held that the sale of a business effected by transferring
14 ownership of 100 percent of a company's stock constituted a
15 securities transaction entitled to protection of the federal
16 securities law.

17 And this had been known as the so-called "sale of a
18 business doctrine," and in the past there had been a split as
19 to whether when you were selling a whole business and it was
20 in the form of a stock sale, whether the federal securities
21 laws would apply or not.

22 A 1985 Supreme Court case came out on the side that
23 this is a securities transaction and it should be afforded
24 the protections under the federal laws. So here we are in
25 broker-dealer registration land again.

1 In 1986 the staff issued a new action letter to
2 International and Business Exchange Company, and that company
3 came in asking for guidance in this area on broker-dealer
4 registration. In particular, considering the fact that
5 Landreth Timbers said the securities laws applied. That
6 letter stood for about 20 years, and a couple years again in
7 2006 we issued another new action letter, Country Business,
8 Inc., which again was asking clarity for transactions in the
9 sale of a business.

10 Now I'm going to talk more about the CBI letter,
11 because it's very similar to what is known as the IBAC letter
12 from 1986. And it's a very limited in terms of the type of
13 relief that it gives. And we came out and gave no action
14 relief, saying you would not have to be registered as a
15 broker-dealer if you are an intermediary assisting in the
16 sale of a whole business, that that the sale of that business
17 first of all was advertised as an asset sale, that you did no
18 evaluation or negotiation of the transaction or making
19 recommendations that the transaction should be done as a
20 securities transaction.

21 However, there is a recognition made that when
22 you're talking about the sale of a business, there's a lot of
23 advisors that come into play from CPAs and lawyers. And
24 there could be different reasons why the sale of business
25 ultimately became a securities transaction.

1 And we didn't want to completely cut it off if
2 there are other advisors involved that said that it should be
3 a securities transaction; however, what we do say is that the
4 role becomes limited in what the M&A advisor can do from that
5 standpoint. They can really only play a support role. They
6 cannot be involved in negotiations of the transaction.

7 And this is one of the few cases where we have
8 said -- we have provided relief and said that the
9 compensation can be a transaction-based compensation. You
10 can also receive a transaction fee, but again you have to
11 meet all these conditions: Sale of a whole operating
12 business; cannot be a shell company; it has to be from one
13 seller to one buyer or a group of sellers to buyers; it has
14 to be a transfer of 100 percent of a securities; the
15 compensation itself has to be agreed upon ahead of time, and
16 it cannot depend on whether the sale is ultimately in the
17 form of an asset sale or if it's ultimately in the form of a
18 securities sale.

19 And another thing that came out in the CBI letter is
20 we actually defined small business, which wasn't something
21 that I think had been previously defined. And we used the
22 Small Business Association regulations. And I think that
23 that was something that got proposed to us, and so we said,
24 "Okay. Let's go with that definition." Coming up with a
25 transaction size at that time was a little bit hard.

1 Since then, I think the pragmatic view has been
2 maybe small business size regulations weren't necessarily the
3 best way to go. So I think maybe if we did that letter again
4 two years later, we might take a closer look at how we define
5 small business, and maybe we might have gone with transaction
6 size. But the universe that we operate under now is under
7 that letter, in terms of small business size regulations.

8 With all that said, that limits the universe of
9 what can be done. If the business doesn't fit those size
10 regulations, if the transaction is advertized as a sale of
11 securities or even a possible sale of securities, you're
12 kicked out of the protections under that letter. If the role
13 of the -- it's called a business broker in that letter -- if
14 the role of the business broker after it's cited, it should
15 be a securities transaction, goes beyond playing a support
16 role and you're very involved in the negotiations.

17 Again, you're sort of kicked out of the relief that
18 was provided in that letter. And that's where we really
19 stand on that.

20 A lot of people have also heard about and asked us
21 about the Hallmark Capital Corporation no action letter that
22 came out about a year later in 2007, because in that case, in
23 IBAC and in CBI, we were actually in a place where we granted
24 no action relief, and said we wouldn't -- what no-action
25 letter states is we won't refer for enforcement action for

1 not being registered as a broker-dealer.

2 We didn't do that in Hallmark and we got a lot of
3 questions. Well, there are two reasons we couldn't give
4 relief in Hallmark. One is the question came in about
5 ongoing activity, which the staff will not take a position
6 on. You know, we might talk to you and give you our informal
7 view, but we're not going to take a formal position on
8 ongoing activity; we will only talk about perspective
9 activity, because we feel like you should probably get our
10 guidance, before you're going to take that action.

11 Second of all, the hallmark letter actually talked
12 about three different types of activity. It talked about
13 capital raising; it talked about this M&A and business broker
14 type activity, and it also talked about some business
15 consulting.

16 The business consulting we weren't so concerned
17 about, but the description of the M&A activity was a little
18 too loose I think. It did give a transaction level of \$25
19 million, but did not sort of hit all those high points that I
20 talked about in CBI.

21 So even if we had been in a position to speak to
22 the activity, it just did not -- it probably would not have
23 fit all of those areas. And we actually do in the staff
24 response where we deny no action relief, we refer to the CBI
25 letter, and we also refer to our guide to broker-dealer

1 regulation, which is available on the SEC website.

2 So there's this limited universe where there are
3 some people that don't necessarily have to be registered as
4 broker-dealers, but as we're going to hear from the panel,
5 we, the staff is full aware that there are more players out
6 there in the market where you've got different sizes of
7 businesses and transactions going on, where it's open to us
8 to consider whether we should be granting more relief in the
9 broker-dealer registration area.

10 I'm going to turn it over now to Denny to talk a
11 little about the state perspective on M&A activities.

12 MS. COLISH: I just crave your indulgence for one
13 second. It is particularly gratifying to the Task Force that
14 in the Hallmark letter you recommended that the requestor
15 read the Task Force report if that person wanted to
16 understand better what the Commission's position was. So
17 that is definitely our footnote in history.

18 MS. CRAWFORD: I would just say from the state
19 perspective, this is a huge trip for the unwary. The states
20 do follow the rationale in the Landreth Timber case, and I
21 say that because we do follow the rationale. However, you're
22 not going to find enforcement cases in this area generally
23 speaking.

24 And the reason that you're not going to find
25 enforcement cases is because folks don't want to spend

1 limited resources in this particular area.

2 Now having said that, it doesn't mean that you
3 should go off and assume that you can be involved in the sale
4 of a business or even a substantial portion of the business
5 and not worry about broker-dealer registration, because you
6 can always be the test case.

7 And as I mentioned before, it is a felony in some
8 states to be engaged in that activity without the benefit of
9 registration.

10 But more importantly, you know, you've got
11 potential civil liability. And you've essentially, if you're
12 the issuer, given the other side of put if something goes
13 wrong, potentially. You just don't want to be the test case
14 in this area.

15 I will say that something that's unique to the
16 state regulatory scheme in this area is that we have in some
17 states, business broker regulation. In other words, you can
18 get licensed as a business broker, and that would suffice to
19 cover you in this area where you're involved in the sale of a
20 business or the sale of a substantial portion of the
21 business, that takes the form of the sale of securities.

22 So that's about all I have to add to what Kristina
23 had to say.

24 MR. YADLEY: Thank you, Denny.

25 Mike Ribert? Would you like to give some comments

1 from the industry side, please?

2 MR. RIBET: Mike Ribet. I'm an M&A intermediary in
3 the state of Illinois, where we do have a licensed business
4 broker category. My firm is licensed.

5 We are now in a period of time and will be probably
6 for the next decade. We're an unprecedented number of what
7 we call the baby boomers are coming of an age where they have
8 to transfer their businesses.

9 Many of these are business entrepreneurs who have
10 spent a lifetime laboring and creating great businesses in
11 the small business category. Businesses that may now have a
12 transaction value measured in the tens of millions of
13 dollars.

14 These businesses represent the culmination of a
15 lifetime of effort for those individuals.

16 Now, to preserve their legacy and to prepare for
17 their financial security and retirement and for their
18 children, they are ready to move on and transfer those
19 businesses.

20 For the economy it's very important that we not
21 take the productivity hit of those businesses not being
22 effectively transferred.

23 The skills required to guide those individuals --
24 and we're talking almost entirely about closely held family
25 businesses -- the skills required are specialized and

1 holistic.

2 I think that in my business, you have to be part
3 psychologist, part finance expert, part salesperson, and part
4 business strategist to be able to provide the right strategic
5 guidance as we help the entrepreneur determine what is the
6 right exit strategy, and then guide them on the execution of
7 that strategy.

8 There are, in fact, four realistic exits for those
9 kinds of businesses.

10 One is to sell to another corporation, to be merged
11 into or acquired by a bigger company.

12 Two is to sell to another entrepreneur, who is
13 going to take over running that business as the
14 entrepreneurial owner.

15 Third is to be acquired by a private equity group.

16 And fourth is to sell what I'll call -- and I don't
17 mean to use this term in the legal term sense -- a related
18 party, meaning sell to your children, sell to the management
19 team that you've brought up, sell to people who are connected
20 to you and the business.

21 None of those alternatives includes an IPO.

22 Businesses of this size, even in good economic times, are
23 simply not going to be candidates for IPO. Nor do any of the
24 exit alternatives involve selling shares of the business to
25 individual investors. These are almost always transfers of

1 control of the entire business entity.

2 So who does that business owner turn to for the
3 specialized expertise and guidance that he or she needs to
4 effect that transfer? Most of the broker-dealers have a
5 floor where they're going to only wish to be involved when
6 that Commission potential reaches a certain level. And when
7 you're near that floor, you tend to get what I'll call the
8 B-team, the junior people assigned to the deal.

9 And I don't think that's fair to somebody who's put
10 their whole life into building a business which is actually
11 quite successful, and they have \$30 or \$40 million of
12 revenue. I don't think they deserve B-team service.

13 And that's where the M&A practitioners who are not
14 broker-dealers operate as M&A advisors to help prepare,
15 strategize, plan, and execute the transfer of those
16 businesses.

17 Decisions about whether it would be a stock or
18 asset sale are made for three reasons. Number one is tax,
19 and that's probably the most important consideration; number
20 two is that the buyer tries to avoid assumption of
21 liabilities; and third is that there may be contracts that
22 are not transferrable that forced a stock sale.

23 And as the advisor, one wants to be able to provide
24 counsel about those alternatives and those strategies without
25 having to look over one's shoulder and worry about whether or

1 not you're stepping into a regulatory problem by doing it.
2 In effect, we want to guide our client in conjunction with
3 their accountant and attorney to the alternative that makes
4 the most sense and is right for them.

5 In conclusion, I'll say that as a former registered
6 Series-7 rep with a broker-dealer -- and I did have the
7 Series-7 and Series-63 registrations -- that the skills that
8 are learned to pass those exams and the skills that are
9 expected in that industry are almost entirely separate from
10 the skills that are required to successfully guide the small
11 family-oriented business owner through the transfer of that
12 business.

13 MR. YADLEY: Thanks Mike. Dennis Roberts, do you
14 want to add something to that?

15 MR. ROBERTS: Yeah, I sure would, hopefully
16 maintaining Mike as a friend. But we don't know, we're fresh
17 acquaintances right now.

18 The first one is -- and this is my same problem
19 with the country business letter -- is that these are not
20 small businesses, these are middle market businesses. Even
21 using the SBA standard of \$23 million, you're looking at an
22 approximate value range of \$10 to \$12 million on a
23 fairly boring business, and more in an exciting one.

24 Also I do agree with Mike very much on the fact
25 that -- as a matter of fact the exact numbers are there are

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1 estimated to be 42,000 middle market businesses disposed a
2 year between 2011 and about 2029. So there's a huge market
3 out there.

4 But these are not small businesses. In respect to
5 small businesses, 80 percent of the businesses in the United
6 States are in fact small businesses, by anyone's definition.

7 I think they're well represented by the state
8 regulations. The various states regulate them in different
9 fashions, ranging from business broker licensing to real
10 estate to several other permutations I've seen.

11 That business brokerage community that represents
12 these people is very skilled, very needed, and serves a
13 really good purpose. And as Mike said, yes, I have no
14 interest in representing that community at all, because they
15 couldn't afford to pay my fees.

16 But when you're talking about a \$10 million
17 evaluation, then I will tell you -- and here Mike and I part
18 a little bit -- that there are hundreds and hundreds of
19 registered broker-dealers that would love to do this.

20 Now on the other hand, this has been a changing
21 phenomena for the last several years because admittedly into
22 the late '90s most broker-dealers operated under the radar
23 screen as unregistered, but with the very steady migration
24 towards registration, you're accomplishing two things.

25 First of all, I am very much in agreement with Mike

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1 with respect to the fact that the licensure examinations
2 required are just inappropriate. There's a very small amount
3 of it that's appropriate. I don't think it's at all
4 unreasonable to request somebody representing a \$10 million
5 or a \$20 million transaction to have some familiarity with
6 the securities laws, if for no other reason to avoid doing
7 things in connection with those transactions that violate
8 those securities laws.

9 But I don't think that you need to necessarily
10 create a different class of broker-dealer to do this. What
11 you really need to do is take the Series-7 examinations and
12 add 15 or 20 questions. Now if I really had my druthers, I'd
13 also eliminate about 50 or 60 questions.

14 But a lot of it is good fundamental material.

15 Anybody that wants to represent a \$10 or \$20
16 million business needs to be familiar with the securities
17 laws. The second distinction I think Mike made, and I'm very
18 much in agreement with, and that is that the distinctions are
19 wholly artificial in respect to an asset versus a stock
20 transaction.

21 If anybody wants to, out on the wall I happen to
22 notice is the prelude at least to the '33 Act. And the '33
23 Act that uses terms something like a "claim on a business
24 interest", something to that effect.

25 In the '34 Act it just deals with the exchanges.

1 We'll, these things are not done on exchanges. But they
2 could arguably be rationalized as a claim on a business
3 interest, maybe because of the 1985 Supreme Court case that
4 kind of posed problems for the regulators and this whole
5 issue.

6 The thing to do is make all these transactions
7 securities transactions rather than try to make an artificial
8 distinction between an asset and a stock deal. I think where
9 Mike and I principally differ -- we agree on 90 percent of
10 the things -- is that I would not want to see a lower
11 class of broker-dealer. By "lower class" I mean here less
12 regulated or less examined, representing \$10, \$20, \$30
13 million transactions when there are plenty of registered
14 broker-dealers out there that would hunger for these
15 transactions.

16 It's just not true that they don't take them on.
17 Now Mike, obviously your background and exposure is different
18 from mine, and so you're entitled to disagree with me, but
19 you can't mention it. No, I'm teasing.

20 Mike, do you have a rebuttal?

21 MR. YADLEY: Any further comments, Mike?

22 MR. RIBET: I will say as President of MBBI, which
23 is the midwest business brokers' organization, that we do
24 have a few broker-dealer organizations, but that most of the
25 intermediaries within our organization who represent business

1 owners whose sales are I would say believe \$50 million are
2 not broker-dealers, and most of the talent that's available
3 to the business owner community is in the category of
4 unregistered.

5 And that's why I think, as we'll hear what Shane
6 has to say about the proposed regulations, why we think
7 they're so important.

8 MR. YADLEY: And that is a perfect introduction and
9 invitation to Shane Hansen to please go next.

10 MR. RIBET: I just want to mention that everyone
11 should wish Shane a Happy Birthday.

12 (Laughter.)

13 MR. HANSEN: Thank you.

14 (Applause.)

15 MR. HANSEN: Thank you.

16 Well, thank you, Greg.

17 And to put it in context, as Dennis says, 42,000
18 transactions a year I think has been quantified as something
19 in the neighbor of \$10 trillion in the course of the transfer
20 of wealth from the baby-boomer generation to the next.

21 The idea is finding a workable solution, because
22 while there may be a few, maybe a hundred broker-dealers who
23 you said, Dennis, might be interested in this, there are
24 literally thousands of M&A intermediaries out there, who are
25 today doing the same activity and are not regulated.

1 And for a number of reasons.

2 And so as we approach the finding a solution to
3 this, we looked at a number of different places. First the
4 Alliance of Merger and Acquisition Advisors, a national trade
5 association of professional intermediaries, looked to the
6 ABA's report, which came out in 2005, as Faith had said, that
7 called into question, "Do we really need this system of
8 regulation for M&A intermediaries?"

9 Because as Denise points out, that there just
10 aren't the number of complaints and issues out there
11 involving this. In fact, historically it's been a very low
12 level of complaint or of problem involving mergers and
13 acquisitions.

14 And I might note that that is largely because in
15 many transactions there are lawyers involved, together are
16 accountants involved, there are a number of financial
17 advisors involved in the transactions, and generally
18 involving sophisticated people who have been in the business
19 for a significant period of time.

20 Secondly in approaching the solution we might look
21 at the recommendation of the SEC's advisory committee, that
22 Faith also mentioned. And I'll quote it for you, Faith.
23 "The recommendation was to spearhead a multi-agency effort to
24 create a streamlined then NASD registration process for
25 finders, M&A advisors, and institutional private placement

1 practitioners."

2 Finally, as Greg points out that in the course of
3 the last at least three years, it has been a recommendation
4 of the forum that there be developed a system of -- I'll call
5 it "right regulation" of M&A intermediaries. Ultimately it
6 comes down to finding a balance between the protection of
7 investors, but also making sure that they have the services
8 available that they need, as Mike points out. And ultimately
9 the current regulatory environment is ultimately -- I'll call
10 it a false sense of security -- because literally thousands
11 of intermediaries are operating without even being on the
12 radar screen.

13 And that's largely because the system of regulation
14 makes no sense to someone in the industry. It does not
15 regulate the same activity, it just -- you just, as you go
16 through the process, find nothing of it relevant, very little
17 relevant to what the current activity is of an M&A
18 intermediary. And so finding the right balance of protection
19 was where we started when we started developing a rule-making
20 proposal.

21 And the proposals are really twofold. One is to
22 create a federal exemption for M&A intermediaries, and with
23 that coupled a coordinated exemption -- and well a
24 coordinated system of regulation at the state level.

25 In proposing this, we've really followed a model of

1 regulation that exists today, actually as mandated by
2 Congress, in the investment advisor world. And that is to
3 say the large advisors are regulated by the Securities and
4 Exchange Commission. The smaller advisors who have a more
5 state-specific or state local practice are regulated at the
6 states.

7 And that system works very well in allocating
8 scarce regulatory resources between large advisors and
9 smaller ones. So in proposing this in the rule-making, we
10 have sought to try to allocate those resources in a way that
11 made sense, and to actually enhance the protection of
12 investors because as pointed out, people who are getting
13 ready to sell the businesses are ultimately in the same
14 classification as seniors, that is a significant regulatory
15 concern.

16 Ultimately these are business owners whose largest
17 investment is being sold, and they are preparing for
18 retirement. And this is exactly the type of individual that
19 we want to protect. And in developing the rule-making
20 proposals, we've built in a number of considerations that are
21 designed to do exactly that.

22 The key features of the system, as I say, largely
23 involve an exemption at the federal level, which would also
24 include an exemption from FINRA membership, with a
25 coordinated state level system of regulation.

1 The idea would be that at the state level, the
2 individual firms would file a registration with the state
3 that would include the individuals who are employed by the
4 firm.

5 And so it would put on the radar screen both the
6 firm and the individuals, so that the regulators are aware of
7 who they are. And it would allow for the ability to do a
8 background check on the individuals to be sure that there was
9 not a bad boy or a bad girl in the firm.

10 It also would require a disclosure document that
11 would describe the firm, describe the services, describe the
12 people, describe any conflicts of interest that the firm
13 might have in performing those services.

14 This is a feature of current broker-dealer
15 regulation that does not exist today. And we believe that
16 this is from a professional standpoint an important
17 disclosure that should be provided to prospective business
18 owners, both sellers and buyers, to understand the single
19 largest transaction that they are about to embark upon.

20 It would require a written engagement letter that
21 would spell out the terms and conditions. It would require
22 simplified business records that are related to the activity.
23 It would require a compliance manual that explains how we go
24 about complying with federal and state securities laws, which
25 really addresses Dennis' point that you really do have to

1 understand what those requirements are, and you need to it in
2 a way that explains how we go about it.

3 So that would be a key component of the proposal
4 that we have made. And like current regulation of
5 broker-dealers, you would be required to have a complaint
6 file, so that if a regulator came in, and did an exam, which
7 they would continue to have authority to do, one of the first
8 things they might look at, as they do today, would be the
9 complaint file, and how did the firm respond to those kinds
10 of complaints?

11 The proposal would also include and define a number
12 or prohibited business practices, but relevant ones that are
13 in the context of mergers and acquisitions.

14 Today there exists plenty of guidance about what
15 constitutes an abusive sales practice in a retail securities
16 environment. None of these are relevant in the context, as
17 Mike describes, of the sale of a business. So we have in the
18 proposal put together some specific practices that would be
19 unethical, abusive sales practices, and would be prohibited.

20 And so the proposal has been drafted up in the
21 form of a proposed SEC rule, along with model state rules
22 presented to the SEC. And we have worked with Kristina
23 Fausti at the SEC staff, and we have also worked with Denise
24 Crawford for NASAA with the finder's project group, to
25 present the proposals, and have been appreciative of their

1 receptivity to considering the proposed rule-making.

2 MR. YADLEY: Thank you very much, Shane.

3 Let me remind those physically in the audience in
4 Washington that if you'd like to join one of the other
5 breakout groups, a member of the staff will escort you.
6 Just go to the back of the room and otherwise, we'll keep
7 going. And we have now transitioned into the private
8 placement broker, M&A broker breakout group. So thank you,
9 Shane.

10 Perhaps we could get from Kristina reactions to the
11 proposal at the federal level and following that Denny from
12 the state level.

13 MS. FAUSTI: Thank you. I'm going to be as brief
14 as possible, because I definitely want to preserve as much
15 time for us to actually get into the breakout discussion that
16 I know will lead to recommendations.

17 I think from one standpoint, as grateful as we were
18 for the ABA report, we were also very grateful for the
19 recommendations that came out of the AM and AA proposal, and
20 you know, certainly thank Shane and his colleagues and team
21 that have been working with him.

22 I think, you know, our hope at the staff level is
23 certainly to continue the dialogue that we have had and to
24 take that proposal and maybe give it a little bit more shape
25 that the Commission could ultimately consider.

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1 I think a lot of you have heard me say before from
2 the staff point of view we do sort of view the private
3 placement broker issue first in the queue with M&A right
4 after it in the queue, just from a matter of standpoint that
5 the ABA did come out in 2005, and was first.

6 But with that said we definitely are always
7 considering the M&A issues in the back of our head. And also
8 if we were to go with an exemptive approach or you know --
9 again I don't think B/D-lite is totally out of view yet at
10 the federal level -- we're constantly using what we're doing
11 at the private placement broker consideration level,
12 instructing the M&A level. And fortunate for me, we've
13 actually at the staff level have been able to form a team.

14 So it's really kind of lock step that as we're
15 moving along in the process, as we are vetting internally
16 among our staff, as we're having conversations with NASAA,
17 and we're getting feedback, that's feedback that's also going
18 to be instructive to the M&A process, which is going to go
19 through the similar consideration I already talked about in
20 terms of vetting of alternatives, vetting of cost benefit
21 analysis, and ultimately making a proposal to the Commission
22 and you know, soliciting feed back and answering any
23 questions that come up within this building, as we look at
24 that.

25 You know, and I think some of the potential issues

1 that come up again that we're very cognizant of are again the
2 referral fee issue that we've talked about, where if some
3 exemption was come up, but there were still some things that
4 would be considered to be broker-dealer activity, that would
5 require the full broker-dealer registration, that issue of
6 broker-dealers being able to share their fees, I think could
7 come up in this context as well. And so that's something we
8 want to keep on the radar.

9 Other issues that come up are, you know, the
10 compensation. In the M&A world, compensation from a
11 standpoint of -- we talked about transaction-based
12 compensation, but what about compensation in the form of
13 securities, and do those raise any issues in this area?

14 And then also again, getting back to which was
15 alluded to a little bit by the other panelists: Business
16 size, transaction size, and how cognizant do we need to be of
17 this especially since we've heard the differing points of
18 view on whether there is a market for certain transactions or
19 not.

20 So with that said, this is also an area staff is
21 actively considering. We've enjoyed the conversations we've
22 had. We've had smaller conversations, I should say, with
23 NASAA staff, but it's something that we've definitely, you
24 know, tried to vet as much as we can, but we want to move
25 that private placement proposal forward first, and then that

1 just we feel sets us up perfectly to then say, "Okay, here's
2 this M&A issue," and the Commission be able to deal with
3 those issues fairly quickly once it was ready.

4 MR. YADLEY: Denny, let me give you a question that
5 we received from the Internet, because I think it will
6 probably be part of your response. But let me ask it.

7 One of our participants said that Kristina
8 mentioned that you're not quite ready to make a
9 recommendation to the Commission yet, and particularly
10 whether there might be an exemption.

11 So the question is, how many states might be ready
12 as a practical matter, to deal with a federal exemption? And
13 if there really aren't too many or if there are too many, how
14 will this affect whether broker-dealer lite may be the better
15 path? In other words, what if the SEC in fact does say, okay
16 we're exempt at the federal level, it's up to you, states,
17 we'll work with you." How many states do you think really
18 would be on board?

19 MS. CRAWFORD: A good question.

20 It's been my experience through the years that you
21 can never get all 50 states. However, it's also been my
22 experience that you don't necessary need all 50 states. Some
23 states have a lot more activity than others. You need those
24 states that have a lot of activity. And then you can make
25 adjustments for the other states.

1 One thing that is fundamentally different about the
2 M&A issue as compared to the private placement broker issue,
3 is that the former is much more complex. When you're talking
4 about the M&A issuers, and in particular when you're
5 talking about line-drawing, there was an analogy made to the
6 investment advisor regulation as between the federal
7 government and the state governments.

8 In the investment advisor area, just to review very
9 briefly, if you have less than \$25 million of assets under
10 management, you fall under the state regulatory purview. If
11 you have more, you fall under the federal regulatory purview.
12 Well, what that means as a practical matter is that the
13 federal government has the big ones but they tend to have
14 less problems.

15 On the state level the investment advisors, we have
16 many more that we are responsible for regulating, and they
17 tend to be the ones with the most problems. One of my
18 concerns with the M&A approach is that if you draw a line and
19 you give the big ones, as it were, to the SEC, those are the
20 ones that are going to have the least amount of problems
21 because you're going to have more sophisticated businesses
22 that are involved, they're going to be lawyered up. And the
23 firms involved are probably going to be much more
24 sophisticated.z

25 Compare that to the situation that we'll have with

1 the smaller entities. You'll have the smaller businesses,
2 you'll have those that are less lawyered-up, and you will
3 have those firms that have less experience by and large.

4 So I'm not saying that this is necessarily a killer
5 point. By no means is it a killer point. I just mean that
6 it causes the states to have to think about this a lot harder
7 and come to some good conclusions about how we want to handle
8 all of this.

9 There was mention made by one of the panelists of
10 sort of having the inferior, or the second team. You can
11 well have a situation develop where the states are regulating
12 all the second teams, and the SEC is regulating, you know,
13 the first string. Again, that's not necessarily a killer
14 point. It's just that from the state perspective, we have to
15 think a little harder about how we would deal with that.

16 I think that a whole lot of good work has been done
17 in this area, and I think that the proposal has merit to it.
18 And I certainly and the states believe something has to be
19 done. So we're going to continue to work with the SEC, we're
20 going to continue to work with Shane's group. We're going to
21 continue to work with everybody who has an interest in this.
22 But it is very true that we're less far along on this issue
23 than we are on the private placement broker issue. It's a
24 little further down in the queue.

25 MR. YADLEY: Well, interestingly, one of the

1 questions we have from the audience may make it even more
2 difficult because as you were talking about drawing lines and
3 larger smaller \$25 million for the investment advisor, a
4 question is -- and I guess it's really for both regulators --
5 but would you consider a limit for determining the small
6 business for these purposes at the thresholds set by the FTC
7 under Hertz Scott Rodino? So we're now up at like \$126
8 million a year in assets, or a value of a business of \$252
9 million.

10 So that really takes it out of the \$10 to \$20
11 million you were talking about. And by the way, remember
12 that the advisory committee, the SEC Small Business Advisory
13 Committee, when it looked at what may be small businesses for
14 purposes of some of the reporting regulations in S3 and
15 things like that, were also up into the hundreds of millions
16 of dollars.

17 So I guess maybe that's sort of a general question,
18 you know -- or let me pose it as a more general question.
19 And also Dennis had earlier made the comment about what's a
20 middle market, what's a small business?

21 And so I guess I think any comment you have on that
22 would be appreciated.

23 MS. CRAWFORD: Greg, I'd like to take first shot at
24 this. There is a lot of disagreement in the United States on
25 what constitutes a small business.

1 For some purposes it's, from my perspective, a huge
2 number. When you start talking about over \$100 million in
3 whatever -- business. When I'm at home doing my job as a
4 state regulator, when I think of a small business, I
5 definitely think of something that's \$10 million or less, \$10
6 million of something, or less. I don't know how the rest of
7 you feel about it, but this is a really big question. It's a
8 big question for the Commission, it's a big question for the
9 states.

10 You know, how do you define it? And it's very,
11 very important.

12 MR. ROBERTS: Can I add something to that from the
13 industry point of view?

14 MR. YADLEY: Yes, you may. And then I'm going to
15 have a comment --

16 MR. ROBERTS: Okay. I very much agree with Denny.
17 By the way, my name is Denny from Texas as well. So we've
18 bonded, too, very quickly.

19 There are a variety of definitions of small
20 business. An easier approach is that are fewer definitions
21 of what are called Mom and Pop businesses, and most people,
22 whether they're in the business brokers' world of in the you
23 know, larger business broker's world, normally define that as
24 valuations of about \$1 million on down, and that would be
25 about \$2 million in sales.

1 But Denny's entirely correct. Bank of America
2 describes the middle market as \$25 million and up. Most
3 authors would describe it as between \$5 million and \$500
4 million. But it's very clear the Mom and Pop industry are
5 the \$1 million and down in value, \$2 million in sales.

6 I mean they represent 80 percent of the U.S.
7 businesses. These are the corner dry cleaners, and you know,
8 the true Mom and Pop businesses. But they are 80 percent of
9 our economy.

10 MR. YADLEY: My comments, really a question for
11 those in the audience here.

12 We've sort of gone through the break. Feel free to
13 take your own natural break as you wish.

14 Part of the thought that the staff had with the
15 breakout group is that everybody gets to participate and it
16 can be a little more free-form and less formal than it is
17 now. Some of us are sitting up on the podium, some of you
18 are in the audience. We're going to have a lot of people
19 come back at 4:45.

20 Is this an okay format? And maybe we can raise
21 hands and talk less formally. There is a breakout room, if
22 people would like to move. Are we okay with stay in here and
23 maybe move up to the front if you'd like, and then we can get
24 a few more direct questions.

25 One question, this is --

1 MS. FAUSTI: I'm sorry, I just want to interrupt
2 and I wanted to weigh in on the size of a business especially
3 since it was mentioned, another agency's definition of a
4 small business.

5 As I mentioned, our experience from CBI, where we
6 turned to another federal agency's definition of a small
7 business turned out not to be the best method because you're
8 always -- each agency has different goals, and has different
9 things it's trying to achieve with coming up with
10 definitions.

11 That's not to say that it can't be instructive. My
12 own approach has always been to first look to what we have in
13 the SEC regulations. Well, that's become a little bit
14 stickier for a couple of reasons.

15 You know, on the CorpFin side, the corporation
16 finance side, we've gone from what we used to, to a small
17 issuer to a smaller reporting company. We also have numbers
18 that are where we've defined a small issuer or a small
19 business, but when you're looking at those numbers, you have
20 to look at, okay, what year was that number set? Is that
21 number adjusted for inflation, or not adjusted for inflation,
22 and what does that number really mean in today's terms?

23 So those are a lot of considerations that go into
24 thinking about whether you want to define a small business.
25 But we definitely want to start at home, and then start

1 looking outward at definitions, and you know, having this
2 process and doing a breakout like this.

3 You know, we definitely like the feedback, but I
4 just wanted to give you, from the federal perspective, how a
5 lot of times when we're looking at numbers -- because the
6 question that's going to come up to us when we make a
7 recommendation is, we'll wait, there are other definitions in
8 our rules and regulations. Why don't those fit for your
9 model? And we have to be able to answer those questions.

10 MR. YADLEY: Yes. So again, some of you may have
11 not been at past forums. When everybody gets back here,
12 we're going to try and condense and consolidate people's
13 views of the day. It won't be the last chance to make
14 suggestions, but ultimately what happens here will find its
15 way in a formal report to the Commission.

16 So maybe I can suggest that we keep doing what
17 we're doing for about 15 minutes, and then after that we can
18 start getting to the proposal stage.

19 PLENARY SESSION TO DEVELOP NEXT STEPS

20 MR. LAPORTE: Okay. So what we hope to do here is
21 have the moderators from the breakout groups read the
22 recommendations that they came up with and then agree on some
23 method of putting the recommendations together and delivering
24 them in a final report to the Commission.

25 So I don't want to overdo my role here. Greg, do

1 you want to sort of coordinate the reports from the
2 moderators?

3 MR. YADLEY: Sure. And the moderators are up on
4 the panel, I assume? Jack and Brian, and you guys are the
5 other three?

6 Okay. And Jack, you want to go first?

7 MR. HOGOBOOM: Sure. Happy to.

8 All right. Our breakout session involved capital
9 formation for smaller public companies. And here are our
10 recommendations:

11 Eliminate the listed company requirement for S-3
12 eligibility. Eliminate the 33-1/3 Market Cap Text for S-3
13 eligibility. Permit forwarding corporation by reference for
14 S-1 registrants. Provide relief to smaller community banks
15 by increasing the 12(g) thresholds for banks. Increase the
16 12(g) acid test to \$100 million.

17 Exempt companies with assets of less than \$100
18 million in assets from Section 404(b) of Sarbanes Oxley.
19 Consider adding certain market information such as securities
20 ownership by institutions, shares registered, aggregate short
21 positions, et cetera, to the 21st Century disclosure
22 initiative. Provide better guidance on other than temporary
23 impairment under FAS 157 that recognizes that even temporary
24 impairments can be long-lasting.

25 The staff should apply Rule 415 on a facts and

1 circumstances basis without giving undue weight to the number
2 of shares being registered. The staff should adopt the
3 rule-making recommendations in the letter by Feldman
4 Weinstein that was signed by a number of other firms. Treat
5 pick interest the same as pick dividends for Rule 144 tacking
6 purposes. And apply the Sarbanes Oxley 404(a) one-year grace
7 period for newly public companies to companies that go
8 through reverse mergers.

9 MR. YADLEY: Thank you.

10 Brian Borders?

11 MR. BORDERS: Thanks, Greg.

12 I'm reporting on behalf of the Private Securities
13 Offerings Breakout Group. I'll thank my described Tony
14 Barone and he can tell me if I'm saying anything that I
15 shouldn't be saying here.

16 We have six recommendations. They may sound like
17 oldies but goodies in that we're reiterating some
18 recommendations that have been made before by both this forum
19 and by the small business advisory committee.

20 First, part of our recommendation No. 5 from last
21 year's forum, which was to support the Commission's proposed
22 new rule 507 of regulation D establishing a new exemption
23 permitting limited advertising.

24 In addition, we recommend that the integration
25 period following a proposed Rule 507 offering be reduced from

1 90 days to 30 days.

2 We also support a portion of recommendation No. 11
3 from the Small Business Advisory Committee report, which is
4 to adopt a new private offering exemption from the
5 registration requirements of the Securities Act, that does
6 not prohibit general solicitation and advertising for
7 transactions. And this is key alliance with purchasers who
8 do not need all the protections of the Securities Act
9 registration requirements, really taking the Rule 507
10 proposal and the philosophy behind that and making continued
11 progress toward elimination of the general solicitation
12 prohibitions.

13 Number three, following somewhat from the
14 discussion in one of the panels this morning, is to modify
15 the rules so that you do not count accredited investors,
16 large accredited investors or QUIBS in the 500 shareholder of
17 record calculations under 12(g) for purposes of becoming a
18 public company.

19 We had a good discussion of two or three examples
20 of where that 500 count probably causes unintended
21 consequences in a variety of contexts, reorganization and
22 bankruptcy where debt-holders become equity holders. And
23 also the circumstance that Steve Bockner discussed this
24 morning of the potential for a new market for privately held
25 securities where the ability to create such a market is

1 fairly limited by the 500 shareholder limitation.

2 Our fourth recommendation is a direct repeat of
3 last year's forum recommendation No. 3, from the reg-D reform
4 proposal, and that is to shorten the integration safe harbor
5 in reg-D from six months to 90 days.

6 Recommendation number five today was the forum
7 recommendation number four last year, which is to support the
8 addition of the proposed \$750,000 investment based test as an
9 alternative means of qualifying as an accredited investor.

10 Our final recommendation is that the Commission
11 should consider extending Rule 144(a) beyond QUIBs to other
12 classes of purchases who do not need the full protections of
13 Securities Act registration.

14 Thank you.

15 MR. YADLEY: Thank you.

16 Tax breakout group, Dillon Taylor?

17 MR. TAYLOR: Thank you.

18 We have quite a few recommendations this evening,
19 so I'll try to go as quickly as possible so as to not put
20 anybody to sleep.

21 First we discussed simplifying the home office
22 business deduction, including permitting de minimis personal
23 use and permitting a standard monetary deduction to make the
24 deduction easier for home office owners to use.

25 Number two, removing cell phones and computers from

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1 the listed property requirements.

2 Number three, adjusting the definition of luxury
3 automobile, adjusting the limit there to \$35,000 and indexed
4 for inflation.

5 Number four, equalization of health insurance for
6 small businesses.

7 Number five, AMT relief.

8 Number six, increasing the deductibility of
9 business meals to 100 percent.

10 Number seven, reforming estate tax, including
11 combining estate and gift tax exemptions, portability, and
12 increasing the exemption amount to \$5 million.

13 Number eight, making permanent the current Section
14 179 expensing limits of \$250,000.

15 Number nine, suspending the application of FIN 48
16 to private companies until there is a consistent definition
17 and treatment of the definition of contingent tax
18 liabilities.

19 Number ten, dealing with business activity taxes.

20 There is currently no definition on the federal level at
21 least of nexus of state activities. We'd like to see this
22 issue elevated to the federal level so that different state
23 governments and courts aren't defining this issue in
24 different various manners.

25 Number 11, mandatory e-filing. Businesses should

1 be allowed to paper file if their e-filing of the return
2 didn't transmit, and there are still I guess various bugs in
3 the IRS system if a certain item isn't identified properly or
4 certain forms can be e-transmitted but other ones can't.

5 Number 12. Incentive investor groups that help
6 small businesses, provide some sort of special tax treatment
7 like a credit for initial investors in the start-up entity as
8 defined under state statute.

9 Number 13. Captive business insurance companies,
10 currently the limit is only \$600,000 to capitalize certain
11 captive business insurance companies. We recommend raising
12 that limit to \$10 million.

13 And finally number 14. Encouraging a carve-out of
14 one of the new stimulus packages that we're sure are going to
15 be discussed in the next few weeks if not next few months.
16 We'd like \$100 billion carve-out to be allocated for SBA
17 guaranteed loans, including paying for all the SBA fees
18 associated with those loans.

19 Thank you.

20 MR. YADLEY: Thank you very much.

21 There was also a private placement broker M&A
22 broker breakout group, had a very lively discussion that was
23 facilitated by a representative from the Division of Trading
24 and Markets, Kristina Fausti, who is intimately familiar with
25 the issues and working on proposed rules or exemptions as we

1 speak. And Denise Crawford, who is the Securities
2 Commissioner from the State of Texas, the incoming President
3 of the North American Securities Administrators Association.

4 Following discussion we have four recommendations.
5 Three are the same as last year. One recommends that the
6 Commission take the lead in adopting rules in coordination
7 with the states to provide a federal exemption for
8 intermediaries who assist in the sale of businesses, M&A
9 transactions, and then working with the states to have a
10 simplified registration system.

11 So, exemption at the federal level and limited
12 regulation at the state level along the lines of some proposed
13 rules that have been drafted by a number of interested
14 parties and associations of M&A intermediaries.

15 Second, that the Commission adopt rules recommended
16 by the ABA's 2005 Task Force on private placement
17 broker-dealers to facilitate capital raising by small
18 business owners as well as perspective buyers.

19 Third, that private placement brokers be allowed to
20 raise capital and receive compensation through private
21 placements only to accredited investors where the investors
22 are acquiring securities with a value of not more than 10
23 percent of their net worth, excluding their residence, full
24 disclosure of the broker's compensation in transactions of no
25 more than \$10 million. Although there was some feeling that

1 that ought to be \$20 or \$25 million.

2 And then, last, provide an exemption from the
3 definition of broker-dealer for finders in the pure sense and
4 coordinate with the states to implement that exemption at the
5 federal level. Thank you.

6 MR. LAPORTE: Did any of the groups make any
7 attempt to prioritize the recommendations?

8 (Laughter.)

9 MR. YADLEY: We have four priorities in our group.

10 MR. LAPORTE: Okay. Because this was one of the
11 issues that we had a few years ago, and we had, up until, I
12 think we had sort of solved that.

13 One year we had the voting machines where people
14 could do that, and we got away from that, and last year I
15 think most of the recommendations went to the pending
16 releases, so the issue didn't arise. But now we're sort of
17 back to where we were three or four years ago. And we have
18 this prioritization. So it's difficult for the Commission
19 to, you know, take a list of --

20 MR. BORDERS: Jerry, my group would be happy to
21 assign, you know, number one through six to our
22 recommendations.

23 MR. LAPORTE: Well, that's what I'm wondering,
24 because it really makes it much easier for the Commission to
25 you know, have some prioritization.

1 I mean, maybe it could be done within the
2 different, you know, groups.

3 MR. HOGOBOOM: I don't think that would be a
4 problem. I'd be happy to circulate a proposal to the people
5 that were in our group and get some feedback from people
6 before we finalize it.

7 MR. LAPORTE: Yeah. Anyway that's just a
8 suggestion before we decide what our next step is going to
9 be.

10 MR. YADLEY: Yeah. You have e-mail addresses for
11 everybody who signed up.

12 If anybody is still listening on the webcast, please
13 send in to the site at I guess the first website address, or
14 either web address that Gerry LaPorte gave earlier in the
15 day, and let us know who you are and which breakout group you
16 wish you could have participated in.

17 MR. LAPORTE: I think the webcast went off a couple
18 hours ago, didn't it, Tony? Yeah. Okay.

19 MR. HOGOBOOM: My mother's still listening.

20 (Laughter.)

21 MR. LAPORTE: But Greg, do you want to talk about,
22 are we going to appoint an executive committee this year?

23 MR. YADLEY: Yeah --

24 MR. LAPORTE: I'm not sure we need it, if we have
25 sort of four different groups and each one is going to

1 prioritize within their group.

2 MR. YADLEY: Yeah. I think if I could ask my
3 colleagues on the podium, if you would continue to work to
4 coordinate language and information from your groups and
5 maybe as a first step to that, if anybody in the audience
6 disagrees with anything any of the four of us said or wishes
7 to provide clarification of what we intended to say and
8 artfully did, that you'd like to say now, that would be
9 great.

10 Mike?

11 QUESTION: (Away from microphone.)

12 MR. YADLEY: No. But only because I forgot. There
13 was a no-action letter, Country Business, Inc., that dealt
14 with whether transaction-based compensation could be received
15 by an unregistered broker in connection with the sale of a
16 business. And I think there were 13 items that were listed.

17 So it's only a no-action letter, so we'd ask that
18 the staff codify that. Thanks.

19 Other comments from the audience?

20 (No response.)

21 MR. YADLEY: If not, we will send you the
22 recommendations as we have them drafted, and give you a
23 reasonable period to respond.

24 One of the things that I know has been a little
25 frustrating for Gerry and Tony and their offices, that we

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1 volunteers go back to work, and they're waiting for us to get
2 the information to them.

3 We actually did a pretty good job last couple
4 years, but with the new Commission coming on, even though the
5 holidays will be upon us, let's all pledge to ourselves to
6 get this stuff done quickly, so the staff can do their job.

7 Anybody have anything else for the good of the
8 order? You can see that one of the things we did since last
9 year was we did respond to everybody's comments. That
10 luncheon didn't work last year, nobody could hear the
11 speaker, so we got rid of the lunch and the speaker, saved
12 you \$75 or something like that.

13 So if you think that was okay, let us know. If you
14 have other ideas for a luncheon, recognizing that it's hard
15 to do something in this boardroom and the Commission can't
16 charge and things like that, let us know.

17 MR. LAPORTE: Yeah. Let me just say we did have
18 complaints from people about not having a lunch, okay. So
19 people feel very differently. Some people feel very strongly
20 that we should have one, some people feel strongly that we
21 shouldn't have one.

22 So this year we decided to try not having one. It
23 meant a lot less work for us. So we'll see, you know, what
24 other comments we get from people when planning this for next
25 year.

1 QUESTION: How do you set the date for this --

2 MR. LAPORTE: Yeah. In past years we thought we
3 were limited to -- we have to hold it annually, and we had
4 interpreted that to require that we hold it every fiscal
5 year, and the government's fiscal year ends on September the
6 30th. So we always thought we had to have it, before the end
7 of the fiscal year.

8 This year a suggestion was made to hold it today
9 actually, and that suggestion was made on the basis that the
10 American Bar Association's Business Law Committee meets in
11 Washington. Their meeting starts tomorrow, so it was thought
12 that at least one year why don't we try holding it today?

13 And there are some people here who were able to
14 attend, who otherwise wouldn't be able to attend, because
15 they come for two meetings as opposed to one.

16 On the other hand, we didn't want to make this
17 totally a lawyer's meeting, you know, and so we didn't really
18 publicize the fact that we were holding it in conjunction
19 with a meeting of lawyers. We didn't want the lawyers to
20 necessarily dominate.

21 I am a lawyer, by the way, so -- but so we thought
22 this was something that we could try this year. Next year I
23 think we probably will have a little bit more flexibility.

24 Part of this is a budget issue, okay? We told our
25 budget people that we might hold two within one fiscal year.

1 That's this one today, and we might hold one before next
2 September 30th. And they said, "Well, that's okay."

3 Actually we've gotten the cost down pretty low, so
4 I'm not even sure what makes any difference to them any more.
5 I mean not intentionally but we just got rid of a lot of
6 the -- you know, I don't know, some of you who were here
7 maybe seven or eight years ago may remember that at one time
8 the SEC subsidized people's hotel rooms. Okay?

9 And so we don't do that any more. And so I think
10 we have a lot of flexibility. We do have a planning
11 committee and we have a planning committee call in the
12 spring, when we talk about available dates.

13 So I think, you know, probably next spring some
14 time. I don't know exactly how we're going to constitute the
15 planning committee next year. We could even do something I
16 think about maybe sending out -- this is a dangerous
17 suggestion, because we are subject to strict limitations on
18 what kind of questionnaires we can send out, because we're
19 not supposed to require people to provide us with
20 information.

21 Our general counsel's office could get very mad at
22 me for even suggestion this, but it's possible that we could
23 send out some sort of a satisfaction survey or something like
24 that and ask people when they would like to have it, because
25 certainly in my judgment, you know, we want to have this when

1 people want to come.

2 Now some people I know -- it was in one of the
3 groups where they didn't like the cold weather in Washington
4 the last couple days, especially people from Florida and
5 California. I don't know if they brought heavy enough coats.

6 This is unusually cold for Washington, even in
7 November. But you know, we can't control that. But we could
8 perhaps try to hold it in October if people would like to
9 come in October. I don't know.

10 Ann?

11 QUESTION: (Away from microphone.)

12 MR. LAPORTE: Yeah. That's something that we're
13 always open to. We did do it I think three years ago in
14 California.

15 There is a desire among a lot of people, they like
16 to come to the SEC. It's easier to get SEC staff people to
17 come here. This year we have the chairman here, which I
18 think is important, even though the chairman couldn't stay
19 for any of the roundtables. Getting the chairman to come
20 here, see that we have a whole lot of people here who are
21 interested in this, knowing that, you know, we have people on
22 the web -- the last couple years we've got several hundred
23 hits on the website for this -- I think helps small business.

24 Just coming here and you know -- so I think there's
25 benefit to the attendees to be able to interact with more SEC

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1 staff. There's a benefit to small business in general that,
2 you know, the people in the building see that, you know, they
3 see signs around, so it helps our profile at the SEC to
4 actually meet here.

5 So there's a lot of different considerations. I
6 know there is a consideration that not everybody can come to
7 Washington for this, so that's something that we'll talk
8 about in the planning committee meetings next spring.

9 Yes?

10 QUESTION: (Away from microphone.)

11 MR. LAPORTE: Yeah. Actually we used to do that,
12 and then nobody seemed to care about that. So we stopped you
13 know, doing that. It's not that much work, but it is a
14 little -- the feedback we were getting from people is that
15 well, nobody, people just go to Travelocity or Expedia and
16 get the cheapest room anyway.

17 So I think we had arrangements with some hotel, and
18 they said a couple years ago that nobody booked through them.
19 So we just gave that up because we thought we were doing work
20 that you know, nobody cared about and nobody took advantage
21 of.

22 But if people care about that, you know, maybe we
23 can look into, you know, setting up that type of arrangement.
24 It doesn't take that much work, that's true.

25 MR. YADLEY: I've got a bunch of yellow cards and

1 there may still be some out in the front, but if you have any
2 other suggestions, please fill one out, give them to us. And
3 then I think there's a little reception area for us at B.
4 Smith's?

5 MR. LAPORTE: Yeah. I think people are just going
6 to gather over there, and I think we told them that we may
7 have some extra people. So I don't know if they'll even have
8 an extra bartender. But there's usually, you know, space for
9 people --

10 QUESTION: Can we go now?

11 MR. LAPORTE: Yeah. Everybody's invited to B.
12 Smith's. Oh, cash bar.

13 MR. YADLEY: So thanks again to the entire Office
14 of Small Business and Division of Corporation Finance and
15 Trading and Markets, and -- for spending almost the whole day
16 here. We appreciate it, all of you and thanks to the
17 participants.

18 MR. LAPORTE: Yeah. We really appreciate everybody
19 coming, because I meant it this morning when I said that we
20 appreciate your insights and your experience, it really makes
21 us able to do a much better job, having this forum and having
22 the benefit of everything you tell us on this day.

23 Thanks.

24 (Whereupon, at 5:24 p.m., the meeting was
25 adjourned.)