U.S. SECURITIES AND EXCHANGE COMMISSION

TRANSCRIPT OF

THIRD MEETING OF

ADVISORY COMMITTEE ON

SMALL AND EMERGING COMPANIES

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

Multipurpose Room, LL-006

Wednesday, February 1, 2012
10:00 a.m.

PARTICIPANTS

Advisory Committee Members:
Stephen M. Graham, Co-Chair
M. Christine Jacobs, Co-Chair
A. Heath Abshure
David A. Bochnowski
John J. Borer, III
Dan Chace
Milton Chang
Joseph (Leroy) Dennis
Sean Greene (attended afternoon session)
Shannon L. Greene
Richard L. Leza
Paul Maeder
Karyn Smith
Charlie Sundling
Timothy Walsh
Gregory C. Yadley

Advisory Committee Members Not In Attendance:

Kara Jenny Goldstein

Steve LeBlanc

Kathleen McGowan

SEC Personnel:

Mary Schapiro, Chairman

Meredith Cross

Brian Croteau

Bradley Gude

Kathleen Hanley

Vladimir Ivanov

James Kroeker

Gerald Laporte

Craig Lewis

Lona Nallengara

Elizabeth Sandoe

Josephine Tao

Jennifer Zepralka

Invited Speakers:

Kate Mitchell

Joel Trotter

Stephen Graham: Okay, well, welcome everyone. This is nice to see familiar faces. Good to meet new ones. I'm assuming that someone did the math and we have a quorum.

Gerry Laporte: Yes, sir.

Stephen Graham: All right. Well, welcome to the Committee members. Welcome to the staff, and again, thank you very much. I think the Committee owes a debt of gratitude to all the work that the staff does do on our behalf, and we thank you for that. Commissioner Gallagher was going to join us, but I guess not yet. Okay. So you guys let us know when he arrives. Okay.

The first thing I want to do is just review the agenda for today. We're going to start by spending the morning addressing two proposed recommendations, which by now you've had an opportunity to review. The first one is dealing with Section 12(g) and the so-called 500 shareholder rule, which is shorthand for a bunch of things. The second is dealing with early-stage offerings focusing on revitalizing Regulation A and facilitating crowdfunding in some form. We will, of course, have a discussion and following that discussion we will decide what recommendations to make to the Commission, if any.

As you know, we issued our first recommendation to the Committee last month. We asked for immediate action to relax or modify the restrictions on general solicitation and general advertising to permit it in the context of 506 offerings that are made solely to accredited investors. We'll be hearing from the Commission in due course, but nothing to report on that today. Our thinking with these early recommendations is to work to effect immediate relief at some level, recognizing that the relief contemplated may be incomplete and certainly not comprehensive and also recognizing that early actions may be superseded in the future by more comprehensive action, but we believe that this approach is preferable to waiting months or perhaps even years for some relief while developing something that might be considered more comprehensive. As you know, our reason for being is to help to effect regulatory change that will facilitate access to capital by small and emerging companies, facilitate trading in those securities, and ease the compliance burden on such companies. And in the coming months we intend to develop a comprehensive strategy for accomplishing these objectives and the idea is to, by developing a series of recommendations along the way, that again, if acted upon will effect meaningful change.

After we address the recommendations, we will break for lunch. You are going to be on your own for lunch. I think in your materials before you there are some ideas of some nearby places. We will then reconvene promptly at 2:00. At 2:00 we will be joined by Kate Mitchell, who is one of the managing directors at Scale Venture Partners, and who is also -- just happens to be the chairman of the IPO Task Force. Kate will in turn be joined by one of her Task Force colleagues, Joel Trotter of Latham and Watkins. And they will give a presentation on the work of the Task Force and we all, as you recall, discussed it briefly at our last in-person meeting. And what we will do is, you know, listen to the presentation and this is just like junior high.

[laughter]

This will be an information item and we'll listen, learn, generate ideas for this Committee -- that this Committee might, you know, for action that this Committee might take. After the Task Force presentation we will discuss the next steps and then adjourn. So that is a review of our agenda. Commissioner Gallagher has arrived. Commissioner Gallagher. Ah, there you are. Good. Usually when you've arrived you don't hide behind a post, but it's -- well -- well, welcome. It's nice to have you here. Before we then turn to kind of the work of this morning, which is taking a look at the recommendations that have been circulated, first I would like to acknowledge the chairman of the SEC, Mary Schapiro, and turn the mic over to her for a few remarks.

Mary Schapiro: Thank you very much. I really just wanted two seconds to welcome everybody back to the Securities and Exchange Commission for the second meeting of the Advisory Committee and to thank you for your continued commitment and contribution to the Committee and its great work. As we seek to balance our investor protection mandate with the important task of facilitating capital formation for America's small and emerging businesses, the businesses most responsible, as I talked about last time, for job creation and economic growth, your ideas continue to be an extremely important addition to the process and to our thinking.

So I want to thank you in particular for your recommendation regarding restrictions and general solicitation in the private offering rules. These recommendations will become an important part of the work the Commission and the staff will consider as we work on revisions to the rules in light of the current environment in which we operate, with heavily information technology-based media and communications.

I think today's discussion also will further improve our understanding of the relationship between investor protection and 21st century capital formation. So your insights on capital raising initiatives, like crowdfunding and new Reg A exemptions, and the triggers for public reporting, the IPO on-ramp, all of those will give us further guidance as we consider regulatory revisions in these areas. And as of course you know, this week in particular these recommendations aren't important just to the SEC or to me, but to the president and to Congress as well and I think they will -- they are coming at really the perfect time to have a real influence on the financial environment for years to come. So I'm looking forward to the discussion this morning and hearing your thoughts and ideas and recommendations and again, I really just want to thank you for being part of what is a very important effort. Thanks.

Stephen Graham: Okay, well, thank you, Mary. Anything else? Gerry? Lona? Meredith? Jennifer? Okay. Okay.

Let's turn to the first recommendation, on triggers for registration and public reporting and suspension of reporting obligations. To again set the stage a little bit, just to review, under section 12(g) of the 34 Act, a company is required to become a public company, as you know, without actually going public if it has 500 or more shareholders of record and assets of at least -- assets exceeding $10 million. Also under Section 12(g), generally a reporting company may suspend its reporting obligations if the number of record shareholders falls below 300. Where this leads us is that some private companies may be required to register and begin reporting sooner than desired and at a time that may not be in the best interest of the company or the best interest of the company's shareholders, or companies may be driven to manage their capital raising efforts or their, at least to some degree, their equity compensation policies to avoid registration, which again, may be -- may not be in the best interest of the company or the company's shareholders. In addition, companies that are already reporting companies can go dark if they fall below 300 shareholders of record. And since shares of public companies tend to be held in street name instead of in the name of the beneficial owner, and with private companies the beneficial owner and the record holder tend to be one in the same, you could end up with a result where a privately held company with 500 beneficial owners could be forced to become a reporting company while a reporting company that has 10 times that number in beneficial holders could suspend reporting.

The 500 and 300 thresholds have been in place since 1964. Times have changed. At the time, many public companies whose shares were actively traded were not traded on exchanges and so, as a result, they were not subject to the '34 Act reporting requirements or proxy rules or short-swing trading rules. With section 12(g), the Congress sought to correct that, and Congress had in mind, you know, companies that, again, had sufficiently active trading markets and where the public interest was at such a level that mandatory disclosure was necessary to ensure protection for investors. I'm not sure what the right answer is, but I'm pretty sure I

know what the wrong answer is. I think numbers that are determined in 1964 bear little relevance to today's markets. Most private companies that are confronted with this issue do not have shares that are being actively traded and thus not the intended target of Section 12(g). And the whole concept of record holder has changed. It is no longer a reasonable surrogate for beneficial owner as it was in 1964.

So, then when you turn to community banks and their unique circumstances, I think that that sector has been hit, you know, particularly hard. I do recognize that this is a complicated problem of should we be focused on trading volume or number of shareholders? Should there be different numbers for different industries? How do you count beneficial owners? Do you count employees? Do you count accredited investors? What's the impact of evolving platforms like SecondMarket? And, I know that further study is required, but I would've liked to nonetheless strongly encourage immediate interim relief in the form of raising the thresholds significantly and that's kind of what is on the table this morning. And I think that I'd like to begin the discussion and hear your comments and again, in commenting, think about the extent to what there should be a distinction between the thresholds for community banks and other industries, whether the test should be beneficial owners or record holders, and as far as changing those thresholds to provide for interim relief, and what those numbers should be. So, any -- who would like to begin?

Leroy Dennis: Leroy Dennis. I think you raised some of the questions that I had and I guess I'm a little troubled by the definitive nature of the recommendation. I hear your points about how this provides some interim relief until the SEC can study this situation further, which is really what I think needs to happen, because I really can't sit here and say 1,000 is the right number or beneficial holders are the right number. I would like to say I think the SEC needs to study those two issues. My concerns would be before we go down the road of beneficial owners, do we know that that's not going to put an undue cost burden on smaller companies to determine that number? They haven't had to do that in the past, so does that all of the sudden put a new system in place that they have to be able to track and how difficult that is for them? And I don't know the answer to that. And then I'm a little concerned, you know, if 1,000 is the interim step, what impact does going to 1,000 have? Does that exempt another 1,000 companies or another 5,000 companies? And I don't know that answer. So, I'd be curious as to what impact this interim recommendation would have on the issuers out there and does it satisfy the objectives we're trying to get to?

Stephen Graham: Thank you, Leroy. I don't know what the cost is. Maybe the staff might have some ideas. I think that that's -- backing up a step. Those are just the kind of details that the SEC is going to -- would dive into before issuing any kind of -- before acting on any of our recommendations. And what we need to do is to formulate recommendations that we think are appropriate to correct issues that we think are out there and then the devil, of course, is going to be in the details and a lot of that is going to be left up to the staff. I'm -- I'd only be guessing, but I would imagine that the cost to most companies to determine the number of beneficial owners, I would just guess that it wouldn't be that burdensome. I mean clearly with privately held companies you know who your shareholders are, so it's not an issue coming from that direction.

As far as small public companies are concerned, you know, most of the smaller companies that I have represented, they've had a pretty good sense for how many beneficial holders they've had, because I have represented companies that have been kind of pretty -- kind of coming pretty close to the going dark option and one of the issues there is okay, we're going to go through all this time and effort to deregister, what happens if these -- if the brokers just suddenly just kind of, you know, blow out all those shares into the individual shareholders, and suddenly when you thought you had 299 shareholders, you know, you're back up to 5,000. So, they tend to have a handle on it, but again, I think that's something that would require a real look as opposed to kind of an educated guess.

And then your impact. I think that's, again, you know, important. I don't know what the number is. I know that if you push the threshold up to 1,000 or 2,000, I'm not sure if you can find the number, you know. Maybe it's possible, but I'm not sure that information would be available.

Meredith Cross: I mean, that is one of the things that the staff study would be looking at. It is very difficult to get that information, however, because these are private companies. And so you know that it would provide relief to some number of companies, but you don't have any way of knowing until we can find a way into this data to know just how many it is. I think if there was a rule proposal it would ask for comment on that. So we're trying to seek that data now.

Stephen Graham: You know, certainly it would be of my own experience with clients is that I say oh, getting close to 500, and every one of those situations having 1,000 would be better. Then you can push out a year or so, whatever it takes, and then you can go, oops, I'm getting close to 1,000. But -- so, you know, again, there's going to be some number and currently there would be some relief, but I'm not -- I can't tell you exactly what that would be.

Leroy Dennis: Excuse me. Would the staff know how many companies, say in the last year, were caught by the 500 number rule and then started to file? I mean, that might be a -- I mean, are we talking 10 companies? Are we talking 5,000 companies?

Lona Nallengara: That's a hard number. That's hard to identify simply by filings that are made, because companies, anecdotally we hear companies see them getting towards 500 and start making plans for becoming a public company. That may change their timetable for doing an IPO. That may set their timetable for preparing their Form 10 and they may, rather than trip over their 500 threshold, they may plan to -- plan for the time, so -- and no one -- I haven't seen, and maybe someone does, they don't usually say we're filing this because we've -- sometimes they may indicate that, but we -- it's hard for us to gather that data simply by the filings. We -- part of the work of the study would be looking at companies that have gone public over the last number of years in various different ways, whether it's an IPO, whether it's through a Form 10, sort of backing into becoming a public company, and then trying to find out what was the reason and what may have -- what challenges, if any, the companies faced with respect to the -- with respect to the reporting thresholds as they entered into the process of becoming a public company.

Stephen Graham: And again, that would be --

Meredith Cross: You know --

Stephen Graham: -- pardon me.

Meredith Cross: -- I was going to say one other point is that the other concern is that companies just have to change their capital raising plans because they're heading to 500. So it may be that they don't come register with us because they hit 500, they then no longer can include employees in their plans or they can no longer provide stock to vendors, things like that where they -- so they just have to change their capital raising because of hitting the 500 I think. So you hear it could come in any number of ways, I guess, is a part of the problem and why is this, frankly, so difficult to get your arms around. We are looking through the study at the IPOs over the time period to see how many holders they had so you can get a sense for whether companies that are coming public would've been hitting the numbers, but I don’t know that that will tell much of the story, frankly.

Stephen Graham: And the only thing I was going to say is that that number would be interesting, but I'm not sure how important it would be in the final analysis. I think your first

number is the key one. Now how many companies are actually out there saying okay, I'm not going to do -- I'm going to change the way I operate because of this threshold that I just can't cross? And you could have two companies that cross because of the 10,000 that really see that as an effective barrier and alter the way they do business as a result. Greg.

Gregory Yadley: Hi. Greg Yadley. I agree with your first statement that a threshold that was set that many years ago, given all the changes, is probably outdated and I'm in favor of raising the number, but it seems that the discussion ought to start with who we're trying to protect. So, you know, is it a large group of widely-dispersed shareholders who otherwise don't have any access to information? And if it is, we can certainly pick a number and maybe it's arbitrary. Probably will be, but that's okay because we've decided that below this we're not going to regulate it in the same way.

I think the employee issue is a real one and that is more easily addressed, particularly where stock is used as compensation. The idea is that those individuals, if they exercise their options or if they get restricted shares, they're not going to sell the shares outside of the company. It may be tied to their employment or a shareholder's agreement or by-laws that require that they be bought back by the company or something that like. So I think we could address that now and I'm in favor of that. I also believe that financial institutions who are regulated, admittedly not in the same way that the SEC regulates a company, but there is financial information out there and available on a fairly real-time basis, at least quarterly, and there are inspections by regulatory agencies. So there are protections and certainly I represent a number of community banks, public and private. It's a huge issue for them and I would like to see relief on that front now.

But the larger issue is having decided who we want to protect, all these other things that we're going to be talking about. What does it mean if you have to register? And today it clearly is a daunting task, even with the smaller reporting company regulations. Overall it's a really big deal, so we're going to address those things. I'm not suggesting we wait until we solve that before we hit the threshold, because it'll probably take too long. But I'm not sure I'm ready to tell the SEC it's our recommendation that they ought to make a change right now without thinking about: who are we trying to protect? I think we can, as I said, attack it on some known fronts, address the employee issues, as we already have with options, and maybe there's enough information already that we could talk to vendors or a class of persons who do a certain amount of business with the company, and then with financial institutions.

Heath Abshure: I want to provide, I think, the state securities regulators’ view on this topic and I think it really dovetails with Mr. Yadley's comments. States aren't opposed to changing any of these triggers; however, we think the triggers need to be based on the clients we're looking to protect or the legitimate secondary trading markets, really. The triggers ought to be based upon the need to ensure an efficient, accurate secondary trading market and for the states we believe that's based upon an assessment of who -- how many -- how big is that secondary trading market? Who are the players there? And we think that count should be based upon beneficial owners, as a more accurate measure. We think it also ought to include accredited investors.

Getting to your employee comments, Mr. Yadley, I think that, as you said, if they're locked up and they're not in the market, they shouldn't count. If they're out there trading in the market, they should. So we're not opposed to changes that reflect this view that the real point of Exchange Act reporting is to facilitate that secondary trading market; however, we would be opposed to any change that would -- could or would facilitate the existence of a secondary market without meaningful, accurate material information.

Stephen Graham: Thank you, Heath.

David Bochnowski: Steve, if I might.

Stephen Graham: Oh, please.

David Bochnowski: I think you framed the issue very well and we're all trying to determine what's the right number regardless of whether we're counting it as record shareholders or beneficial owners. To answer a specific question that was asked of me and I went back and did our homework, we have roughly 416 shareholders in our $650 million company that has roughly $60 million worth of capital. On an average day we trade 200 shares, which isn't a whole lot. Our record shareholders count is 416. We think that our beneficial shareholders is somewhere in the area of 900 and the way we came to that, and it's very hard to put a pencil to it and get an exact number, but when you go out to do your proxy statement, those who are holding a record name have to send us a request for the number of annual reports and proxies that we have to send them so they can send them forward. So that's how we get to that number.

Remarkably, we have several single shareholders, several shareholders that have three shares, some that have five, and that's because probably grandma and grandpa or somebody's aunt and uncle thought it would be great for someone to have shares of the bank stock and I think that applies not only to banks, but probably to some small companies.

I would express the concern that I'm not sure we have the proper predicate yet for shifting from record shareholders, which is where the world seems to have been, to beneficial shareholders. This discussion starts that process, but I would agree that I'm not prepared to do that, because we don't seem to have enough information. We do know that the SEC Small Business Forum that was held here at the SEC in November of 2011, part of the recommendations in there were several very good recommendations, one of which was to take Reg A to $50 million. Another was to take the thresholds to 250 shareholders of -- 2,500 shareholders of record, and that was from individuals who were small business owners who were at that particular forum. We also know that the House of Representatives passed HR-1965 this year, which was admittedly a carve out for the banking industry, but it took the number of record shareholders to 2,000, and for exiting and deregistering and I really object a little bit to that "going dark" phraseology, because some companies actually make a good strong corporate decision that they are better off not having to pay the cost of continuing to be a public company because it hurts their capital formation and their leverage. It hurts the way they have chosen to run their companies. And so I think there are good legitimate reasons why companies deregister. I would also recognize and acknowledge, as we all do, that there are clearly abuses and that's part of what we're trying to resolve here. So we have to have a balance and I think we have to have more information.

I would also add that the GAO just this January issued a report on small institution -- small financial institution capital formation. And it found that 89 percent of all those who were polled and there's roughly 5,000 banks that probably were in that study, 89 percent found that the climate for access to capital was not very good and 86 percent found that laws and regulations for raising capital, including the 500 shareholder rule, which was mentioned I guess voluntarily by a number of respondents, was part of the problem.

So my point is this, is that I think we need to have a little more time to study. We're going to, later on this afternoon, hear a very good discussion, I think on some scaling principles. And part of the testimony that was given in Congress there on that particular subject had to deal with, I guess, Barry Silbert and I read his testimony that was sent to us. He said very clearly that from his point of view that the 500 shareholder rule, record owner rule, was a disincentive for small companies to hire. And so those are all issues that we have to deal with here and I realize we're trying to get to the right number.

So as we approach that, it seems to me that we need to have further information so that we can arrive at the right number that does not provide disincentives. In our company right now if we were to adopt this, these rules are more restrictive, if we were to follow this beneficial rule that's

being suggested. Because I think in our circumstances it would be almost impossible to get under 500, because you have those single shareholders. And yet we have a very small capital base and hopefully we run our company well, but I think it would become very difficult for us and perhaps for other banking institutions to be in that same place.

And I only have one other fact. The community banking industry roughly is 11 percent of the total asset base of all banking assets in the United States and yet, as I mentioned the last time we were here, those institutions are roughly 40 percent of all small business lending in the United States. So if they can't have capital formation that avoids SEC rules, and I don't mean that in a negative way, I mean they don't want to take on the additional cost of being an SEC registrant, that impacts them dramatically. In addition, those same banks hold 76 percent of all loans that are agriculture related in the United States and the problem is that those small companies at some point have continuing costs that are going up. If they choose not to take on the additional cost of being regulated, or if they're trying to exit the regulatory structure on the SEC side so they will diminish those costs, if those factors come into play in a manner in which they can either -- they have to no longer be in business, that they have to have an exit strategy, then the question is who's going to do the small business lending and who's going to do the agriculture lending?

Stephen Graham: Thank you, David. I think those are great, great comments.

John Borer: Steven. Excuse me. Could I just make one comment quickly?

Stephen Graham: Sure. I'm not cutting off the discussion. I was just saying thank you, David.

John Borer: Oh, okay.

Stephen Graham: And I think your, you know, certainly your point about changing from record holders to beneficial owners on the basis of the way things operate currently, is -- that's a point well taken. John.

John Borer: Thank you. John Borer. This is one subject matter I don't have a big amount of dog in the hunt, so to speak, as I do with some of the things we're going to talk about later today, but it seems to me that the intent of the rule here is to protect beneficial holders and not record holders, the people who own the securities beneficially. But the record holder definition is there because it's easy to find. It's to find what the stock ledger books say and, as a result, we've seen, and I've had some of my competitive brethren on Wall Street take advantage and, the last couple of years specifically with respect to some of the high flyers, the Facebooks, et cetera, create SPVs where they'll sell 99 people interest in the SPV and then they'll go buy a bunch of secondary Facebook stock or one of the other companies to make that just be one record holder. I think the ambiguity created around those types of vehicles needs to be taken into account in whatever the assessment is here that takes place, as I think it would be with respect to an ESOP plan. And I think there's probably specific provisions for ESOPs and how many holders there are in those types of things, but if truly the beneficial holder test is what's applied and, as David just said, ambiguity created in even knowing what that is, I think it could create a lot of burdens, but those two things need to be reconciled. And whether it's 500, 1,000, or 5,000, if these pieces are left in place where the rules can be circumvented by creating these pass-through vehicles or even, for example, private pocket at Wellington that runs money for private accounts, may be one entity, but it may be managing it for, you know, 50- or 100,000 individual investors who have chosen to go into an asset class with a little bit more return potential. So, those points I think need to be evaluated as those pieces are taken into account. I'm sure the staff has already thought of these things, but I think that goes back to the root of what -- who's benefiting and also what the costs are going to be, not only to the companies, but to the brokerage community, for example, having to comply with these rules. If we just have to get close it's one thing. If we have to comply and all of the sudden have an additional set of

restrictions all the way up to who owns these certs, especially today, because most certs are electronic. I think it's going to be a lot of work.

Stephen Graham: Thanks, John. Catherine.

Catherine Mott: I explained to others earlier, this is my first meeting. I had missed the first meeting. I'm with Blue Tree Capital Group and Blue Tree Allied Angels. We're a professionally managed angel group in Pittsburgh. I'm also chairman of the board at the Angel Capital Association. So, there's about 370 professionally managed angel groups in the U.S. and Canada, so we deploy a lot of capital. So the only comment I have, I said to Gerry earlier, I'm not the legal guy here. I'm the operator. So, as I think about all the things that you're talking about, I'm thinking about how this impacts what we do and how we operate, and I heard Heath allude to this earlier, and one of the things, whatever the rule making becomes, I would hope that we would protect the profession, a very good efficient secondary market.

Angel capital, which is, you know, I forget what Jeffrey Soles [spelled phonetically] estimates the dollar amount, but in -- in the U.S., but it's roughly $20 billion a year. This is -- an efficient secondary market is good for the economy since what we look for as angel investors, is someone to buy out our shares, give us a liquidity event. So it might not be the return that we want, but let me tell you what we do as angel investors. We can't help ourselves. We continue to invest more capital. We look for the next -- we're looking for that Groupon, the Facebook, the Google, the whatever, and many of us have 18 to 35 to 40 companies in our portfolio. And so having an efficient, healthy secondary market is good for capital formation, because we're going to -- we earn more, we deploy more. It just is something we do as those angel investors are building their portfolio. So that's the only thing I would add to this.

Stephen Graham: Thank you, Catherine. When you talk about secondary markets, that's -- I think that that's an important topic. I'm not sure that that kind of hits dead on with the specific issue that we're trying to address this morning, but it's all related. I mean, it goes back to some of the comments that were just made a few moments ago about who are we trying to protect? And then you go all the way back again to 1964 and you really were saying okay, there are companies out there whose shares are actively traded. And so, you know, how do we make sure that we protect the people that are participating in that market? So, it's -- but it's kind of evolved to the point now where that's, I think, people have forgotten that and it becomes kind of, you know, almost secondary. But I don't think we should lose sight of it. Milton.

Milton Chang: Just to be a little bit simplistic, seems to me many of our issues can be simplified if we have a much easier reporting process. So that's another direction of attack.

Stephen Graham: You guys heard it first from Milton. If we just make registration not a problem, then we don't have an issue anymore. So...

Karyn Smith: Stephen.

Stephen Graham:
That's a good point. It's -- it might be too much to ask for.

Karyn Smith: Stephen, I just wanted to weigh in on the employee issue and excluding, you know, those numbers from the total count, I think that for a lot of companies, regardless of whether the number is 500 or a thousand, if you were to take employees out, it just wouldn't become an issue. There aren't many companies that I know, excluding the community banks, that are out there, you know, that have 500 actual stockholders if you're not counting employees who have exercised their options. So I think that staff really should consider excluding employees from that number regardless of what the number ends up being.

Stephen Graham: Would it work for you if the staff excluded employees under the condition that those employees didn't in turn trade their stock?

Karyn Smith: Yeah, I think that's fine and, I think actually, you know, if just more companies were putting those restrictions in place in any event.

Meredith Cross: An interesting question for the Committee to discuss, I would think, is how that plays into what Heath mentioned about the secondary trading markets and the interest in there being full disclosure in secondary trading markets and what is a secondary trading market. So if you're looking at markets where securities of private companies can be traded and are those the secondary trading markets or are secondary trading markets only the ones that securities trade freely within? If you look at the question that should employees -- so that's one issue to discuss.

And then another issue to discuss is if you don't count employees, because they're not impacting the trading markets, that's consistent to some degree with what happened in 1964 when the Act was amended, but you do need to remember what happened, for example, with Enron where employees lost their savings and their jobs. And they didn't know, you know, they were employee holders. I think employee holders may need information anyway. It might be that it's appropriate to provide it privately, not have to provide it publically on EDGAR on the SEC, maybe there could be a condition to an exemption that includes an information condition, something like that. These are things I think are all important to discuss and that we've been discussing on the staff. The employee issue is a very compelling issue we think, but there are issues to think about on the trading of the employee securities and the need of an investor of any kind, employee or not, to have information.

Karyn Smith: Yeah, Meredith, on that point, I mean, we -- one of the things we were thinking about last year was just that, you know, to the extent we were going to be tripping that number because of our employees. We would've been more than happy to provide information to our employees. That's a very different proposition than having to file a Form 10 and provide that information publicly. So I think that's definitely worth thinking about as well.

Heath Abshure: And the way we would look at it is not necessarily, I mean, throw out the word secondary all together. Just looking at the vehicle that you're providing shareholder liquidity, at some point, either the volume, the size of the issuer, something has changed and it justifies requiring that issuer to provide the material information necessary to make that liquidity market, trading market, whatever you want to call it, transparent. It needs to provide that material information necessary for it to be truthful, accurate material. And the triggers ought to be based on that. And in terms of what they are, I don't know, and I think that takes some real thinking, but that's when we talk about the secondary trading market and that's really what we're talking about.

Stephen Graham: Karyn, I think your point about employees is a good one and it's -- it would seem to me that certainly if you had a system where employees are not counted as long as they didn't trade the shares, then you would take that circumstance out of the situation that 12(g) was intended to invest in the first place, wouldn't you? So, but, that said, it's important for employees to have information as Meredith pointed out, but I think it might be a little -- it's a related, but different issue, I think. If we feel that the employee should have more access, you know, once they're exercising options and buying the company shares, then maybe that's something that should be addressed from a different direction.

Karyn Smith: Well, you know, presumably at a certain point they're getting the 701, the information --

Stephen Graham: That's right.

Karyn Smith: -- that's required under 701, and that's a different, you know, whether those are the right thresholds is a different discussion, but it seems like, you know, to the extent companies were already preparing that information for 701 purposes, it's not that much more of a stretch to provide that on an ongoing basis to employees who have already exercised their options and hold stock, if that's what the concern is.

Stephen Graham: Right. Right. Paul. Richard, I think Paul was --

Paul Maeder: Yeah, just two comments.

Stephen Graham: -- and then Richard.

Paul Maeder: My only concern with this, and I really don't have a concern, my only concern with making this change is that it takes pressure off us to fix the public, the IPO market. The IPO market is broken. If we make it easier for companies that would otherwise go public to stay private and raise capital privately, we're effectively defeating that problem rather than solving it. Karyn's proposal to exempt employees, I think, is the best of both worlds. It solves the 500 threshold problem of companies inadvertently having to report without in fact taking off the pressure to fix the IPO market. If you get to 500 true outside shareholders, that is a lot of shareholders. I've rarely seen a company with that many shareholders, with the exception of small community banks.

And the second comment I'd just make with respect to Meredith's comment is that, as I understand it and I have a very limited understanding, I haven't read any of the books, but Enron, they were crooks. And forcing crooks to report false things doesn't really -- and forcing everybody else to make reports that are expensive doesn't really change anything. They would've gladly reported and then lied in their reports. I'm not sure that would've obviated that particularly notable and notorious issue. I think when we do regulations we have to fundamentally assume what is true, which is that 99.9 percent of companies and people are honest and what we're really trying to do is facilitate informed decisions on the part of shareholders.

Stephen Graham: Thanks, Paul. Richard.

Richard Leza: The question here is whether the 500 number should be changed. There is really no impact, the way I see it, from the venture capital side, because you know, when we make investments we might have 100 people that are beneficial investors, but only one for the record. Okay? But the thing that becomes important is the employees, because when you look at it and you say okay, let's look at 500, you look at it and you say, okay, I'm going to build this company. I'm going to get beneficial investors, but I'm going to need so many for the employees. And if you look at it and divide and say okay, I'm going to keep 250 because I'm limited by this 500 number, that tells me that I can only have approximately 254 employees, and it seems to me that when you start getting at that limit it creates the limitation of the size of the company, but if you go to a number bigger than that and say 500 and you evaluate that approximately each employee is going to generate $200,000 to $300,000 per person, you know, you start getting into $100 million revenue company and that's a pretty good-sized company. So I think from the point of whether it should be 500 or not, I think the main thing we've got to do is release it so that employees are capable of participating in these companies at a greater detail than we have now and I think you increase the number or exempt employees from this issue.

Stephen Graham: Okay. Other comments?

David Bochnowski: Stephen, I'm sorry. I meant to make a point earlier and I did not and I apologize for that. One of the issues that I thought about here is that if we were to approve this today, what happens to companies that exited and are no longer registered? Are we contemplating that they should be brought in if they violate this rule?

Stephen Graham: I would contemplate that that's something that we need to be thinking about, but that would be the wrong result. I think you have to --

David Bochnowski: And that would be a concern.

Stephen Graham: -- yeah, yeah. I don't think -- I personally wouldn't be in favor of trying to unwind things in that way. I mean, they've -- anyone who's kind of acted kind of in reliance in today's framework and at least in this context, it seems that if we end up changing it, I just can't imagine saying okay, oops, you deregistered, now you have to go back and register.

Lona Nallengara: Just one question to think on on that point is on the -- it's an annual task. You check to see the number of holders. How would you look at -- how would you want to look at the next year for these companies where the -- with the way you're counting changes, could a company back into becoming now a public company then that had relied on the -- so that's, again, something to consider as you're doing this. You know, every year these companies are going to have to check to see what their number of holders is. If we change the number or change the way you count, it could have an impact each year.

Stephen Graham: Right. We're going to have to think that one through. And clearly there's going to be a transition, whatever we do.

Lona Nallengara: Stephen, one other question if I could ask the members to think about. The legislation and proponents for change in this area, at least the legislation in the earlier drafts, had included, along with employees being not counted, it had proposed that accredited investors wouldn't be counted and, you know, the theory behind both of those is when you're looking at who you need to protect with public reporting, employees -- proponents would argue you're getting information another way. They don't need the '34 Act reporting. And accredited investors are big and smart enough to be able to figure it out themselves. They don't need the '34 Act reporting. So, a question for -- we've talked about employees. What are your thoughts on whether an accredited investor or some definition of sophisticated investor, whether that should be excluded from the way -- from the number that's counted?

Heath Abshure: I would say that the accredited investor, the sophisticated investor, has had the '33 Act protections there when they purchased the security directly from the issuer. When you look at '34 Act reporting and trading, you're looking at something totally different. You're looking at their activity in the market, presumably, at this point as a seller. Well, you're also considering the protections of the purchaser there. So the fact that the original purchaser is accredited or sophisticated, they've already bought it and already had protections on the '33 Act side.

Leroy Dennis: I would just add also that, you know, an accredited investor makes a decision every day by -- based on the current information out in the market as to whether to sell, but also whether to hold. And so that decision they make daily. And so how are they going to get information to do that?

And as far as the employees, I have a hard time telling an employee they're not a stockholder. Now if they can't trade the shares, then I think there's a question of whether it's really a security or not. And I think that's a different issue, but if I'm an employee of whatever company and I own a share of stock, I make that same decision every day of whether I'm going to hold it or whether I'm going to sell it or whether I'm going to buy more. And how do I get information to

do that? And absent a separate reporting system that we're going to establish for employees, which I'm not sure we want to go there or not, but that seems to be the alternative, either establish a separate reporting system for employees or you report under the '34 Act. It's a tough issue, but I just have a hard time saying they're not a stockholder.

Stephen Graham: Yeah. I'm not sure if we'd be saying that they're not a stockholder. I think we'd be -- what we would be saying is that you are avoiding that, at least you're controlling that secondary market. You can't transfer them, because you can't transfer -- because there are transfer restrictions in securities and, I mean, obviously they're not permanent transfer restrictions. There are obviously going to be certain exceptions and ultimately there is going to be a liquidity event that everybody waits for.

Leroy Dennis: Yeah. I don't have an issue with excluding employees that can't trade the stock until an IPO.

Stephen Graham: Right.

Leroy Dennis: I mean, that to me is it's not a security. I mean, they probably didn't buy into it. It probably was given to them and it's compensation and they can't do anything with it. So even if they had information they can't exercise any actions on that information. But when they have the ability to buy and sell it, that to me sounds like a stockholder that's no different than a non-employee. So, how are they going to get that information if it's not through the '34 Act filing? So it seems to me we have some kind of obligation to make sure those investors are protected by current information. I'm not opposed to a separate reporting system, but you know, what would that be?

Stephen Graham: If I'm an employee and I am one of 100, why don't I get information? Why should I be entitled to information? Why do I have to wait until there are 500 of us?

Leroy Dennis: Good question. I guess I'm not proposing -- willing to take the number down to 100, but you know, we have set the rules at 500 to say that's when you're going to do a '34 Act filing. Whether 500 is the right number or not I think is the debate here. I just have a problem with excluding employees because they're employees under the, what I think may not be, a common situation that they get all the information that everybody else gets. So --

Stephen Graham: Yeah, I guess --

Leroy Dennis: -- including the CEO and CFO, that's easy.

Stephen Graham: -- right.

Paul Maeder: I can answer that, Steve. If you're an employee you're getting options and therefore the right to buy stock as an incentive to work hard. You're not making a capital allocation decision. So it really isn't a security. It is not a security. I agree with you. It's really an incentive to stay the course and work hard. When you -- if you want to make a net worth allocation decision with regard to that stock, you do it by quitting, by leaving the company. Then your stock becomes -- then you can exercise. You have 90 days to exercise, and then it becomes a security and then you can buy or sell it and it becomes a capital allocation decision, a wealth allocation decision. But up until that point I don't think of it as a security. I totally agree. So it shouldn't be counted.

Heath Abshure: Well, I guess I'm a little confused. Was the question, how do we ensure that employees or others that already have the shares that are shareholders have information about the company? And I don't think that's the focus of the securities laws at all. You provide disclosure when there's a purchase and if there's a market and you're a publicly-traded

company, then the securities laws require certain disclosures to facilitate that market. Your rights to receive information as a shareholder just by virtue of being a shareholder is an issue of corporate law, not securities law.

Gregory Yadley: I think Heath is right, and Stephen, at whatever point you think we've gotten enough discussion. It seems to me that the sense of the group is that this is an area where the staff ought to study it, but at least as to a specific number we don't have enough information; however, most of the comments reflect the belief that employees who are not traders should be excluded from the count and I think there's been a number of comments that indicate that with respect to banks and bank holding companies, they're a special class that maybe deserve treatment now or we could talk about that some more.

But we haven't had a lot of discussion yet about the record versus beneficial ownership. I agree with the earlier comment that it's probably burdensome to figure out how many beneficial owners you have, but I don't think it's that burdensome. You do every year have to figure out how many proxy statements to send out and you have a number that's pretty close. So I think we ought to have a little more discussion about that and whether, I guess whether the staff believes in general that moving towards beneficial ownership, not simply for 12(g) purposes, but for other purposes is something that you thought about and what the impact would be on other regulations.

Stephen Graham: Yeah, it's -- this whole beneficial owner versus record holder is just -- that's just a tough one. We have -- when, you know, because there was a time when record holder was a good surrogate for beneficial owner. That's not what we have anymore. But nonetheless, that's -- we still have regulations that kind of use that as a basis. So I don't know what the answer is.

I hear David's comments about community banks where the issues that they -- I mean, they have issues right now, because I think we're all familiar with, thanks to David and others, the circumstances that community banks operate within and they're already having issues with respect to the 500 number and talk in terms of pushing it up to 2,000 or 2,500, or 3,000, whatever the number is, and then if we want to switch from record holder to beneficial owner, they would be even in worse shape. So I don't -- I don't know what the right answer is, but I think -- I think you're right. I think if anyone has any other comments they would like to add, and then let's talk about what, if any, shape this, you know, what shape, you know, what if any recommendation that we make might take.

Leroy Dennis: I was just going to add, Stephen, that I might suggest the recommendation be tailored a little bit. One, I would probably scrap the beneficial notion for right now, because I don't think we're ready for that, and include that in an SEC study. And then rather than specifying the 1,000 or the 500, suggest that the SEC develop a short-term rule with the objective of increasing those thresholds to be commensurate with what makes sense in the market and then points two and three be a longer-term study as to: is beneficial holders the right answer? What is the effect of all this and what is the right answer long term? So it seems like a short-term solution for the SEC and then a longer-term play. I'm just not prepared to say 1,000 is the right number.

Stephen Graham: Yeah. I do agree with you on that. The only thing that I would add to your modified recommendation is that I would like to see employees excluded, as long as they can't subsequently transfer.

Leroy Dennis: I would agree with that.

Milton Chang: It seems to me if logic prevails, then the number is beneficial holders, because the purpose of creating --

Stephen Graham: I don't -- yeah, I don't disagree with that at all.

Milton Chang: -- okay.

Stephen Graham: Sometimes we just have to fly in the face of logic.

Milton Chang: I know, but then I mean, you fix it by the number. You don't try to fix one thing, too, anyway.

Stephen Graham: Yeah, I know. I don't disagree with that, Milton, but I tend to agree with Leroy and Greg that we've got to focus on that number, but I don't think we're ready to make that shift quite yet. And, again, I think we all would like to see some relief sooner as opposed to later, and so if we can structure something that we know is going to provide some relief, let's go ahead and do that, you know, recognizing it for what it is. It's not comprehensive. They're open questions, but as far as that one, you know, pain point, if you will, it's -- we've come up with something to I guess ease the pain.

So, that then would be the recommendation that's before you and just to, and correct me if I'm wrong, just to reiterate, we make a recommendation that the Commission come up with an interim rule to effect some relief with respect to the 12(g) number, not prepared to say whether that should be -- not prepared to say precisely what that should be at this point, but it should be some number higher than 500, and in addition to that, I think there should be some number higher to address the concern of the community banks, if we should stick for the time being with record holders, not beneficial holders, and we would exclude employees as long as they are prevented from transferring their shares upon the exercise of options.

Richard Leza: Steve?

Stephen Graham: Yes.

Richard Leza: -- I would propose that we get relief now and that we take the 500 as defined to 1,000 and then we can study it as much as we would want and see whether it's going to be beneficial or a record person, but I think that number should get some relief now and we should go straight to 1,000.

Stephen Graham: Oh, I agree 100 percent that we should get some relief now, but I was going to leave it to the Commission as to what that now number should be. Would the Commission rather see a specific number?

Lona Nallengara: We'd love to get your recommendation. It's hard for us to say what we'd like to see.

Stephen Graham: [affirmative]

Lona Nallengara: But for us to -- for us just to understand our rulemaking process for the staff to recommend and for the Commission to adopt a rule with respect to interim relief would be -- would not be customary, but we would need to have a basis for selecting a number. So, if your recommendation is we should provide interim relief to change the number to some greater number than 500, we would have to have -- we would have to have a basis for selecting that number and we'd have -- and that's the work of the study. That's the work that the study that we would do to be able to get us that information to be able to select the number. So, we would be identifying a number out of -- we would be identifying a number without support, and that poses problems for us.

Mary Schapiro: It strikes me, just off the top of my head, for those reasons focusing on employees, focusing on community banks whether there's an appropriate approach there effectively raises the number. In most instances, based on what Karyn and others have said, and that, I think, is a helpful recommendation for us to look at.

Gregory Yadley: I agree. I think that's what we ought to do.

Stephen Graham: Okay.

Gregory Yadley: I mean, I think that will do exactly that and, the sense of the group is that the study will reveal other things. But I would stick with 500 with those two modifications for financial companies and employees.

Stephen Graham: What's the modification for employees now? We'd still need -- we'd still need to have --

Female Speaker: It depends on if you would exclude employees from the count.

Stephen Graham: No, I'm sorry. What's the modification for community banks?

Gregory Yadley: I think we could raise that number today. I just don't know what the number would be.

Male Speaker: Yeah.

Stephen Graham: We could raise both numbers today, but we don't know what they should be. I mean, should it be a thousand or 2,000, or 1,500, or 2,500?

Gregory Yadley: Yeah, I think they're different, though, qualitatively and so the staff would have a different predicate for doing that. I think with employees we've talked about it.

Stephen Graham: Oh, employees are fine. That's -- I just misspoke there.

Gregory Yadley: And then banks, I think, it's because of the availability of financial information and another federal and state regulatory scheme that the number should be higher for them. And I'm fine with 1,000. That's the lower of the numbers that's being used in the bills pending now and I think we could suggest that the Commission raise 1,000 or such higher number as they feel would be still protective of investors.

Five hundred is definitely too low and I think for the reasons you said, Stephen, and as Dave has pointed out, changing the beneficial ownership, which in the long run I think we ought to do, because we're trying to protect the holders and the beneficial owners are the holders, but certainly for banks, and I think I remarked at our first meeting, I've just been through a fairly large bank transaction, a billion dollars on each side, and one was over 100-year-old bank and the other was a less than 10-year-old bank, but between the employees and all the nieces and nephews and grandkids and ESOP and everything else, you know, it was a mess trying to figure out.

Stephen Graham: Okay, well two things. One is that, you know, maybe I'm out here by myself, but you know, I kind of would like the idea of raising that 500 number to 1,000. I don't know what the right number is. It deserves further study, but I know that a number picked in 1964 is not the right number for 2012. And, as far as community banks, David, what's --

David Bochnowski: Well, see the House Bill was 2,000 for registration, 1,200 for deregistration. That passed 420 to two and so whenever you can get people in this town to

agree on something and something as esoteric as that number for banks, it would suggest that maybe that is the right number. The other thing that I would like to point out, and I think where the conversation interestingly enough has gone, is that legislation coupled with our comments today, the legislation contemplates that the SEC Chief Economist is supposed to do a study as to the impact of that decision and report back. And so it seems to me that we are all saying the same thing, which is we'd like to have some basis, I think, for the decision that's made. I certainly would support the banks mirroring what we have suggested here for -- that has been suggested in the House legislation.

Shannon Greene: Stephen, can I ask a question at the risk of showing my ignorance? When I first read this my thought was private companies that have 500 shareholders are being forced to start reporting because they hit the 500 number. So, but we're really talking about private companies whose stock trades in some sort of security market, right? I mean, a public company --

Stephen Graham: No we're not. You're right.

Shannon Greene: -- well, okay, so if a private company has untradable, they're not marketable, you can't go out and sell them on the street --

Stephen Graham: Yes.

Shannon Greene: -- why are we, I mean, why is that a problem? Why are -- where's the number in terms of oh, if you have 500 closely-held shareholders, you've got a public obligation to report when they can't trade their shares anyway, except back to the company. I mean, maybe I'm --

Stephen Graham: No, you're not missing. I don't think you're missing --

Shannon Greene: Then I don't understand what -- I don't get what we're doing.

Meredith Cross: The legal requirement is that if you have 500 holders of record you have to register and $10 million assets, you have to register. There's not a test based on whether or not it's tradable. A question from a policy perspective is whether there should be a requirement that there be trading before you have to register. This was put in place in 1964 when there had -- trading had developed. They were trying to decide what should be the test to require companies to start reporting, and after much discussion they finally settled on we're going to count holders as opposed to trying to figure out, for example, trading volume or venue where it trades, because those were all too unpredictable was one of the concerns. A company needs to know, when am I going to have to report, so they just picked the number.

So right now when you're looking at what should we be doing with this? Should we change it? Many people are saying you should be looking at trading volume, market interest. Why should someone have to file all this information on EDGAR if no one can use the information anyway? Those are all really good questions. That's one of the reasons why the employee point is relatively less controversial, because if they're not trading and, you know, all you're doing is protecting the employees, get them information, but do you really need the world to have that information? So your questions are very good, it's just that the law right now does force reporting once you get to 500 holders and $10 million in assets.

Shannon Greene: So in 1964 we were worried about exposed 500 stockholders that didn't get good information and all that and you get to 501 and now we're going to be responsible for 501 and above. Now we're saying it's okay to take 1,000 people that aren't getting good information and that's okay. I mean, if it's -- I'm back to Greg. Who are we trying to help here? Private companies who get forced into reporting or are we trying to protect what I consider closely-held

stockholders or companies and so then it's okay to leave 1,000 -- 500 back then and now it's okay to leave 1,000 that aren't getting good information? I guess I haven't -- I can't figure out exactly why this -- why the number needs to be changed if we're talking about what I would consider closely-held companies.

Stephen Graham: Yeah, and that's what I was kind of alluding to. I think you're spot on as far as just kind of understanding there are a lot of issues floating around here and it can be kind of confusing, and we seem to be doing cross purposes sometimes. But that's what I was getting at when I was saying earlier that there -- a number of things need to be looked at, like whether or not even having a number is the right way to -- is the right measure. You know, should it be trading volume or something instead? Since when you go back to the beginning, that was a primary impetus, was to make sure that people that were engaged in a trading market had the information.

And so what we're trying to do today, though, is fix a problem that has evolved over time because of this and that is so when you have privately held companies where there isn't an active trading market, that notwithstanding that, because of the 500 shareholder rule, they end up having to kind of twist and turn sometimes in ways that are not beneficial to the company in order to avoid registration. And so as we go back and try to address those things in a comprehensive way that you are alluding to, today what we want to do is to relieve, you know, those, you know, issues to at least some extent on kind of an interim basis.

So, we recognize that, you know, that, you know, your points are valid and -- but I think that what we want to do today is kind of fix the situation that we're currently in where, again, companies make capital-raising decisions and make equity comp decisions based on this rule as opposed to what is best for the company.

Shannon Greene: And I guess my point is that if it's closely held, and that's a horrible term, but what I would consider closely-held stock, if I choose to invest in the corner dry cleaners and 500 other people decide to invest, too, it shouldn't be -- I don't think it should be the SEC’s responsibility to make sure that I get information. If I choose to do that as just a simple investment, my choice. The SEC’s got plenty of other things to deal with. If the dry cleaner stock is tradable on some secondary market somewhere and you get all these outside people in that don't know the guy that owns the thing, they find it on a bulletin board and buy it, I'm all about reporting, but what I would consider closely held, the number of stockholders, to me, seems like -- I guess if you're going to do numbers, stockholders in a company that has some sort of tradable stock as opposed to a company whose stock is not readily tradable.

Stephen Graham: Yeah.

Meredith Cross: One point I think, just to be clear, just to make this more complicated, right now the OTC market, companies that have never been reporting companies, never traded on an organized market, can be traded on the OTC market and, in fact, a lot of them are and their securities can be deposited through DTC so that the number of record holders actually stays very low; below 500. There might be thousands of holders, so your dry cleaner could go, you know, a broker could deposit that through DTC and there could be thousands of holders, and that's sort of what led, in 1964, to section 12(g). What caused all this is that back then what became NASDAQ was the OTC market. There was trading in that market. There was no information and there were concerns about it. So now here we are many years later. There's trading in this OTC market. There’s no -- after a year the securities are freely tradable. The restrictions under the securities law only last a year. So if the company doesn't restrict it in its organizational documents like Karyn's company did, but other companies might not. Those securities can start trading. So your point is really good, but it bleeds over very quickly.

Stephen Graham: Okay.

Lona Nallengara: And at the time of the study the same questions that you're asking, why shouldn't it be the trading of the securities, why shouldn't that be the test? That was considered. I think the analysis came back that it was easier to count holders. Things have gotten much more complicated since then. Companies are staying private longer than they did in 1964. The IPO horizon for a company -- there's a lot of studies that have shown it's gone from three or four years to eight or nine years, and when you do that you have successive rounds of financing, you have more employees, companies are bigger than they were before when they went public. So proponents argue that because of those changes you have more holders and the 500 holder threshold that was set in '64 may not work for the, you know, for that company on getting to the brink of an IPO. So that's why proponents are saying someone needs to look at this threshold again. Well, part of the reason, rather.

Paul Maeder: So it's pretty clear that there isn't -- the data doesn't currently exist to make a logical decision on a number increase. This reminds me of a marketing person I interviewed once. I gave him a test to see how his quantitative thinking was and I said, "How many of these items do you think we could sell in a year?" And after being flustered for a while and not doing any numbers he blurted out 100 million. I said, "That's an interesting number. It sounds like a big number. How did you come up with 100 million units?" And he looked at me for a while and then he said, "Well, 100 million isn't what it used to be." I don’t think we can apply an inflation number to the 500.

The only argument you could possibly make, and I don't think there's a study you can do, because how many companies are out there who've artificially and gone through gymnastics to keep their shareholder count below 500? We don't know. It's unknowable. The only way you find that out is by increasing the threshold and seeing how many people migrate up. So, the only objective way to set this number is to say the population has doubled since 1964, so let's double the number from 500 to 1,000, which is absurd, and it's probably -- this is, as Meredith said, not the right parameter. The right parameter is trading, but that's a very difficult parameter to measure.

So I would suggest the best approach is incrementalism. Increase it to 1,000. Use the justification that the population has doubled and probably the number of companies has more than doubled since then, and see what happens. And if you get significant relief and the number of comments coming in decrease materially, keep it there for a while. If not, then maybe you should go to 2,000. But absent the ability to collect any data, I think only incremental step-wise improvement will give you any kind of information as to what the appropriate number is.

Stephen Graham: I don't disagree with that. So let me --

Richard Leza: Steve, can I just add one additional point to that? The reason why you also need relief here is that in the 1960s to build a company to a billion dollars on the average statistics show took about 25 years. If you go down to 1980 and that, an ability to build a company to a billion dollars went down to something like five or six years. So when you count the number of employees and other people that have to go in there, I think it's appropriate to give some relief immediately to this number.

Stephen Graham: Okay. Fair statement. So the recommendation now would be raising the threshold to 1,000 for all companies other than community banks, and then as far as that number is concerned, adopt the numbers in the House Bill, leave it at record holders, not beneficial holders, and exclude employees. Yes, Greg.

Gregory Yadley: What's our thinking about exit from the system? That's my only reservation on raising it right now to 1,000 is, you know, going dark is a problem for some people who are

investing in the stock and now they're not going to have information. So, in your first draft you had 500. So is that still part of this motion?

Stephen Graham: Good point. Yes.

Shannon Greene: So let me throw in. I get this part a little bit better. Going dark, I mean, I'll give you our example. We've got approximately 400 registered shareholders and as best as we can tell, 2,500 to 3,000 beneficial holders. So, if going dark is based on shareholders of record, it won't, I mean, we can probably make that happen fairly quickly, but you leave several thousand people out there who are the beneficial holders that going dark would mean, I mean, you know, what number, again, how many people need to be -- need to have information? So to me going dark, I don't know how you can do that and not consider beneficial holders, because we can get under the 300 registered shareholder number pretty quickly.

Stephen Graham: Yeah.

Shannon Greene: But you've got several thousand out there that are all of the sudden just going to get nothing.

Stephen Graham: Yeah. It's -- you make a good point and that's why this is -- we're only talking about interim relief. That's an issue that needs to be addressed.

David Bochnowski: Steve, not to beleaguer the point too much, but if our logic is to double because of what's happened since 1960 on the registration side, then it would seem that we should double on the exit side.

Stephen Graham: So you --

David Bochnowski: To 600, because it's currently -- it was 500 and 300, I believe, so it would be 1,000 and 600.

Karyn Smith: Isn't the question, though, what happens to the companies who went dark because they went under? We're going to raise the number now. Is that what the concern is, Greg?

Gregory Yadley: I think it's both of them. That point and then Shannon's point that there will be companies that will be able to now go dark and you're leaving some greater number of beneficial owners out there. I mean, so I guess you could do two things. If this is an interim rule, you could look at beneficial owners for the exit or you could leave companies that are already -- this would be for new companies.

Stephen Graham: Yeah, it's -- I'm afraid that if we start going down too far in that direction we're going to start making this too complicated. I think we want to try to -- I think what we're trying to do is to come up with an effective reasonable kind of interim measure to address the problems that were articulated at the beginning of this meeting. And, you know, understanding that these issues that you raise, Greg, and that you raise, Shannon, are valid and very important and clearly they are issues, but I don't think we have enough to kind of properly resolve those today. But as far as giving companies relief that would otherwise, you know, have to register, you know, that's something that we can do on an interim basis, you know, recognizing that a lot has happened since we first got 12(g), and to, you know, properly address all the issues that are before us. More time, more study is going to be needed and what we propose today is something that's going to be superseded, but this is an opportunity to revise some measure of real relief, at least as far as this isolated issue is concerned. Paul.

Paul Maeder: Yeah, it seems like there are two reasonable answers to this, 300 and 600.

Stephen Graham: Yeah.

Paul Maeder: Either you don't change it or you bring it up pro rata with the threshold. And Shannon's comments notwithstanding, I'd probably go to 600 under the same argument logic that I applied earlier, which is let's try an incremental change and see what happens. If you don't change it, you won't learn anything.

Stephen Graham: Right.

Paul Maeder: Granted people who otherwise would've received information will now stop receiving information, but going from 1,000, this is a pretty wide gap on the thermostat. You know, a thermostat usually has a gap between when the heat goes on on the way up and when it goes off so that you don't have the heating system constantly going on/off, on/off, and that's what you do want to prevent. You want there to be a pretty wide ramp between the time you have to report and if you shrink back down, you want people to have pretty good warning to get out of the stock if they foresee that they're going to stop getting information and they're uncomfortable with that. I think 600 does that.

Stephen Graham: Okay. Then the proposal is now modified to provide for 600 on the way down. So, I guess -- okay.

Lona Nallengara: Steve, it would be also helpful to the extent for us as -- and for the Commission, for the recommendations to identify questions that you've raised about transition periods and things like that. So if you -- directing us as part of a study to look at a number of items that to the extent those are things that are important, that's helpful for us to have that as part of your recommendation.

Stephen Graham: Okay. Can I get a motion? No one wants to move?

Shannon Greene: I'll move.

Stephen Graham: Second?

Male Speaker: Second.

Stephen Graham: Anymore discussion? All those in favor signify with saying aye.

Multiple Speakers: Aye.

Stephen Graham: All of those opposed?

Leroy Dennis: Nay.

Stephen Graham: How many opposed? Okay. Two opposed. And everyone else was a yes. So, Gerry, you're doing the tally?

Gerald Laporte: Yeah. I would just like to note for the record that Leroy Dennis and Shannon Greene are opposed.

Stephen Graham: Okay, well that took a little bit longer than I expected. Let's have a quick bathroom break. So, let's say, you know, 10 minutes max. Okay.

Morning Session Continued after Ten Minute Break

Stephen Graham: Okay, the next proposed recommendation deals with Regulation A and Crowdfunding. I think they are related, but you may wish to take them on separately. Regulation A offerings, as you know, are sometimes called mini registration statements. It's kind of like "going-public-lite." They're not used very often. They involve essentially preparing an offering circular, which isn't quite as detailed as a Form S-1, which is filed when a company actually does go public, but they are filed with the SEC and also every state securities commission that is impacted. And each agency then reviews the offering circulars separately.

Regulation A is, of course, exempt from the registration requirements under the '33 Act. The dollar limit is five million. Within that $5 million limit you can have up to $1.5 million in secondary sales. Of course there's no reporting, there is no SOX (Sarbanes-Oxley requirements). Regulation A is not really viewed as a viable tool for capital formation. I think primarily for two reasons. The first is the $5 million is a bit low and second, there's no blue sky exemption.

What they -- the recommendation that's on the table is coming up with a new exemption to replace Regulation A, kind of the view that we shouldn't have an amended Regulation A. We should just have something new, that would be modeled after Regulation A, but with increased disclosure requirements, being careful to make sure that investor protection is appropriately enhanced, in light of this raising the cap significantly, and also, but also making sure that those protections are appropriately calibrated, and then raise the number up to -- from five to fifty million, which is a number that seems to be fairly popular when others talk about doing something with Regulation A.

The other proposal is -- has to do with Crowdfunding and, as you know, the securities laws don't only impact the companies that all of us in this room are used to dealing with, but they impact those small businesses, the small launch maneuvers with the non-sexy business plans, and businesses that will never attract equity capital from other sources. It's been asserted that the Crowdfunding is -- could be a cost-effective method for those kinds of businesses, those, that kind of class of entrepreneur to raise relatively small amounts of equity. I think the idea has merit, but certainly any changes in this regard would have to be within, I think, a framework that is uniquely tailored to these circumstances, so, as to do what we can to prevent fraud. I think that that should be at the forefront, and it is, on everyone's mind, both in the Committee, both at the Commission. I think we also understand that people who want to commit fraud will commit fraud. I don't care what kind of rules we have in place. So, it's something that is a legitimate concern that needs to be thought about, but it shouldn't be a reason for not taking any action. I think, again, the context would be investors making, you know, small investments, with, you'd have to assume, incomplete information about the companies that we'd be investing in. One of the controls would be the dollar amounts, limiting the number that -- the amount that investors could invest in these contacts, and also limiting the size of the offerings that could utilize such an exemption. So, the recommendations, which again, I just kind of wrapped them into one, you've had an opportunity to take a look at and that's what is now on the table, and so we'll open it up for discussion.

Timothy Walsh: Good morning, Steve. A couple of questions, you're willing to -- if you can -- answer them, or the staff too. When did the five million cap? Was that since '34?

Stephen Graham: No. Reg A -- I can't remember if it was Reg A.

Timothy Walsh: It was five years ago or --

Stephen Graham: Oh, no. It was a long time ago.

Timothy Walsh: Thirty?

Stephen Graham: If this was Jeopardy and I had to guess, I'd say 20 years, 20 years ago.

Timothy Walsh: About 1992, something [inaudible].

Stephen Graham: Okay, '92 --

Meredith Cross: It was raised. It was raised from 1.5 to 5 in 1992, I believe. I think I did that rulemaking.

Stephen Graham: Okay. So, that sounds like 20 years.

Timothy Walsh: Twenty years, okay.

Meredith Cross: I can't remember.

Timothy Walsh: And you had mentioned something earlier this morning, in the first five minutes. You mentioned something about $10 million in assets. I didn't quite [inaudible] --

Stephen Graham: I know what you were -- that goes back to 12(g).

Timothy Walsh: That's 12(g).

Stephen Graham: Right.

Timothy Walsh: And then I think I passed a series seven three or four times in my life, but could you refresh my memory?

Stephen Graham: Pardon me?

Timothy Walsh: I said I've passed the series seven about three or four times in my life, but I can't remember exactly what blue sky is.

Stephen Graham: Oh, just the state securities laws.

Timothy Walsh: The state securities laws.

Stephen Graham: Right, and so the issue there is what effects the utility of Regulation A is that you have to -- there's no exemption, unless you have a so-called "covered security," and if you're not a "covered security," then when you go out and do an offering, you have to be concerned about the securities laws in every state that you're making the offering in.

Timothy Walsh: And one last question, too. You made the -- we talked earlier about basing our recommendation on the population going up, doubling in the last 30, 40 years. Is there [inaudible]-- that we actually put in some of these regulations, where it's based on GDP, so it's not this thing that goes from a million to five million, to fifty, over 30, 40 years? Is there some type of mechanism where it automatically changes if, for instance, GDP or population goes up?

Lona Nallengara: Some of the -- actually, some of the legislative proposals -- I'm sorry. Some of the legislative proposals relating to thresholds like this have proposed having annual or twice, or once every two year adjustment, based on things that you mentioned. So, that is something to consider as well.

Meredith Cross: And just so you know, we have in the past, the Commission has considered having inflation adjusted tests, in various rules and that was considered in the 2007 proposed revisions to Regulation D, which were not adopted, but that reasonable idea just hasn't been baked into any of our rules to date.

Stephen Graham: Does that do it, Tim?

Timothy Walsh: Yes, thank you.

Stephen Graham: Okay.

John Borer: Steve, I've got a couple of comments. First of all, on the blue sky, I think if you don't somehow get the blue sky issues out of the way with respect to whatever we call, you know, the new Reg A, then it's going to be irrelevant, no matter what you do with respect to the amount and those types of things.

The other thing, and again, I've been doing this for years and years, and the last 10 years we've been the, you know, very, very active in raising companies that are public money and have brought a bunch of public -- there are fewer and fewer of us around to do it, so maybe this is sort of the end, but on Reg A, the fact that it's an exempt offering, but that there's a requirement that the offering materials be filed with the SEC, and are going to be reviewed, and that there will be no practical way, in reality, to go out and market the company, until those documents have been cleared. In my guess, similar to the way an S-1 or, and S-3 would be, makes this something that is -- it won't be used, other than very, very rarely, because even with the $5 million threshold, with some companies over the last two, three years, that we've looked at, that initially did not have a big need for capital, but wanted to become public for purposes – to become a reporting company, and maybe raise a little bit of capital, particularly to get more shareholders, et cetera, to use something that was -- get public-lite. We've explored this, but never wanted to go through that process, because of what has to be done in order to be ready to go sell securities. Now, I could be completely wrong. I have never in my 21 years in the chair I'm in right now at work, done a Reg A offering, and we do more capital raises for small companies than just about anybody on the planet. So, that tells me something, and I don't think it's the five million limit. So, if maybe somebody from the staff could explain why in the exempt offering we're requiring the offering materials be filed and that they will be reviewed, just like in my experience, I'm told this by our lawyers. I studied law too long ago to remember what it was like. Why is that being done? Because if that piece could be somehow modified, like for example, some of the, you know, in state offerings or with what used to be -- was it, you know, the offerings where you could do under a million and you didn't have to file anything. You're just completely exempt. You can go sell to anybody and I don't even know if I'm-- I took the Series 7 a long time ago, so I don't remember, and the 63 a long time ago, what that was either, but could you -- could somebody on the staff just deal with those points? I could be completely missing the boat also. I can be wrong, but when I went back and read the history of Reg A, my belief just as a common language reader, was that, oh, you don't have to file a registration statement before you go raise the money.

Stephen Graham: I think, and the staff would know this better than I, but it is a public offering, so that's, well, it's exempt from registration, *per se*, but it still is a public offering and that's certainly, you know, from -- in my view why it's being reviewed by the SEC and why it was being reviewed by the State Securities Commissions.

Meredith Cross: I think, to give you some perspective on what Reg A was all about. You know, the -- it's a public offering that does not give rise to a reporting obligation and that's the big difference. So, if you do a Form S-1, at the end of it, no matter how many holders you've got, at least for a year you have to report. If you do a Reg A offering, you can sell to, you know, however many people you want in the offering, and you don't have to report at the end of it.

The form, the offering statement that has to be filed is a streamlined form and the idea was that it could be done on a less costly basis than a full blown registered offering, so, something of a hybrid. The staff review was viewed historically as necessary in order to protect the investing public, since it was going to be sold retail, and was, again, could be sold without any limits on who could buy. I think questions could be raised about what that level of review should, how it should be conducted, what the information should be, but as you're talking about making it bigger still, then it becomes more important, I think in the staff's view, that we would have some presence in the area.

Lona Nallengara: And the existing Reg A framework does allow a company to test the waters. So, you can go and see if there's interest in purchasing securities before you've done all the work preparing this streamlined offering document and gone through the staff review. So, that has a flexibility as well.

Gregory Yadley: The other thing was is that the reviews used to be done in the regional offices, so there was some feeling that, you know, you knew the people -- huh?

Meredith Cross: Yeah, that it was local.

Gregory Yadley: -- that it was a local deal, yeah, and, but I haven't done one since 1986, I think.

Meredith Cross: I did one in 1985.

John Borer: Well, but the point I was making, and thank you very much for those clarifications, yeah, I think that raising -- forget blue sky for a second, changing the amount will not change whether people will use this or not, because there have been a number of deals done over the last five, six years, where companies wanted to get public in a way that was not going to take a lot of time. Uncertainty, time to market was a problem, *et cetera*, and they just did them on a 144A Reg S combined basis, and then subsequently undertook to register. The result was obviously QIBs in the United States and Reg S, could be anybody offshore. They would get the requisite number of shareholders and make sure that they did it that way, and those transactions took place in the case of, I think like with Horsehead Holdings was a $200 million deal initially, then they became a publicly reporting company that way, I think, and if you take, and you subject this to the same level of review ahead of time, that the company at that level, that might be able to raise $50 million, is not going to be doing it retail. They may have some retail investors, but there's no amount of retail capacity to raise $50 million in the way the capital markets are structured today, and we can talk about IPO on-ramps all we want in the afternoon, but that industry is gone. They don't have the distribution anymore. And the sophisticated investors are going to say, "We're not going to give you money if you're not going to be a fully reporting company, once we've given you our money, within some limited period of time." It's just not a -- there isn't enough capacity out there. They're all from Missouri, okay, and in this case, they want to see it and they want to know it. They want to have a contract that says this is going to be done, *et cetera.* So, if those -- it's going to continue to operate the same way and all we're doing is raising the amount, I don't think it's even worth going through the process of doing this.

Heath Abshure: I agree, and I think especially considering that it's entirely probable, because we're going to have general advertising allowed in 506 offerings. That's probably a more attractive alternative for these companies. I do want to address the blue sky issue. As some of you may know, NASAA has formed a Small Business Capital Formation Committee and its first task was drafting that and model Crowdfunding exemption that would provide a cost effective, efficient method of Crowdfunding for issuers selling their securities and one stop filing within the states. We plan on doing the same thing with revised Reg A and the reason we haven't done it yet is that the bills currently before the House and Senate that would revise Reg A, authorize the

SEC to create filing requirements, both ‘33 Act lite filing requirements and ‘34 Act lite filing requirements. We can’t really build a uniform review standard that all the states will use, until we see what has to be filed. So, I don’t want anyone to think that Reg A is not going to work because of all these disparate filing requirements in the states. We plan on bringing uniformity and efficiency there. It’s just we’ve got to have the form to start with.

Gregory Yadley: Stephen.

Stephen Graham: Yeah, yes.

Gregory Yadley: I don’t object to the resolution, but sort of having the same view that I’m not sure it’s going to be used that much, and given the staff’s limited resources, we certainly rather work on the other things that I think have a better chance of working out.

Stephen Graham: Yep, it’s -- those points are well taken. I think that this probably bumps, into the IPO on-ramp discussion a little bit, but if what you’re doing is creating a situation where you can effectively do a public offering, then I think it goes back to John’s comments a little bit, if I understood them correctly, and that is it really goes back to the question as to whether it’s even feasible to do a public offering of that size, in today’s markets, because where are you going to get the retail investors and the sophisticated investors aren’t necessarily going to take that route. So, and then if you do a Reg A offering and so now you’re kind of public, but you want to be more broadly followed, and so you both kind of volunteer to become a reporting company, then why not just start out that way, and do an S-1, and think in terms of making sure that the S 1 is structured the right way, which kind of goes back to, again, I think, the IPO on-ramp discussion.

Gregory Yadley: Yeah, I totally agree. I mean the point that when Meredith was explaining to us and when she said, “It’s a public offering,” I mean remember, what that meant was that you could solicit, which you couldn’t do in, you know, in any of the private offerings. So, if we’re addressing that and we’re going to talk about Crowdfunding, which is a different sort of market, and then the IPO on-ramp, which has benefits of looking at a class of companies, before, when, and after they go public. All those seem to be very worthwhile items for discussion and rulemaking, and just when it almost seems like we’re grafting on to something that is sort of there. It’s really not used, and I think John’s absolutely right. I mean I just don’t know of real and, you know professional investors who are going to want to have a limited participation in a company with no easy exit strategy, which means, as you said, Stephen, companies are going to have to voluntarily report, so I don’t know. Is maybe a question for the staff, is this something that because there’s legislation pending and so on, you would like us to sort of weigh in on, so that you got some other views as you formulate your proposals?

Stephen Graham: Meredith, could Chris say something before you chip in?

Christine Jacobs: What, no. We’re probably going to say close to the same thing. I wanted to go back to our first meeting and remind the Committee the reason this is here is Reg A was brought up, and we roundly disagreed with it, and talked about how it had lost its utility as a vehicle, and thought that perhaps the $5 million limit was indeed the baffler or the reason why Reg A was no longer being utilized, and so I think what you’re seeing today is there’s a lot in the press. There’s precedence where people have said, “Reg A will go to a $50 million limit,” that I think it’s rather than to kill it as a vehicle, we’re refreshing it as a vehicle. Is that...

Meredith Cross: I think that’s what people are thinking. You know, the staff doesn’t have any basis to know whether or not if it goes to $50 million it will be used and what if we add requirements to it that would then make it less popular. It couldn’t be less popular than it is today, because it’s virtually -- nobody knows what it does. So, you know, perhaps this would make it more popular. It is a question of, you know, if we spend all this effort building it, will

anyone come? I don't know. Do we hurt anyone if we do it? Probably not, because there's such robust investor protections built in. I think, you know, there's -- the legislation doesn't take the states out of it, and we certainly aren't suggesting taking the states out of it, but the Reg As are the classic transactions that have historically been reviewed by the states. So, this is -- it's really just a question of is it worth the resources, I suppose, and I don't think -- I don't see a lot of danger coming from this, just from a personal perspective. We didn't give a disclaimer this morning and I will say this, my personal views are not the SEC's views, but again, I think it is a question of does the Committee think it's a worthwhile thing for us to do or not bad, or, whatever you want to tell us is helpful to us. If Congress doesn't, then we'll do it anyway. So, those are my thoughts.

Stephen Graham: Well, let's, unless someone else has another comment, let's jump over to Crowdfunding. I'm sure that we have some commentary on that.

Paul Maeder: Yeah, I'll just kick it off and suggest that the email that I think we probably all received from the gentleman in Nigeria who's offering to --

[laughter]

Paul Maeder: -- give us $20,000 if we give him $283, I think.

Stephen Graham: It's kind of moved to -- my emails are now, I think, coming from Hong Kong.

Paul Maeder: Hong Kong?

[laughter]

Paul Maeder: Well, I think that would be the -- this would be a huge job creation engine for those folks and my biggest concern, of course, is that precisely what a true Internet market for private financings would create is a market in which people who shouldn't be investing would be investing in a company that shouldn't be able to raise money, or worse yet, scam artists. So, however, I'm sympathetic to small businesses around the country that need to raise capital, that don't have access to Angels and Venture capital, because they don't exist in their communities, and so, I would suggest that the SEC be very cautious. I think this is a hot potato and a very dangerous one at that. As Professor Coates says in his paper, "This could in fact have the perverse effect of increasing the cost of capital and access to capital, rather than decreasing it, because it would create so many examples of notorious fraud that everyone would be afraid of investing, but I think, and even if you limit the dollars to small amounts, $1,000 is a lot of money for my mother to lose. It may not be a lot of money for my firm to lose, but certainly for most Americans, it would be very bad, if not catastrophic. So, I would suggest that if you move forward on something like this, that the Internet be allowed to -- be a medium for information and for distribution of perhaps offerings, but that there be an absolute requirement that before any transactions can be consummated, there be a face-to-face meeting and presentation, so that people know whom they're investing in. We can't, you know, Ron White says you can't fix stupid, we can't, you know, a fool and their money are soon parted. We can't outlaw foolishness, but we can certainly make sure that before anyone writes a check, they've looked the person making the offering in the eye, met them, had a chance to ask them questions, and not entered into a heavily advertised transaction that's distributed over the web, that's promising all kinds of unreasonable benefits, that then merely defrauds a lot of people.

Stephen Graham: Thanks, Paul. Catherine?

Catherine Mott: Another perverse effect that could happen here is that your growth companies and your gazelles, which we all want, would likely not get funded if it was initially funded by a Crowdfunding source, and there were 500 shareholders with all these little pieces of equity.

Sophisticated investors, sophisticated angels, as well VCs will pass on providing the growth capital for a company that is going to be problematic and have a bunch of shareholders, which we have to get approval from, or for which you can't get approval from. So, there's another negative impact that it could have on the marketplace, however, I'm the same way. I'm sympathetic with small companies if, I think I heard dry cleaner earlier, if a small dry cleaner needs $15,000 to buy a new piece of equipment, and they can garner $1,000 from 15 people, or people want to put $50, whatever, towards something, I just don't -- I think there'll be an issue around equity. I think that would be tough to do. Right now, Kickstarter, I think gives them t-shirts for investing in a company. You get a company t-shirt. You don't get anything. You just get, you know, and they get the money. So, I guess as we think about this, I think we should consider whether or not we give equity. I don't think equity is the right ownership for crowd funding. If it's an online lending micro-lending vehicle, I think that can be probably monitored in a way, but if you're looking for -- if companies are going to be looking for follow-on funding, they're not going to get it from sophisticated investors, if they get it from Crowdfunding.

Stephen Graham: You know, you've -- you put up a very important issue and I don't know how you properly deal with those kinds of issues, because basically what it is, you're talking about someone who's starting a business that could grow, but doesn't know enough about the way things work to understand that when starting out, you can't go out and get a gazillion shareholders, because that's, you know, for the reasons that you state, and I don't know how we kind of provide a regulatory framework that protects people from their own ignorance like that. On the other hand, a lot of these companies, they could take advantage of something like Crowdfunding, are companies that would never have that opportunity, no matter what you did at the beginning, because that's just not the nature of the company, and it's companies like that that I think we have to remind ourselves of. I mean it's certainly not the companies I see or most of us see, but they're out there and they're impacted by the securities laws, and sometimes all it takes is $50,000 to have that community business started, and thriving, and providing 10 jobs, or whatever, and so, what -- you know, to what extent in those kinds of scenarios does the existing regulatory framework prevent that from happening, and is there something that we can do? We've got all the -- at one end of the spectrum, you're talking to your neighbors on your street. At the other end of the spectrum, you're just launching something on the internet and trying to tap into the world. This is wrong. This probably won't get you there. I don't know what the right answer is, but I can see the issues.

Gregory Yadley: Stephen?

Stephen Graham: Yes.

Gregory Yadley: One of the aspects of the NASAA model exemption is that there would be an intermediary who would be required to register as a broker/dealer, and I think that's an interesting concept, and I like the idea. Tangentially, one of the issues that I've worked on quite a bit as a volunteer lawyer through the ABA, which has been a recommendation at the small business forum for the last number of years, has been a private placement broker, which, for those of you who may not have followed this, that the idea is that there could be someone who would register in a limited fashion or the exemption from registration, with certain requirements. For example, the states would regulate these people who could help a company, and could take transaction based compensation, and help find investors, because one of the things about Crowdfunding that does scare a number of us is there is no vetting, other than the crowd saying, "Yeah, we'll all -- we're all in this together," kind of thing, and intermediaries historically, because they've been regulated and have obligations, and reputations, will do a better or a worse job, but the best do an excellent job with helping companies decide what kind of security they should sell and how much they need, and they know about 500 shareholders or, you know, getting themselves -- it's like going to a lawyer and anybody can start their own corporation or LLC, but what are the issues you ought to be thinking about when you start your company, so

that you don't create a monster for yourself down the road, and so, I think the states are on the right track with that intermediary.

Heath Abshure: And just to follow up there, actually we envision a kind of a dual system and all the platforms, intermediaries, portals, whatever they ultimately, they're going to call that entity, the cost it looks like most of the acts will mandate their participation. Well, they ought to be -- the subject to sort of oversight. If they get into full blown broker-dealer activities, then what we're going to fall back on is likely to require broker-dealer license. However if we define limited responsibilities that are unique to just the funding portal, the platform, then I think that we bring in a BD-lite or a certain, I guess, a lesser tier of registration there, and I think our concern is just what you said. You're talking about really circumventing the suitability analysis that occurs in a traditional sale at this point. You're directly marketing the most speculative securities to the least sophisticated investors, and there's no professional there, and as state securities regulators, we're not interested in being an artificial barrier in keeping people away from investments. I mean we -- our citizens have to have it. We got to have retirement funds. We got to have savings. We want to get the bad guys out, so that they can get to the good guys, and we think the intermediary is probably really going to be a linchpin of this.

Leroy Dennis: Stephen?

Stephen Graham: Yes.

Leroy Dennis: Just a comment. I mean I share all your concerns with this. To me this was fraught with potential dangers. My sense is that, and I like the intermediary concept, but when I think about it more, I wonder who would get involved in that, because absent some blanket liability protection, I would never do it, and so, you know, it seems to me that we're talking about a group of companies that want to use a vehicle to raise very small amounts of money, because I can't imagine any sizeable amounts being -- using this vehicle, without seeking professional help or legal counsels, and broker-dealers, and some other vehicles, and so, my sense is this is already happening. And I think as the more we try to put regulation on top of it, you'll probably just kill it, because I don't think it will ever happen. So, if you stick an intermediary in and require that, the local laundromat is probably not going to be able -- probably not going to do that, and so I just wonder whether you can make it de minimus enough and wash your hands of it, so to speak, and say, "We're not involved. Buyer beware," and yeah, it's the -- maybe the most risky to the least sophisticated, but, you know, the maximum amount is $1 million or some very de minimus number, and if you go beyond that, then you need to seek professional help, and go more traditional routes.
The other comment as I was listening to comments, you know, and I agree with Paul's comment about you always like to sit across the table from somebody and shake their hand, except I think of my 20 year old daughter, and they don't do that, and that's not how they operate anymore, and I think as we go down the road in this next generation, they're going to do things differently than we do it, and although I agree that for me, that's the way you do it, but my kids are not wired that way anymore, and, you know, maybe they'll get that way when they lose money in the markets or something, but today they're not, and so I just, again, I come back to, I think, a recommendation is fine, because it says the SEC should it, and it says the SEC should be cautious and put some -- what protection should be in place, but I'm not sure you can put much on it, without killing it completely. So, to need or allow it on some de minimus basis, or if you try to regulate it, I don't think it'll -- I think it just all goes away.

Milton Chang: I think Leroy started a good precedent here to use children as an analogy. I think the raising children by being permissive is not a good way to raise children and so, here we are trying to basically help people who cannot raise money, to get money. You know, if there's a filtering there, by definition, the hurdle is what makes them qualified, so to speak, and so I still don't believe that you couldn't really, if you really have a good idea, you can get funding [inaudible].

Stephen Graham: I guess I sympathize with that point of view, but I disagree with it, because on the one hand you have the kind of snake oil, and yeah, they can't get funding. There's a reason why they can't get funding. On the other hand, you've got the dry cleaner or the laundromat, or pick your small community business, that, again, does not have access to the traditional sources of capital, and it seems like, you know, to the extent that the existing regulatory framework gets in the way of someone like that raising money from their neighbors, which gets to the face-to-face part. Then we should make a change. We don't have easy answers, but I think it's too easy to say that if you're failing, then it's because you deserve to fail.

Milton Chang: I think the laundry example is an excellent one. If you have a neighborhood where laundry service is needed, I still cannot imagine you couldn't get money for a laundry, and I think this issue is in front of us because of legislators, and I think we can do very well by providing them some sense, by saying, "No, we shouldn't do this." I think this is also one of our responsibilities, I would think.

Male Speaker: Stephen, I'm sorry. Go ahead, Charlie.

Charlie Sundling: No, I also just wanted to weigh in on this, you know, speaking in terms of an entrepreneur, where my default position is typically little to no regulation on anything, and let the markets do what they're going to do. We debated this recently with a number of other folks who are of the same ilk, right, entrepreneurs who started companies from garages, and built things from scratch, and still couldn't come up with a really good argument for being supportive of crowd source funding, and the reason is a lot of this stuff that was mentioned here today is it does poison your next round of financing right? There's a lot of different, you know, reasons why you wouldn't want to do it. The other is that if we get these improvements in the disclosure regulations, right, so that, you know, the bills that are on the floor now, and I'm not sure where they are right now in the process, but about the, you know, the solicitation being lifted, and being able to generally solicit a PPM, I think that those who are serious about raising money have a new tool, right, that wasn't previously available to them, and then the whole question becomes, you know, really, when you look at a laundromat, you know, is an equity vehicle the right way to raise money for these things in the first place? You know, I don't really view the Crowdfunding as a tool for the neighborhood laundromat, but maybe more for the individual that's got an idea, and just needs to get a couple of bucks together, to take that idea to the next step, but the realities of this whole, you know, the, of raising funds is -- and this crowd source evolution, which is coming out of the whole social media, Facebook, everything else, right, and the conclusion that we had as a group talking is that, you know, this is kind of an evolution of the theory that anything you can do socially, whether Twitter or Facebook, right, why not apply it to equity fundraising, right, but the reality is it's not a good idea for a whole bunch of different reasons, and if we can fix the general solicitations, so that when you're raising money, you can actually tell people about it. Right? I think that goes a long way to addressing a problem being able to raise early stage money.

Stephen Graham: Good points, Charlie.

David Bochnowski: Stephen, the folks that are in the garage building that new laundromat dry cleaning piece of machinery, whatever it is, or doing something technologically, before they can get to the Angel investors and before they get to the VC investors, they probably got to us. They probably got the community bankers and one of the problems that I think a lot of those folks have is that coming up with the capital, and to Leroy's point, generationally, there is some difference now as to how things are going to be done, and I think we have to modernize, and we have to be aware that there are incredible dangers involved in Crowdfunding, but if there is a way to -- I like the idea of the face to face. I like that piece of it in keeping a, some de minimus number involved, so that if they do get solicitations from Nigeria or Hong Kong, they have to be

wise enough not to look at those, but be able to get the word out in their local communities, and then follow that on in some ways, so that there is some face to face, or some method by which the investor has real information, and if that's what we're intending to do here, I'd be in favor of that.

Stephen Graham: Catherine.

Catherine Mott: Following up on Leroy's point about de minimus, I think $1 million is not de minimus. Again, I mean that's what we invest. We invest typically $1 million, $1 million and a half. This is, again, if we're looking at who does this benefit in the entrepreneurial community, for the tech startup, the startup in the garage, you know, it's going to take a lot more than a $15,000 piece of equipment. They're going to need the million and a half, and so, if we're going to do something like this, it's not going to be circling and creating an equity instrument, then we should be looking at smaller amounts, whether it's -- the total is $200,000 or something like that, even if it is the garage startup raising 200,000 from the category of what we call friend, family fools, you know, then that $200,000 might, you know, vet out the prototype, get the business plan well oiled, allow them to get some, maybe some help with the FDIR, you know, application, or something like that, but at the end of the day, you don't want to mess up the structure for this company to get follow-on funding. So, when we think de minimus, I know that the million dollar number's been out there's I think three legislative proposals for this, but it needs to be smaller than that, in my opinion.

Stephen Graham: Okay. Well, a couple of things that I'll toss out. One, just backing up to the recommendation with respect to Reg A, you know, the more I think about it, the more I'm inclined to think that Reg A was something that didn't work and if we make it better or kind of, you know, tinker with it a bit, I'm not sure if that's going to bring it to life, but I would be in favor of, none the less, recommending that it be changed from -- that the rule be changed from five million to $50 million, because we know that five million doesn't work. Maybe $50 million will work. I'd be inclined to not -- although I -- unless something happens on the blue sky side, I don't think whatever you do is going to be that effective, even if that is a barrier, but I'm inclined to leave that alone for now, and then see what happens with the state commissioners, and I wouldn't do anything if the go forward is going to mean that the Commission has to commit significant resources, because I think there are other things that are more viable and that are more important, but if we can make those changes and just see what happens, and see if they do some good, then that would make sense to me.

In terms of Crowdfunding, I'm not sure if we're in a position to make a meaningful recommendation. If we could throw something out there and say, think about it, but that's not very helpful. I think we understand what the issues are, but as I think David just said, this whole area is fraught with danger. There are ways to maybe address that danger, that maybe we can think about, and maybe down the road, come up with a recommendation that might be meaningful. I think having an intermediary has merit. Face to face has merit. You know, squeezing down the number, there will be limitations. Well below a million, you know, makes some sense, but I don't think we have any consensus at this point, and I don't think we've given that enough thought at this point to come up with a recommendation that is meaningful, so --

Paul Maeder: Steve, I just make one quick suggestion --

Stephen Graham: Yeah.

Paul Maeder: -- on that, and this is -- and I totally agree. Having the SEC use resources that divert from solving the IPO could mark a problem and I think it would be a big pity, but this might be an example of where, as an island country, we tend to just completely ignore what everybody in the rest of the world is doing, and we could probably learn from it. It'll be instructive for somebody from the SEC or me, at home, tonight, to just get on the web and look

around the world, and see who else has tried something like this, and see what they've learned, because somebody may have stepped into this puddle before us, and had some experiences from which we can either learn about how to do it smartly, or at a minimum, how not to do it.

Stephen Graham: Right. I agree with that a hundred percent. I think, looking, you know, looking for the opportunity to get smarter, to try to put ourselves in a position where we might be able to make a meaningful recommendation is what we should do, but I just don't think we're in a position to do that today.

Christine Jacobs: Stephen. So, I want to paraphrase what we're talking about. The Crowdfunding, we're not going to make a recommendation. Are we going to then term it abstention right now for the purpose of the minutes or --

Stephen Graham: It just won't be on the table, but I'm making that suggestion. The Committee has to decide what it wants to do, but it's --

Christine Jacobs: And then, two, clarification for Reg A, are we -- how then do we make our recommendations if we are concerned that the resources needed to amend that regulation are too grey?

Stephen Graham: I think, you know, if Lona and Gerry kind of push back or give us some feedback , but I would envision saying that, just kind of paraphrasing a little bit, that we're not sure if there is, much to be done to make Regulation A that useful. None the less, there are some things that we can do, that could change things, but we wouldn't want the Commission to be taking time coming up with a new Regulation A, if that's going to mean committing, a lot of resources to the effort, because other issues, 12(g), the on-ramp, Rule 506, and general solicitation. I think would rather have the Commission spending time on those issues, as opposed to working on something that probably is -- it's an Edsel today, it will probably still be an Edsel tomorrow, but...

Long Nallengara: Right. I think you can craft a recommendation that identifies the increase in the dollar amount, but also acknowledges that the Committee doesn't have enough information or is uncertain about what that would do, and expresses the caution that you've described. So, I think that's a recommendation that identifies, I think, sounds like what the expression of, at least your view that you've proposed to the Committee. So, yes, we could help you craft a recommendation like that.

Stephen Graham: Okay. So, any comment? Is there --

Milton Chang: Sorry, can I make one more comment on the Crowdfunding?

Stephen Graham: Yes.

Milton Chang: Basically, I think the issue in front of us is how to address funding issues for companies to get going, and we can change that to how do we provide a continuation for funding to proceed. So, lowering the number to 100,000, 200,000, as Catherine suggested, to really get the -- over the hump of the initial hump, but once you get over the initial hump, I believe there are mechanisms such as Angel groups, which is I think, what, about 390 around the country, to provide the rest of it. So, I think having a small number diminishes the abuse and also provides a continuation of funding, of continuity in the funding.

Stephen Graham: I think that's right, but what I'm suggesting is that we don't make any recommendation today, okay. Are we in agreement that we make no recommendation today in crowd funding?

Okay.   Are we in agreement with the recommendation, with respect to Reg A? Okay.

Shannon Greene: Real quick question, on the 50, if we raise it to $50 million and people go out, and do that, but the thousand, going back to 12(g), if they end up with thousands of shareholders when they raise this 50,000, I mean $50 million, then 12(g) kicks in, right?

Stephen Graham: Right.

Shannon Greene: So, the 50 million's got to be raised, which based on our proposal this morning, with 999 shareholders left, which means -- right? In order to [inaudible].

Stephen Graham: It could. Someone could see Reg A as a stepping stone to becoming a full-fledged public company. You don't count it until the end of the fiscal year anyway, and so, that could be part of -- what is it? Do you have to start reporting 120 days after the end of the fiscal year, when you've reached the thresholds, and so that can be all part of someone's master plan, for that matter. I don't know, but you could say, "Okay, I'm going to do a Reg A offering. Now, I'm going to bump over to -- I mean, now I have a thousand shareholders, and I'm going to finish out this year, then the next year is going to begin, and I'm going to have to, you know, file a report within 120 days after that, and which is what I want to do, because I want to it to be a reporting company, because I want people to follow me. So I don't know how that would sort out.

Dan Chace: Can I just ask a quick question?

Stephen Graham: Yeah.

Dan Chace: I think if I read on this, on the draft, it says that only 24 offerings were registered, which I think gets to your point [inaudible] --

Stephen Graham: I think only 24 were even filed.

Dan Chace: Oh, filed. I'm sorry, filed, only three were --

Stephen Graham: Right.

Dan Chace: See, that's more my question, is -- I mean, would the $50 million increase change anything in terms of the approval --

Stephen Graham: Yeah, we have no idea.

Dan Chace: But what's the reason that only three out of 24 were --

Stephen Graham: We don't know. We're speculating it's because it's five million and that's too low, and that dealing with a bunch of state commissions is just daunting.

Dan Chace: But there's an SEC approval question, right? The word is qualified, right?

Stephen Graham: And that's because the SEC has to advance, to approve and every state commission has to approve.

Dan Chace: So, that might not just be the SEC. It would be the state commissions did not approve it?

Stephen Graham: It would be because of that framework --

Dan Chace: Okay.

Stephen Graham: -- that you have to run the gauntlet, and it's -- in theory, what, 52 reviewers maybe?

Lona Nallengara: Fifty three.

Stephen Graham: Fifty three? Okay. So...

Dan Chace: Thanks for clarifying.

Stephen Graham: Okay, can I get a motion?

Christine Jacobs: Do we take questions and discuss this [inaudible].

Stephen Graham: No.

Christine Jacobs: -- at the end of the --

Stephen Graham: No, I don't think so. Second? Do I get a second? Okay. All those in favor?

Multiple Speakers:
Aye.

Stephen Graham: All those opposed? Motion carries. We're still late, but it's only 10 minutes. So, we're adjourned until 2:00, when we'll reconvene with the folks from the IPO Task Force. Thank you.

Afternoon Session

Stephen Graham: Okay, we will reconvene, and as you know and as we talked about this morning, we're going to be spending this afternoon talking about how we might fix the IPO market. We will -- we're familiar with the IPO Task Force. We talked about it at our last meeting. We looked upon their work with admiration, and I think we'll benefit from the discussion today from some of the representatives from that Task Force. But before we do that, I want to set the stage a little bit by hearing from some of the members of the SEC staff, and so I will turn it over to Lona at this point.

Lona Nallengara: Thanks, Steve. So what we're hoping to do, at least in the front part, is give you some background on some of the regulatory framework for which the IPO Task Force made some of their recommendations. So we have some of our colleagues from the Trading and Markets Division that will give us a background on the research proposals that are part of the Task Force report. They will describe the historical framework that has led us to the set of research rules that we have in place from which the Task Force has made their recommendations. We'll also have individuals from our Chief Accountant's Office talk about the current 404(b) requirements and the historical framework there as well, and we'll also describe some of the existing current disclosure requirements, some of the smaller reporting company disclosure framework. I think we're going to start with Jennifer Zepralka, who will walk us through the smaller reporting company rules, again, which is a framework for the Task Force recommendations.

Jennifer Zepralka: Okay, thank you. So this is the disclaimer. We didn't officially give this this morning, but -- these are all staff views, and don't necessarily express the views of the Commission.

We talked about this a little bit at the October meeting, so some of this is a recap. The Commission has experience with scaling the disclosure requirements for certain types of companies. For small companies, the Commission first adopted a scaled system in 1992 and then made some pretty significant changes in 2007. 2007 was when the category of smaller reporting companies was created. Generally these are companies, as many of you know, with less than $75 million in public float. There are a few other tests, but that's the main one. The scaled disclosure requirements at that time were also moved into Regulation S-K instead of in Regulation S-B where they were before. I'm not going to walk through every item. I think those of you who work for or own smaller reporting companies already know this in detail. I'm just going to give some of the high points of the scaling. Smaller reporting companies are allowed to provide a less detailed description of their business than larger companies do. That includes leaving out the financial information about segments, which makes sense when you think about the size of these companies, and they get to do their business development activities for a shorter period of time.

The performance graph, they get to not do that. The selected financial information is a five-year table that you usually see in larger companies' annual reports. They get to not do that if they so choose. MD&A, a small number of reporting companies that provide only two years of financial statements, which they are allowed to do, instead of three that larger companies do, only have to cover two years in their analysis in the MD&A section. So that shortens that section that you see, and for larger companies a year-on-year comparison that covers three years. They get to leave out the market risk disclosure, and then executive compensation is another pretty big item that's scaled. One of the big things is that the smaller reporting companies do not have to do a compensation discussion and analysis. We call it CD&A. That's the narrative that describes your compensation decision making. There are fewer tables that smaller reporting companies have to put into their proxy or their 10-K to cover executive compensation, and then a big difference is the summary compensation table only covers two years instead of three, as it does for larger companies, and they get to present disclosure for fewer named executive officers than larger companies have to. For related party transactions, the test for larger companies is any transaction over $120,000. It's the threshold for disclosure. Smaller reporting companies have a lower threshold. It's the lesser of $120,000 or one percent of the average of the total assets at year end for the last two years. So this is one item where smaller reporting companies actually may have more that they need to do than a larger company would.

They do not have to disclose their policies and procedures for reviewing these transactions, which is something that larger companies must do, but this is the one requirement that is probably slightly more burdensome than the non-scaled rules, and we have a provision in these rules that says that smaller reporting companies can pick and choose whether they will want to do it on an item-by-item basis for the scaled disclosure or the non-scaled, except when the scaled is more than the non-scaled, so this is one of them. These are just a few more. Smaller reporting companies leave out their disclosures on compensation committee interlocks. Some of these are proxy disclosures. No need to disclose your ratio of earnings to fixed charges. I already mentioned financial statements. Smaller reporting companies are required to provide two years of audited financials, where for other companies it's generally three, two years of balance sheets. There are other scaled or phase-in requirements under our rules that apply to newly public companies such as the Sarbanes-Oxley 404 requirements. Brian is going to go into them in more detail, so I'm not going to spend more time on that now.

And then I just wanted to quickly mention -- this is not about the smaller reporting company scheme -- but there are a few other disclosure requirements that are referenced in the IPO Task Force report and recommendations. I just wanted to make sure everybody knows what they

are. One of them -- these are all Dodd-Frank provisions. One of them is the say-on-pay, say-on-frequency, say-on-golden-parachutes, what we tend to call it, you've probably heard of it, basically public companies that are subject to the proxy rules, when they have a meeting to elect directors, need to include a shareholder advisory vote on executive compensation, a separate advisory vote on the frequency with which that say-on-pay vote will happen, because the statute allowed the shareholders to vote on whether it should be every one, two, or three years. And there's also a provision that requires certain disclosures about golden parachutes arrangements and shareholder advisory votes to approve golden parachutes in the context of certain transactions. These rules are in effect for everybody except smaller reporting companies right now who have -- we gave them a phase-in until January 2013.

The other two -- I'm not going to read these slides to you, but there are three other provisions from Dodd-Frank. There are the "Conflict Minerals Disclosure" provisions. The Commission proposed rules last December but has not adopted anything as would require certain disclosure about conflict minerals that originate in the Congo. And I'm not working on this one, luckily, so I'm not going to go into detail on this one. And then the other two are compensation related under Section 953 of Dodd-Frank. There is a disclosure item about the relationship between executive compensation and company performance, and another that would require disclosure of a ratio between a median of annual total comp of all employees versus the annual total comp of the CEO of the company. The Commission hasn't acted on these yet either.

Stephen Graham: Jennifer, just a question, are -- any of those provisions have sunsets on them, like the minerals in the Congo, or are you going to be dealing with this 20 years from now?

Jennifer Zepralka: I don't think there's a sunset on any of them. Right, Lona?

Lona Nallengara: I don't -- no, I don't think there is a -- there's no sunset on the -- so, yes, unless Congress acts, those are [inaudible].

Christine Jacobs: Jennifer, clarification, January 2013 is only say-on-pay and frequency?

Jennifer Zepralka: Yes, yes. I believe, and I don't have the rules in front of me, that the golden parachute disclosure did not have a phase-in. I could be wrong, but that's only -- you wouldn't have done it, Chris, because I think -- now I'm getting beyond myself.

Lona Nallengara: Well, you wouldn't have done it if you didn't have a --

Jennifer Zepralka: If you didn't have a transaction.

Lona Nallengara: -- if you didn't have a transaction, and companies haven't been doing it in advance of --

Christine Jacobs: Yeah, no, my recollection is that if indeed there is a transaction, then it gets disclosed --

Jennifer Zepralka: Correct.

Christine Jacobs: -- Correct? Yeah, okay, got it. But the other $75 million market cap exemptions, they do not have an expiration, do they?

Jennifer Zepralka: No.

Christine Jacobs: The others that you listed?

Jennifer Zepralka: No.

Christine Jacobs: Okay, good, thanks.

Lona Nallengara: So now we'll provide a background on the 404(b) auditor attestation requirements, and we have -- from our Chief Accountant's Office, we have our Chief Accountant, Jim Kroeker, who I think you all met last meeting, and the Deputy Chief Accountant, Brian Croteau, who -- I think Brian is going to walk us through some of the history and our current [inaudible].

Brian Croteau: Sure, great, glad to do that, and thanks, Lona. Good afternoon, everyone. Just a few remarks I guess on SOX 404(b) and the internal control requirements. Some of this may be very familiar, but just to set the stage, certainly the importance of internal controls over financial reporting and having internal controls is something that's long existed. The Foreign Corrupt Practices Act in 1977 introduced the requirement for companies to devise and maintain a system of internal controls. SOX, in 2003, added a requirement relative to management making an assessment of the effectiveness of their controls and disclosing that assessment in their annual filings as well as having the requirement for the auditor to audit the assessment of the effectiveness of internal control over financial reporting. So the Commission's rules, of course, have those two components in them in Item 308 of Regulation S-K, the management requirement and the audit requirement. I thought it might make sense though to say a few words about the current exemptions that apply as well as the phase-in that exists in the Commission's rules today relative to ICFR.

First, the Dodd-Frank Act last year provided a permanent exemption really for non-accelerated filers. So companies with under $75 million in public float are not required to have compliance with 404(b), the audit requirement. They're still required, of course, to make management's assessment on an annual -- on an annual basis. So this permanent exemption for non-accelerated filers covers roughly 60 percent of issuers in terms of at least a current snapshot in terms of thinking about the percentage of companies covered by that. The Commission implemented that aspect of Dodd-Frank. In fact, I think it was one of the very first rules implemented after the passage of Dodd-Frank back in September of last year.

Another piece to point out really I think relates to the phase-in that exists today, and back in 2006, shortly before the Commission went through the exercise as well as the PCAOB of implementing reforms to improve the implementation of SOX, the Commission provided a phase-in for newly public companies in complying with the requirements of both 404(a) and (b). And essentially, that phase-in means that companies in their IPO, and in their initial public offering, and in their first annual report are not required to comply with either 404(a) or (b) and provide either management’s assessment or the auditor's report. In the second annual report essentially, companies would start complying with the requirement for 404(a) and (b) to the extent that they're not exempt from 404(b), of course, if they're a non-accelerated filer in their second year. So essentially there's a two-year on-ramp, if you will, in the Commission's rules today relative to compliance with both 404(a) and 404(b).

The Commission in its release in implementing that phase-in recognized certainly the importance of providing public company -- newly public companies time to focus on their internal controls and improving the quality potentially of their first reporting on their internal controls.

The other thing I might just mention is there was a staff study that was required as a result of the Dodd-Frank Act that we completed last year -- in April of last year, which you can find on our website. That study was really with respect to a relatively narrow range of companies with public float, between $75 and $250 million, to examine whether there were ways to further reduce the compliance costs and burden, and whether doing so would result in increased volume of initial public offerings. And, generally the results of that study found that, investors have

found benefit from the reporting, the liability of financial reporting has improved, there are fewer restatements relative to companies that are reporting effective ICFR, and particularly when there was auditor association with that. The study was very much focused on 404(b), the audit requirement, and again, a fairly narrow band, $75 to $250 million of public float. The other thing we found is that range of companies tends to be somewhat transient in that companies move through that range, or in and out of that range, fairly frequently rather than stagnate in that range. The GAO also has a study to complete. Theirs is due next July, and theirs really focuses on the effect of the exemption of 404(b), thinking about -- to the extent that those company -- for those companies that have been exempted, the effect on restatement rates, cost of capital, confidence of investors in the reliability of financial reporting, and considering the extent really of the voluntary compliance that we see for those companies that have been exempt. So I think that provides a bit of context at least in terms of the current requirements and phase-in that we have in the rules today.

Lona Nallengara: Great, thanks, Brian. At the last meeting where we had talked generally about the IPO Task Force report, and on-ramping, and scaling disclosures, many of you expressed some interest in getting some background on the research analyst rules, that many proponents for change in our regulations and rules generally to facilitate IPOs, they've -- many of you expressed some interest in getting some background on the rules that are in place today. So we've invited some of our colleagues from our Trading and Markets Division who are real experts in this area, which -- who will provide us not only a sense of what the rules are today but also give us some sense of history to understand how we got to where we are today. So we have Josephine Tao, Liz Sandoe, and Brad Gude, and I think Brad is going to lead us through -- we're going to spend a little bit more time on this topic because I think many of you are aware of the 404(b) rules and the reporting rules at least generally, but I think some of the research rules and particularly the history is an area that I think we'd all benefit from, from a little bit more focus. So, Brad, thank you.

Brad Gude: Thanks, Lona. As Lona mentioned, we're here to discuss research regulations, why they exist, and how they currently are structured. I am a lawyer, so I would like to give the disclaimer again. The Securities and Exchange Commission as a matter of policy disclaims the responsibility for any private publication or statement made by any of its employees. The views expressed herein are those of the author, do not necessarily reflect the views of the Commission or the author's colleagues on the staff of the Commission.

So basically, as I said, we'd like to provide sort of a background on the activity that occurred before the current rules were put in place, as well as a description of the current rules and regulations, culminating in a discussion of the recent report by the GAO on research analyst regulations.

So prior to the existence of the current rules, there were abuses by broker-dealers and analysts that shook investor confidence in research, and there was even some commentary that it harmed the IPO marketplace. Analysts were expected to help broker-dealers obtain investment banking business, market investment banking deals, and issue favorable research on investment banking clients. This is despite there being some regulatory controls. For example, the NASD had their fair and balanced requirements at that time.

The primary case in this area is probably a slew of cases that are collectively referred to as the "Global Settlement." And on slides four and five we have sort of a bullet point list of the allegations that the Commission made in those -- that string of cases, I thought would help illustrate the arrangements that helped create these allegations. If I could just walk through a couple of the specific ones. For example, in one case, the Commission alleged that -- in the pitch book for an issuer, the discussion regarding research coverage headlined: "Easy decision strong buy," implicitly promising that the broker-dealer would issue a strong buy rating upon initiation of coverage. In another example, in a Fall 1999 pitch to a different technology

company, the broker-dealer’s pitch book stated that the particular broker-dealer technology research analyst who would cover the company, quote, "gets it," would pound the table for the company and would be the company's, quote, "strongest advocate." In addition, the pitch book stated that research analysts would engage in premarketing one-on-one meetings with potential investors prior to launch. Another situation in these allegations was that the Commission alleged that an analyst had a neutral rating on a large telecom company and disparaged that particular issuer in media and research.

The CEO of the broker-dealer was also on the board of that particular issuer, and the issuer's CEO was on the board of the broker-dealer’s parent and was a close personal friend of the broker-dealer’s CEO. The telecom's management complained to the broker-dealer’s CEO that the analyst's, quote, "unprofessional tone and comments," made it difficult for the telecom to do business with the broker-dealer. The telecom, for example, was omitted from remarks by the analyst at a trade show as one of the important telecoms of the future of which the telecom's management complained to the broker-dealers CEO. The analyst drafted an apology to the CEO and the broker-dealer generally for putting the telecom in an awkward position in dealing with that particular broker-dealer. The CEO of the broker-dealer later asked that the analyst take a, quote, "fresh look" at the telecom, and assisted in getting the analyst's children admitted to a selective preschool. The analyst did take a fresh look at the telecom, including new access to the CEO, and upgraded it. He later admitted that he did so to get his children admitted to the preschool. After the upgrade, the telecom selected that broker-dealer to underwrite the IPO of their wireless division. In selecting which broker-dealer to use, the telecom gave significant weight, over half, to its views of each investment bank's analysts. After the IPO, the analysts downgraded again.

So, I just also wanted to point out that this isn't just a historical problem. We still see this sometimes. There were comments in August of last year by a CEO of a large issuer that candidates for that issuer's next offering must have research that indicates, quote, "a clear understanding of the company and why the issuer is a stock that investors should own." And FINRA, who's the self-regulatory organization for a lot of broker-dealers, ended up having to put out some guidance about what brokers should do in that sort of circumstance.

A couple of the Non-Global Settlement cases, also I thought I'd just quickly go over as well, Bank of America securities was -- we also -- we settled charges with. In that case, the firm failed to maintain adequate controls over the release of its research. It was similar stories to the Global Settlement case. The Commission alleged in that case that analysts went to downgrade or drop coverage, but investment banking concerns kept them from doing so. As a result of this settlement, Bank of America is under similar restrictions as the Global Settlement firms. Another case that I thought I'd point out was the Paul E. Johnson case. Mr. Johnson was found liable for securities fraud. He issued positive ratings on companies that were inconsistent with his privately held beliefs, and he also failed to disclose, in his research reports or public statements in favor of various mergers, ownership of pre-IPO shares that stood to provide financial windfalls to Mr. Johnson should that merger proceed.

Now, however, we have a number of regulatory enforcement initiatives that address this conduct specifically, and this is the -- these are the items that I'll be going through now in more detail. So the Global Settlement first: This was an enforcement action against certain firms that were the culmination of investigations into undue influence of investment banking on research analysts. There were a number of regulators that participated. It began as 10 firms and then expanded to 12. And it is now down to 11. It's called the Global Settlement most likely because of the nature and the size of the firms and regulators involved. I think it's important to point out that there's another element to this settlement. It's not just a set of structural reforms, which is, I think what people think of. There were also a number of penalties. There was disgorgement, and funds that had to be provided for independent research and investor

education, as well as these structural reforms. And as a settled enforcement action, it's subject to court oversight and only applies to the firms that participated.

On the next slide, this is the overview of the structural reforms that were required as part of the Global Settlement. This was part of the documents that we provide as background documents. Amendment A -- Addendum A, I should say, has the full list of these. There was also a press release and a fact sheet that we provided on the Global Settlement. These are the reforms that still stand after the amendments last year, and I'll discuss that amendment process a little bit later, and I should point out that these reforms only apply to equity research, so fixed income research it doesn't apply to.

So of the specific elements to the Global Settlement, I thought I'd go over a couple. The education of the sales force. The high points are on the slide, but this is one that kind of is relevant in the context of the IPO recommendations. And there's a general prohibition on communication between research analysts and investment banking personnel. Under the Global Settlement, there is an exception that allows it -- allow research analysts to educate the sales force, and these were the restrictions on that sort of exception. On the next slide are the requirements on the Global Settlement that allow analysts to communicate to investors regarding potential offerings.

I'd also like to point out, as I briefly mentioned before, independent research was part of the Global Settlement and $460 million was provided by the settling firms to acquire independent research for their clients. It was overseen by an independent consultant that we received reports from every year while this was in effect. We understand that some firms may still be providing independent research to their clients, but they're not under any obligation under the Global Settlement to do so anymore. So the agreement provides a method for amendments or modifications to the structural reforms of the Global Settlement. This slide has the actual specific language. You'll see that it has to be superseded by a -- one way is for it to be superseded by a Commission or SRO rule. It was originally after October 2008, but it was extended, and it's subject to court approval and unless the Commission does not believe that the change is in the public interest, sort of check. The settling firms did, in fact, propose changes in 2009. They filed a motion with the court, which the SEC did not oppose. Generally these amendments were to remove provisions that were duplicative with existing SRO rules. There were some that were removed where the costs outweighed the benefits, for example, the Global Settlement used to require separate legal and compliance team, both for the research analyst part of the firm and the firm generally. That was done away with in these amendments.

The court approved them in March 2010. There was one that the court did not approve, and that was one relating to investment banking and research, talking about market trends without a legal or a compliance chaperone, for lack of a better term, being present. And the firms have not, to this date, requested any further modifications beyond this. I should note that the Senate Bill 1933, wouldn't affect the Global Settlement because it only applies to SEC or SRO rules, but this is kind of a useful background for these firms and the obligations that they're under.

So that's the Global Settlement, but what about the rest of the broker-dealers that aren't party to the Global Settlement? That discussion starts at Section 15D of the Exchange Act. This was part of Sarbanes-Oxley and basically requires the SEC -- or upon the authorization and direction of the SEC, SROs to pass rules to accomplish certain objectives regarding research. There's a general requirement for these rules to address conflicts of interest where analysts make recommendations on the specific -- certain specific requirements under these rules, including a requirement to adopt rules that, quote, "define periods during which brokers or dealers who have participated or are to participate in a public offering of securities as underwriters or dealers should not publish or otherwise distribute research reports relating to such securities or to the issuer of such securities," in other words, quiet periods.

These -- the objectives of section 15D were accomplished through SRO rules, and I should note that obviously the Senate bill would change this. It's in the House, too, obviously. The SEC and the SROs would be prohibited from enacting quiet periods in relation to emerging growth companies, in relation to the IPO period around the expiration of lock-ups.

On the next slide, which is already up actually, the next set of requirements comes from us as well -- or it comes from the SEC. It's Regulation AC, which basically requires research reports and certain quarterly records to be kept in connection with public appearances that have two certifications, and those two certifications are posted up there basically, that the views are the analyst's own and that they're not compensated to say, "buy," instead of, "sell," kind of thing. There are certain limited exceptions for Reg AC, but for the most part, it's -- applies to the industry.

The SRO rules I think are where many of the substantive requirements regarding research analysts that people think of. There's two primary rules. There's the NASD Rule 2711 and NYSE Rule 472. And I should note that 2711, we provided a copy of as part of the background document. Both these rules predate the merger of FINRA. Prior to FINRA's existence there was two separate SROs, NASD and NYSE, and they merged their member Reg operations into FINRA since then.

So they're administered by FINRA now. They're mostly identical. They apply only to equity research, and there are some other types of research that are accepted, for example, if a research report goes to 15 or fewer people. Obviously, as SRO rules, they apply to the members of those SROs. And the next slide is an outline of the provisions of those rules. I provide sites there in case anybody is interested, but there's also the full documents in the background. On the next slide, this is the quiet periods that are required under the SRO rules, and it varies according to offering or the participant at issue. The IPO bill would require FINRA to remove all these requirements for emerging growth companies except for secondary offerings, which don't appear to be implicated, at least from first blush. I think the considerations here -- the purpose of these quiet periods was to reduce the manager's ability to improperly reward the subject company for its underwriting business by publishing favorable research reports after completion of the offering. They later added requirements to other participants to ease competitive disadvantages.

There was a report by the SROs in 2005 that looked over all of their rules and research analyst areas to look at the effectiveness of these rules. And one of the things that the SROs had found was that the first post-IPO reports were being more neutral or negative, for which they attributed to other provisions than the quiet periods, and in that report they proposed to reduce the length of quiet periods. Regarding lock-ups, the issue there -- so there's two sets. There's the ones around IPOs and secondary offerings, and then there's the ones relating to the expiration of lock-ups. Those are there to address the issue of booster shot reports. There was -- this came up in inspections that the SEC had done leading into some of these Sarbanes-Oxley elements as well as some testimony on the Hill about the issue of booster shot reports; so this was kind of the regulatory response to that. In the 2005 report, the SROs did not provide any evidence that they were not overly -- that they were not effective or were overly burdensome, but they did split on the analysis of the provision. The NYSE thought that the regulatory concerns behind this provision were still warranted but felt that they could be reduced to five days, whereas the NASD thought that other provisions filled the gap and wanted to remove the provision altogether.

On the next slide, another provision I thought I should discuss is the prohibitions on research analysts, basically soliciting investment banking business. These include a prohibition on joint appearances with investment banking or issuer of management when discussing an investment banking transaction with customers. This has been interpreted also to prohibit joint appearances when engaging in efforts to educate the sales force. Whereas the Global Settlement has a

similar provision, the Global Settlement provision has a further restriction that it be post-mandate, which doesn't apply for the SRO rules. The IPO bill would change this provision in two ways. First, FINRA would not be permitted, in connection with an IPO of an emerging growth company, to restrict by functional role who can arrange for communications between an analyst and an investor. So in those cases an investment banker could arrange those calls. Second, FINRA would not be permitted, in connection with an IPO of an emerging growth company, to restrict an analyst from participating in any communications with management that also is intended by non-analyst personnel such as investment banking, and it's possible that this provision implicates the prohibition on pitches, and analysts participating in pitches, or deal roadshows found in the current rules.

The next slide. These are ongoing developments. These are kind of the notices from FINRA that outline some of the significant activity I mentioned. There was a 2005 report. FINRA had proposed to adopt some of the changes from there. They were never formally adopted. In 2008, which is FINRA Regulatory Notice 08-55 up there, FINRA published a regulatory notice to members to solicit comments about consolidated rule, so they take the two separate rules consolidated into one FINRA rule. This would've incorporated a lot of the 2005 changes including the quiet periods. It would've eliminated quiet periods altogether for everything except for IPOs, and in that case all IPO quiet periods would be shortened to 10 days for all participants. We should note that this may be in conflict with the requirement under Section 15(d) that there be quiet periods in connection with public offerings, not just IPOs.

Last March, FINRA issued a regulatory notice to its members seeking comment on a concept proposal relating to fixed income research. That's Regulatory Notice 11-11 up there. And then also last September, as I mentioned briefly before, FINRA issued a Regulatory Notice to provide guidance in situations where the issuer's management has put pressure on the member to issue positive research. As far as the proposals are concerned, we have not received any formal filings yet. We understand in our discussions with FINRA staff that they're working on a consolidated fixed income equity research proposal. And then on my last slide, and I swear I'm wrapping this up, we also wanted to highlight a recent report by the GAO regarding research analyst regulations.

This was one of the background documents we provided. Just last month -- this report was just issued last month -- and it was required under Dodd-Frank, and it went into an in-depth review of the background and some of the studies that were done on research and regulations related to those. They highlighted studies where research was associated with improvements with recommendations from their view. Recommendations were less optimistic than before the regulations were in place. The influence of conflicts was weakened. There was greater analyst independence, but in other areas, results were mixed. There was no clear outcome as to whether following the recommendations created better profits than before the regulations were in place, there was no clear outcome as to whether research was more informative, and there was no clear outcome as to whether analysts were more accurate after the reforms. They did also note that most industry -- or they received comments from the industry that the reforms helped I think address a lot of the conflicts of interest but didn't completely correct them.

The recommendation from the report was for the SEC to formally assess whether to codify any of the remaining Global Settlement structure reforms I mentioned before. Their specific concern seemed to be that investors at non-Global Settlement firms potentially are not given the same protection as investors at Global Settlement firms, and we agreed with this recommendation. So just to wrap things up, the abuses that happened absent the -- there were abuses that occurred absent the current regulatory regime, and also were tied to the sales aspects of broker-dealers in such a way that it impaired their ability to provide research that was useful and reliable to investors. There were some rules prior to these abuses such as the fair and balanced requirement and reports, but as the GAO report indicates, the regulations have been effective in insuring useful and reliable research as required in section 15D, which is the focus of these

provisions. And I should also note we have been obviously amenable to amendments that do not harm investor protections.

Lona Nallengara: Thanks, Brad. So the background that Brad provided, it was detailed, but what it was trying to identify is that the perceived abuses in -- or the activity of the research analysts impaired, in many people's view, the quality of the research that was being provided and whether that research could be relied upon by investors. What was driving the research? Was it true analysis of the company, or was it an effort to facilitate the investment banking side of the institution? And the rules that were put in place and the Global Settlement were designed to separate both -- separate research from investment banking in creating barriers between them, creating barriers between compensating both sides of the institution and interaction between them. And we'll hear from Kate and Joel that some of those separations, as discussed by the Task Force, may have had some unintended consequences on the IPO market. So with that, Steve, I will turn it back to you for introduction for our guest.

Paul Maeder: Steve, could I just ask a historical question of Brad?

Stephen Graham: Absolutely.

Paul Maeder: Would that be okay? Recognizing that you've stated your disclaimer to the fact that you work for the SEC is purely coincidental and --

[laughter]

-- lucky you walked in here today. This whole issue -- I've been dying to ask somebody this question -- somebody at the SEC this question for years now -- this whole issue reminds me of the Claude Rains line in Casablanca where he walks into the casino at the end and he says, "I'm shocked to learn there's gambling going on in here." Is there any evidence that there were any people before this settlement that actually thought that research was objective, that it was anything but advertising? So when I go to a Ford dealer, I pick up a brochure written by Ford telling me why a Ford is better than a Chevrolet. I expect there to be a buy rating at the top. I treat it as advertising. I don't expect to see any words in there that say Chevrolets are better than Fords. It's informative, it's useful, and it's taken with an enormous grain of salt. Research was always seen as advertising, and the idea that you could compel Ford to be evenhanded in their discussion of the 150 versus the Silverado seems to me as absurd as the idea that you could create a research industry that was truly unbiased.

Was there any consideration -- so here's my question, Brad -- was there any consideration at the time, to either eliminating the words, "buy, sell, hold" from analyst reports and letting things continue, or forcing research houses to put a big advertisement stamp and just letting things continue as they did? Because the effect of all of this has not been to make research unbiased, it's effectively been to eliminate the ability of investment banks taking tech companies public to explain what the companies do. There could've been a restriction that just required everything to be factually correct. So -- but right now, these companies can't explain actually what they do, and they're often very technical companies, and it's often very hard for investors to figure out where they fit into the great scheme of technology companies. So was there any thought given to any of those ideas that you're aware of?

Brad Gude: I wasn't at the Commission at the time a lot of this stuff was put together, so I'd probably be --

Paul Maeder: Well, bring Donaldson back in here.

[laughter]

Do we have power of subpoena?

Brad Gude: I think that they're -- I mean, some of the things that you mentioned are, I think, attendant to a lot of these things. In the Global Settlement, for example, there is a health warning that's required as part of the disclosures. I think also in the FINRA rules is a requirement to provide -- as I recall, they -- you have to say -- even if you don't use the words, "buy, sell, or hold," you have to say, you know, "If I did use 'buy, sell, or hold,' this is where my ratings would fall out." So I think that there were some -- I think the -- I think part of the problem, too, is that maybe not all investors are maybe as sophisticated as you are, so we have to keep that in mind.

Paul Maeder: Oh, no, I've only lost money in public markets.

[laughter]

I am -- believe me, I am not very sophisticated.

Brad Gude: So I think that's also a concern for the Commission.

Lona Nallengara: Part of the philosophy behind it was that if you do create the -- if you do create a separation -- physical separation, and organizational separation, and a compensation separation, and you create a research part of an institution that doesn't -- it doesn't necessarily have to answer to the investment bank, then there is a way that you can create a research function within an institution that has an investment banking side that is independent, that isn't Ford saying they're the best when they're selling a Ford car. That was -- that's the -- I think that's part of the philosophy behind it.

Paul Maeder: But, of course, it hasn't turned out that way. The analysts are compensated purely from trading revenue and, therefore, only the big companies that have the trading volume get analyst coverage, and small companies don't. So they're essentially prohibited in the process of doing an IPO from explaining their business, and that has had an enormous damping effect on their ability to access public markets. That's the tragedy. We've made it safe for investors certainly, because if they can't buy a new issue, they won't lose money. But that's not the -- that's not the goal of promoting fluid capital markets.

Meredith Cross: We don't have the senior folks from TM here to react, and I don't want the fact that we're not debating with you whether we think the research settlement was a good or bad thing to suggest that we're not actually big fans of it. I just -- I don't want the silence to go unnoticed. I think we think it's very important that the abuses that were present at the time be addressed, and we appreciate your point of view.

Stephen Graham: Okay, well, thank you, Paul, for bringing that up, and thank you, Lona. Thank you, Brian. Thank you, Jennifer. Thank you, Brad.

Now let's turn to a presentation from our friends from the IPO Task Force. As indicated to you this morning, we were going to be joined, and we are, in fact, joined this afternoon by Kate Mitchell, who is a managing director at Scale Venture Partners and who chaired the IPO Task Force, and one of her Task Force colleagues, Joel Trotter, from Latham & Watkins. And again, as you'll recall, at our last meeting at -- been -- well, not our last meeting, but our last in person meeting I guess -- in October, we talked about the Task Force's work, and we all agreed that it was helpful and informative. You've all had an opportunity to read the report, and we thought it would be a good idea to give the Task Force an opportunity and give you an opportunity to hear directly from members of the Task Force and have an opportunity to ask questions and engage in discussion. The point I think primarily is for us to share ideas, identify areas of common

ground, and find opportunities for mutual support. We're going to generate information over the next hour or so, but there won't be any action item for today. And so with that, I would like to turn it over to Kate.

Kate Mitchell: Well, Steve, thank you. Can you all hear me well enough? Good. Thank you for the introduction. Thank you to the co-chairs for having us come. Thank you to the SEC. You've had a welcome and open door for good conversation since this started. And thank you to the Committee for all the reading you do before these meetings. [laughs] I'm impressed, having seen the whole list. So again, really appreciate the opportunity to have this kind of dialogue going forward.

And, Steve and Christine, let me check with you, what I thought I would do is give a quick overview of the Task Force for context so you kind of know from where these proposals got born, briefly go through the proposals, give some business context for them, and summarize what they do, talk about what's not changed because I think that's equally as important and something we considered quite a bit, and then open for questions. But I want to be thoughtful about how you want to manage the time you'd planned to break. If you'd like to manage it a different way, I can try to keep this to the 30 minutes we talked about, but I'm happy to do it any way you'd like.

Stephen Graham: I think what you propose is fine.

Kate Mitchell: Okay.

Stephen Graham: here are a couple of -- there were some materials that were just circulated to the Committee I think yesterday.

Female Speaker: They're in the blue folders.

Stephen Graham: In the blue folders. I don't know.

Female Speaker: Right.

Stephen Graham: [inaudible] Did they make it to my blue folder?

Kate Mitchell: Yeah, you should've gotten two things. One is -- and I am happy to say, the thicker of the two is a document that talks about the things that are unchanged from the proposals, and there is also a summary, as should be in there, of S. 1933, right?

Stephen Graham: Yeah, I don't think --

Kate Mitchell: Since that's kind of the relevant -- since that's being discussed right now --

Stephen Graham: Oh, attached to the agenda?

Kate Mitchell: -- so two pieces.

Stephen Graham: Okay.

Female Speaker: Visual aids.

Kate Mitchell: Visual aids and [inaudible] --

Stephen Graham: Got the summary. Okay, Kate.

Kate Mitchell: Great, so I'll talk a little bit about the Task Force. We were born, if you will, at the Treasury's Access to Capital Conference they held last March. A group of us left and had sort of a common concern about the decline of IPOs, the impact on the economy and, in particular, job growth. And what we agreed, and this is kind of important when you look at what we've put together, that page with all the recommendations that's now embodied and most of which is embodied in S. 1933, not all, is our perspective was it was a cumulative effect of things, not one thing. It's easy for people to point to SOX, to point to specific issues. Our view was that it was a cumulative impact, and so to look at things cumulatively, both on the cost side and on the research sides, which we've talked about. Important things to know about who the Task Force was, it was 16 of us, and we put it together purposely, much like this Committee, with a cross-section across the industry. We had venture capitalists like myself, small investment bankers who focus on this market, William Blair and JMP, securities attorneys like Joel at Latham & Watkins, academics, a former Chief Accountant of Corp Fin at the SEC, and the former head of PWC's tech practice in Silicon Valley. We really wanted people who understood and who would come in with differing points of view around the table.

We didn't want "group think," which is easy to have done, and our point of view is that if we were going to bring something to the public, it should work for all of those groups. So there were things that any one of us came in that room with that dropped by the wayside because they didn't pass muster with our peers. And I would say a representative from Wasatch was on the Committee along with T. Rowe. They in essence got a veto. If the things did not work, if it didn't qualify in terms of supporting investor protection, and frankly wasn't of interest to institutional investors, I mean, this is all about an initial public offering, that was a complete blackball opportunity. There was no discussion. There was very quick discussion. So I think that was probably the most important aspect to understand about how this group came together. And then when we started our first meetings in July, we had good conversations about where we wanted to go with this, and our perspective was to make these recommendations practical but meaningful.

We didn't want to boil the ocean, we weren't trying to come up with radical solutions that while it might please somebody to speak about, really would be very difficult to frankly both understand and probably ultimately implement, and when we got done with our first draft of recommendations, we actually polled three, I'd say, broad different groups. First, more institutional investors, again, back to the veto that institutional investors would get because of the investor protection issue, you know, we started with that. And we used the investment banks to go out to their network. We used the exchanges to speak to institutional investors, et cetera, to get some feedback. We really did not want to put anything in our proposal that would, again, harm investor protection.

Secondly, we touched base with CEOs. We did a survey in August of both pre and post IPO companies. It was anonymous. We did it with NASDAQ, asking: would these issues matter; what concerned them about going public; pros and cons; what was most important; *et cetera*. And we -- some of that is in the very back of the actual proposals that came out of the Task Force, itself. And then before we published in late October, we got feedback from the ecosystem. We actually came to the SEC. We had a very productive conversation and included some of that thinking in our write-up. The Treasury Department spent a lot of time with the exchanges. So, again, it was all about a cross-section with this goal of being practical. So that was really how we got to where we were.

And so then I thought I'd talk about three aspects that are probably the most important parts of the recommendations, that are consistent with what's in S. 1933. First is the definition of what is an emerging growth company. Second is looking at those cost elements that go on the on-ramp. Third is to look at the communications information research aspects of it, and, fourth, what's not on. So with that, I'll start out with the definition of an emerging growth company.

It's really a new category of issuers that we're recommending, called an "emerging growth company," under the Securities Act of ’33. That would be defined as companies with less than a billion in annual revenue, less than 700 million in public float, and -- this is probably the most important piece because we looked at things like that -- 60 percent impact of -- and we looked at some of the prior proposals around some of the improvements that came out of the Donaldson Commission, and there were some interesting ideas, but when they impact 85 percent of the companies on the exchanges, we completely understood why that didn't make sense. So, one of our themes being practicality, we decided a temporary status was really important to have implemented ultimately so that would be fully compliant and consistent with the broad regulatory requirements. So that was really sort of number one. The result then, we did a retrospective study the last five years to say, given the size limitations and the time limitation, how many companies would qualify, the parallel to that 60 percent. It would be 11 to 14 percent of the companies, depending on which year -- of the number of companies, and less than 3 percent of the total market cap. That felt right to us in terms of risk for the exchanges.

And then sort of how did we choose our definitions? Again, we're focused on emerging high growth companies that can grow more than, you know, 2X a year, companies like Zynga, companies that we invest in. Important to note, Ford and Facebook -- I don't know if they became officially filed today -- wouldn't qualify. They shouldn't, given their size, given their scope. That's not the intention. It's really for those, $150 million companies that are doubling every year. In fact, a company of that size would probably fall off the on-ramp even in its fourth year, but that's the company that we were trying to focus on. We didn't want it to be too small and too short-term for entrepreneurs to find it meaningful, and we really want them to change their behavior and preference around wanting to sell themselves as opposed to going public. So the goal was to encourage emerging growth company IPOs, but clearly within the context of U.S. securities regulation.

We also chose measures because we had a lot of questions about the market cap test. We didn't choose that, and, you know, folks that have recently gone public know the vagaries of the public markets, because it takes a long time to comply with these things appropriately. We wanted measures that could be anticipated. So revenue and float can be anticipated in a way that market cap cannot, and we wanted to build on existing definitions. I know it's no surprise to the folks at the SEC, our $700 million definition really builds on the well-known seasoned issuer definition euphemistically I come to know, I know it as WKSI filer, all the things I've learned on this [laughs] project. So that's how we define what a small -- an emerging growth company is. And then we had these two pieces.

We had an -- when we thought about -- even back at the March event, there were really two issues. One is the supply of companies willing to go public, and a lot of that really revolved around the cost of going public. They wanted to delay that cost and then ultimately because it takes so much time, really ultimately ended up selling themselves to larger companies domestically and internationally. We also then looked at the demand side which really gets to the research piece. So let's first focus on the supply side.

We came up with this concept of the on-ramp. It's this temporary piece that we were just -- that we were referring to that -- as Brian was referring to smaller reporting companies who have permanent exemptions resulting in 60 percent of companies being impacted. Our view is this would be a transition period. I say that, you know, there's a baby chair, and a papa chair, and there's a mama chair. This is a mama chair, but it's a transitional phase for these companies. You know, when you -- we polled the CEOs -- and I do encourage you to look at the research that we did -- the concern about the cost of going public was really a number one issue for them. When we took their responses and we asked them to give us the ranges of their total cost of going public, it, conservatively estimated, was $2.5 million to go public and $1.5 million to stay public.

One of the CEOs that did ultimately go public later this year, CEO of Angie's List, actually also did his own research of all the companies who went public the first half of 2011, and that number to go public was actually closer to $4 million. These were typically bigger companies. So a big cost element when you're a CEO, and it's going to take you a couple of years, and you don't -- you're not certain if you're going to be successful going public -- because remember right now it's a less than 20 percent likelihood if you file, or ultimately go public, it's the biggest backlog we've ever had right now -- spending those millions on getting prepared to go public versus another engineer, another salesperson, it's much easier and more predictable to continue to build your company when you have limited resources than to have another engineer, another salesperson. And that's why people put off IPOs and then ultimately sell. What we did do was sit down, and we looked at smaller reporting companies, and they have a long list of things they're permanently exempt from, and we looked at what large companies do. And what we did was we kept most of what large companies need to comply with, and did a shortened list of the things that we thought both were the true cost drivers and did not impair investor protection. Good example, forecasts of future cash flows. That's something that Dan Chace wants to know. No matter how much that costs, we're not taking that -- we're not putting that on the on-ramp. So that is the kind of thing that we kept on.

There were a lot of things that are not expensive to keep on and absolutely appropriate to keep companies having to adhere to; things like disclosure of corporate governance policies. Absolutely, let's include that. So we really came up with what we believed were the things that drove cost and were as short as a list as possible. When we went back and polled CEOs, after we came up with this list, they believed this would end up with about 30 to 50 percent reduction in cost; so… significant. Also, kind of healthy to know it wasn't 80 percent, which might make us all a little worried, so that felt about right when we went back in and spoke to folks.

So I'll go through quickly the primary elements of this. You know, I typically don't like starting with SOX because that's such a poster child for people, and I think sometimes take up more time than it needs to in these discussions, but I will -- but I bring it up first because it was the number one element that CEOs cited from a cost point of view, and it's both the external auditor fees but also the internal costs of people, systems, *et cetera*, that need to be put together in order to be prepared to comply. And again, it takes two or three years to get, you know, all the way up to speed on 404(b). Today, as was noted, it takes two years to comply. What we're saying is at most, give companies another three years. My example of that $150 million company doubling would actually have to comply probably by its third to fourth year. And so it would probably begin to ramp up very close to after its IPO, again, a reasonable thing for them to begin to do, because obviously it is certain they can go public, and, therefore, very reasonable to get to ramp up, and then ultimately comply.

Again, to reiterate, you know, smaller reporting companies are permanently exempt. This is a short-term aspect. And, for better, for worse, and I apologize for some of you companies that were around the table, CEOs and CFOs still have to have effective internal controls, have to disclose any weaknesses, have to certify, and are liable. So we really haven't done away with the importance of what we think is underlying all this, I mean, the issue of internal controls. The second whole piece of it was the disclosure obligations, you know, sort of two aspects, financial disclosures and executive compensation on financial disclosures, because companies typically don't use a national accounting firm until they are anticipating an IPO -- to be able to go public with two years' worth of financials, rather than three, having a new accounting firm come in and do three years of history was more than needed. Two years gives your every-year comparisons. By the third year, they've got their full three years. So, again, that burns off relatively quickly and, again, that's consistent with what smaller reporting companies are allowed to do.

On executive compensation, likewise, not to allow no disclosure but to use the smaller reporting company rules that are out there that are detailed for the top three. Typically, companies have much simpler comp packages for those that are going public versus, let's say, you know, Jeffrey

Immelt at, let's say, GE. They only wish they had more complicated CD&As because there aren't the resources to get them all the goodies, and that's not what the shareholders and buyers of an IPO would certainly expect. This was cited when we went out to CEOs -- and this surprised me, I didn't realize this, although I'm now chair of a comp committee for a public company, so I do now know this intimately -- but they cited this as the number two -- the second most expensive piece, and we went through the issues -- yeah, Karyn's nodding -- it is a lot of time and expense. So, again, we want to have the data come out. We do want to talk about compensation. They should know what the senior executives have. They typically, by the way, have smaller executive teams -- and get it out, and, again, a company that I cited earlier, that $150 million company that's doubling every year, by the fourth year would be fully compliant, and wouldn't even last that full five years. Then we talked about two other things that have garnered a lot of conversation, so I'll put them out there. Meredith hasn't kicked me yet. I haven't gotten to the research piece. So -- but --

[laughter]

-- you'll have your opportunity -- we've had good conversation about these things -- but the things that I've had a lot of attention on are new accounting pronouncements, and that really goes to FASB, and auditing standards, and that really goes to PCAOB pronouncements. First taking the FASB piece, what we put in the proposals and have ended up in the bill is that emerging growth companies get the same transition period for the accounting pronouncements that private companies do. So, important to note, this does not impact the substance of any new accounting guideline and standard, it simply impacts the timing. And, by the way, of course, the -- FASB might decide that private companies also have to instantly comply with a given standard. We're simply, again, consistent with the other on-ramp concept here, giving them timing. Important to note, because there's been a lot of discussion on this, this is not intended to impede the independence of FASB, its ability to set standards, or its status as a standard setter. It really was to give both, again, timing not impacting substance for small companies as these new pronouncements come out. And then last but not least, accounting standards, something that actually came up from the accountants on our Task Force were proposed standards that are out there right now, mandatory, not auditor, but audit firm rotation out there as an issue.

So we included those in our proposals, but we also said as it goes forward we ask the SEC to evaluate new audit standards as they come their way, and to see whether or not they felt emerging growth company, you know, on-ramp status would apply for that given auditing standard, considering obviously investor protection and other issues. So we really left that going forward in the hands of the SEC. So those were really the things that we, you know, looked at. Again, there were a lot of things on the list that we'll talk about later that companies have to comply with, and, again, we believe they should. So now, getting to some of the juicy stuff, if you will, and I think really good conversations -- and, Brad, I appreciate you going through a lot of these issues because there -- it was good background for us on the Task Force to go through some of these as well. The reason we focus -- and it was interesting, when we got together as a Task Force, I frankly thought what we would've recommended would've stopped with what I just talked to you about -- when we got in the room, CEOs brought up issues around concern about information. You see that in their surveys. But actually we heard a lot more from investors, and a real concern about how opaque it is for an IPO. You can't talk to a company, post an org meeting that -- now, today -- I have company yesterday that just pulled an S-1 in our portfolio. It was two years. So you can't, you know, talk post org meeting. You can't have regular, you know, contact.

There is little information both pre and post in IPO, and kind of the the sense of; "If I haven't talked to somebody in two years, making a decision about investing in a 45-minute road show, I'm just not going to do it. I'm not interested." So we really became concerned about this impacting the demand side, and the objective was to look for transparency and consistent data

within the context of all the regulatory requirements, and conflict avoidance, and elimination that are there, but allow access to information. So I'll go through four of them and even touch on the FINRA issues, Brad, that you brought up as well.

The first is allowing an underwriter to publish research concurrent with an IPO, similar to what large companies do. Large companies, as some of you already know, have continuous coverage, even around offerings, as they're going through. So they have -- there are no constraints on their ability to communicate with their investors, and what we're really saying is giving emerging growth companies that same opportunity. And we want to be really clear -- and this is something we spoke about very plainly, in fact, some people have given us some push-back who may be on the other side of the argument -- we did not change any aspects of the Global Settlement; that's not our intention. And, number two, did not want to do away with the FINRA Codes of Conduct. And, interestingly enough, this includes the investment banks that were on our Task Force, I mean, that view that this is a helpful construct in terms of conflict avoidance, they are comfortable with using it, it always applies, and something that they felt comfortable continuing to keep in place. So that, we thought, was really important.

We also sort of underlined again the prominent -- you called it, "health warning," we called it, "a black box disclosure" -- you know, warning that you see on the back of your pack of cigarettes, you know, "This is research --" it's to your point, Paul -- "This is research that comes from a broker-dealer who is an underwriter in this offering," making it really clear what we mean about that. And, interestingly enough, the banks that we were involved with were not party to the Global Settlement, but their legal departments, it's clear to follow those. So that was really kind of our point of view on research.

Secondly, and I think important for really the quality of the market, is expanding permissible communications. We call this the "Test the Waters Provision," allowing a company to come talk to institutional investors, to come see Dan and his team before we file a registration statement, perhaps after we've had our org meeting. It's good for the market and investors. You know if we come talk to Wasatch and they say, "You know, this is interesting, we want to track you guys, but you need another year to prove out this new market, or new product," or whatever the issues are, that's actually good ultimately for the market. It's good for investors. It's good for us. We're not crowding up the pipeline because we're trying to get out when, in fact, you know, we really shouldn't be trying. So Test the Waters was one piece we recommended. We also recommended post offering communications.

We talked earlier, Brad went through the quiet periods and lock-up periods, and our thinking around that was, you know, in many ways, the timing is sort of arbitrary because, again, back to the first principles, you always have to eliminate conflicts in everything you do. So whether it's the 39th day before a 40-day lock-up or the 41st day after that lock-up, you still have to adhere, obviously, to all the conflict -- Codes of Conduct, and Global Settlement issues, *et cetera*. So for that reason, we felt, again, opening up the -- you know, putting a -- getting rid of the opacity around IPOs, and this is when it's, in particular, obviously important to investors.

One thing I'll touch on, Brad, what you referred to, and so you kind of understand the business aspects around the FINRA rules, around the calling, our thinking was -- and those of you that have been, and kind of looking at Karyn here because she's been through it recently -- they were really oriented around efficiency, and as Brad referred to it, the proposals and the bill have picked up, allowing a banker to transfer a call so that an investor can speak to a research analyst -- it is really arcane today. You actually can't even get a phone number. You actually have to find -- it's really complicated. It's sort of like you have to go out the door and -- it's sort of odd, almost, awkward, if you will, and, secondly, that if I'm a company, and I'm giving -- I'm updating, and I'm talking about my business to a group of bankers, that we could also have the research team sitting in because, again, doing it twice is twice the work as doing it. So it was really oriented around efficiency.

It was not meant to undo -- you know, all the, again, conflict rules, *et cetera*, would still apply. So the focus there was keeping everything else in place, but just sort of getting rid of what are almost socially awkward things to do, and frankly just inefficient for a team that's trying to take a company public. And then last but not least truly is confidential filing and, you know, when you think it -- when you say to somebody, "Gosh, I want to be able to file confidentially," that sounds contrary to what the objectives are of the Securities Act in terms of transparency or communication. And this is -- was really important to CEOs in particular. This is something today for certain non-U.S. companies is available, and what this means is that you file your statements, you're filing registration on a confidential basis, so that it comes in to the team at the SEC, they look at it, and evaluate, and amend, and come back with suggestions, concerns they have, and then post that period -- so and during that period, your information, it's -- as one CEO said to me, "It's like undressing in public." And remember, it's like undressing in public and standing out there for two years, in the case of our company that just pulled its S-1, all your competitors have all your financial information, your customers see your financial information, and, again, today when you have a less than 25 percent likelihood of going out, your customers say, "Well, hmm, I now know everything about you, and you didn't go public. Why?" and there's a real exposure.

This -- you know, right up there with the cost, for CEOs, this really keeps them from wanting to move forward, and something, therefore, they really put off and have to be thoughtful, because I will tell you, the minute somebody files, you know, as an investor, all of that gets sent around, and all the competitors are picking it apart and looking at it, and here you are exposed, and you still don't know if you can go public. What we did -- and this was useful conversations that we've had, it was folks including the SEC -- we did ask that once that preliminary registration statement does become public at the end of that first period, and when it's sent out to the public, that it be open for financial writers, bloggers, the Wall Street Journal, you know, it's out there for everybody then to look at, so when it does get public -- also, by the way, all the amendments, if I put something in my original statement and it got taken out, and that sense that I tried to put something in that got taken out by the SEC, that should be public, too.

Brad Gude: If, for example, you said that your revenue was X but by the time you were done with the comment process your revenue is one-half X?

Kate Mitchell: Yeah, that -- exactly. It should be --

Brad Gude: Hypothetically.

Kate Mitchell: -- hypothetically, it does happen. So all -- you know, first, during the confidential period, all of the discussions we've had with the SEC, you could do -- literally share a redline version to the street, then there's 21 days post -- minimum, three weeks -- post that publication now of finally public statement -- registration statement, at that point there may be further discussions from the public about: "Oh, what are they -- why are they using that metric? Why are they not using that metric?" and those kinds of things. Remember, at the end of that period -- and you just went through this, Karyn, so you know -- before you issue your final registration statement, you stop back at the SEC. Often amendments are filed during that period, and there may be further amendments that are required before that is finalized, before it gets priced, and before the company ultimately goes public, so, you know, there is an opportunity to accommodate, in addition to the SEC's input, public comments before all these documents get finalized. So that's really the intention and the process there, and, again, good conversation that we had in putting all this together.

Then sort of last but not least is what is not changed. And I'm not going to -- you have the long document. I won't go through it in great detail, but I'll hit on a few things, the offering

regulations, Global Settlement, the FINRA rules, the Codes of Conduct, all the general antifraud issues, duty to disclose.

I'm sorry, again, for companies -- liability for false and misleading statements, I mean, you owe that to the institutional companies, executive officer certifications, the SEC disclosure and reporting obligations, Reg FD, annual audits, quarterly reports, reportable events, description of corporate governance policies, and criminal penalties to be enforced against certifying officers. Focusing on corporate governance, which is so important right now, elements of the Exchange Act and the SOX requirements such as, you know, audit independence and financial expertise, independent auditor with five-year rotations, no conflicts of interest, you know, all those things stay in place. In addition, NASDAQ and the New York Stock Exchange have listing standards that further will remain in place. And, you know, to reiterate, in all instances where the on-ramp is in effect, which is, again, a temporary status, we are still complying -- asking these companies still to comply with SEC rules. They are never unregulated. The question is, are they complying with small reporting company, large reporting company, private company standards? We did not suggest that companies shouldn't be regulated. That’s kind of where we are in terms of what we propose. Love to open it up for questions and discussions, but I'll say in summary, again, these were -- it's a temporary status. We did try to build on the regulatory frameworks where they existed. We wanted enough of a runway so that it was a real transition for companies, not an artificial one, and we did want to obviously be sure to increase demand for IPOs by improving the quality of communication. So thank you all for spending the time, and look forward to questions. Turn it back to the chairs.

Stephen Graham: Thank you, Kate. I have one question for you. It just seems that -- it seems to me that, again, there are a lot of good ideas here, in terms of making sure that we properly calibrate a disclosure, that we fix some of the issues on the communication side, and that sort of thing, but at the end of the day so much depends on the markets, and if all of the Regs are like they need to be and the cost is like it needs to be, if there's no market -- and part of that goes to analyst coverage, and some of your thoughts as you've already mentioned there, but that's just a piece of it -- any further thoughts in -- and the part of the Task Force about how that's repaired?

Kate Mitchell: We couldn't agree more. We wish we could have a recommendation about the stability of financial markets. I know Dan would like that, too, but it's sort of in the "luck favors the prepared" kind of idea that when you look at the decrease in small cap IPOs, and the decrease not just for those under $50 million, even under $200 million -- there's this huge decrease since the late '90s -- talking to institutional investors that are really aggressive about looking for where they can get growth, I mean, that 50 to 100 X you could get with Symantec, and McAfee, and Microsoft, at Apple, *et cetera*, you can't get in the public markets anymore, you know, that it made sense to build in a logical transition so that as markets, you know, continued -- and, frankly, they're relatively stable right now, look at Dan, I don't know where VIX is today -- that, therefore, companies could go public and would be more incented. It was telling in talking to the exchanges who both speak to folks domestically and internationally; internationally companies really want to go public. They see that as the opportunity to build a big company, and that when they talk to CEOs in the U.S., they're more likely to want to sell themselves. And you see this huge reversal from, you know, 90 percent IPOs in the early '90s to 90 percent M&A now, and it's really, you know, reversing that, again, with the understanding that markets will wax and wane in terms of when windows are open, but let's make the windows more doable for when they do open.

Stephen Graham: Yeah, and I think stability is great. And open and closed windows, I guess we've been dealing with those all of our lives.

Kate Mitchell: I bet. I bet.

Stephen Graham: But this -- but a lot of it could -- just kind of goes to just the structural changes that have occurred --

Kate Mitchell: Right.

Stephen Graham: -- Whether it's decimalization or online trading, or high speed trading, or of --, just pick your --

Kate Mitchell: I agree.

Stephen Graham: --Pick your poison.

Kate Mitchell: I agree.

Stephen Graham: If you're not a Facebook or pick your highflying company --

Kate Mitchell: Right.

Stephen Graham: -- you know, and how do you -- and you're going to need people to support you, and to follow you, and to write about you.

Kate Mitchell: Right, right.

Stephen Graham: And that's not going to happen unless they're getting paid to do it.

Kate Mitchell: Right -- well, and it's a great question, Steve. We spent a lot of time on this, and there's been a lot of discussion around the changes in electronic trading, and decimalization, and really the shift in volume, which everybody in this room knows, on the exchanges. I mean, the average holding period for an algorithmically traded stock is 22 seconds. Wow, no time for research report on that one.

[laughter]

I was shocked. But, two things; one, when we talked to our investors, the idea of raising prices or raising prices for small companies, it makes it even less attractive to buy a small company. And when we talked to the bankers, they did feel they could -- and, again, the bankers we had were smaller investment banks who make more of their business around supporting small companies -- that they can make the math work. One of the things we did talk about is making sure that -- and this is not in a -- legislative discussions, it's not in our discussions with the SEC, this is really something -- in fact, Paul and I were talking about the need to educate private investors and CEOs about how -- since the nature of the public markets have changed, most of the transactions are very large cap stocks that are traded frequently, not long term holding of small cap stocks, it's become less friendly, but you can go public if you're thoughtful about how you go public, how you build your syndicate, that could obviously, if you can qualify for large investment banks but perhaps some that are more boutique banks, that may have differing investor bases, have broader economics around being able to support research, *et cetera*, so there is some education aspect of this that, again, we're not recommending anything from a regulatory point of view change, but there are ways for small companies to be smarter about going public, but I think you raised a good point. I joke that a small company in the exchanges today is like a ballerina on a freeway.

[laughter]

You know, it's really changed. But there are ways you can be prepared, so we do think -- and you do see some smaller companies -- and, you know, you could ask the folks at Wasatch -- you

do see smaller companies able to get out and go public. But, again, if it's more cost effective to do so, and we get them smarter about how they can get the right partner to take them public, we think it's possible without turning back the clock on pricing.

Dan Chace: I can chime in just to agree with that. I mean, I think there is actually -- the economics have gone way against trading small cap stocks for brokers, but there is actually a pretty vibrant community of midsize and smaller banks that specialize in these names, both from a trading and research side and also a banking side, and I think you'd be surprised that there's -- from my perspective, there's actually quite a bit of research coverage on a lot of small companies. I think the issue -- and it's not a regulatory -- an SEC issue as much as a perception issue -- is I think there's a mismatch. I think there's probably a broader pool of capital that's interested in these small deals than is widely perceived. And a lot of that has to do I think with -- and you touch on it in the full report -- but there's a kind of -- for VCs, for companies, that -- in a sense that "I've got to have a bulge bracket name leading my deal." And the bulge bracket names typically give their allocations to large investors in hedge funds, not small long-term investors, and there's data that supports essentially that -- there's data that supports that, that, you know, on initial allocations from regulatory filings it goes to big mutual fund firms. The hedge funds don't show up because they've already sold it. And then small firms like -- smaller midsized firms like Wasatch and others show up way lower and tend to increase their allocation over time. So I think there's a -- as I said, a supply of capital that's interested that doesn't get the attention it deserves. And that's an education issue, but I think in terms of your proposals, the most applicable to that is probably the expanding communications, just to bring it into something that's actionable.

I think there's a lot of changes that could be made to the IPO process because it is fundamentally flawed. Like you say, it's -- you know, you get a 45-minute meeting or -- we always joke about the 30 -- you know, the 15-minute call from the Lincoln Tunnel where management's dropping off the phone all the time. It's not conducive to making long-term decisions, and I don't know the regulations as much. I understand some of them from the discussion, but I think relaxing premarket, relaxing Test the Waters, allowing long term investors to get earlier impressions and relationships with management, to elect or extend allowing research coverage, you know, that's less relevant to us. It may be relevant to more, but really kind of smoothing that process out so that you can build a relationship and make an intelligent decision at the time of the IPO rather than, you know, have a quick call, and talk to your trader, and see what the allocation is, because I think there's so much uncertainty in that process -- another side to that as well is there's enough -- that's -- it's almost not doing -- worth doing the work for a lot of larger small guys when, you know, you know you can spend a couple hours, half-day, whatever, and you get 10,000 shares. And it's just not worth your while. So I think there's -- and I think that would be helped by a better penetration of a small and midsize banker syndicate. There's a lot of other details you could go into, but I think I just wanted to mention that.

Paul Maeder: First, thanks a lot for incredible work over the last six months. I think after 12 years of an IPO drought for small emerging businesses, it is safe to say that this is not just a cycle. There is clearly something structural that's wrong, and it just took a lot of straws to break this camel's back. You talked about a couple of them. Dan just touched on some that fall on us, and that require education and a change in behavior on the part of companies and backers, but one thing is very clear, we're not going to fix the problem if we don't start removing straws from the camel's back. And these are two really big straws, and we -- the camel may not stand up after these, but we got -- we have to do something as a country and as an industry.

One comment and one question, you spoke a lot on the cost side, on the demand side, about the cost of going public. And I think it's just important to mention that it's not just the dollar cost, because after all if you're going to go out and raise $20, or $30, or $40 million, spending $4 million dollars for compliance doesn't seem completely onerous. The issue is that the compliance

cost goes to the bottom line through the income statement, and it often wipes out whatever earnings the company has, so it's sort of a catch-22. You're ready to go public because now you finally have some earnings to show investors, but then you have to comply, which wipes out your earnings, and it's back to square-one. Keep building the company for another two or three years until you get to the point where that hit to earnings won't overwhelm what profits you're generating. And that's a critical issue that has moved the threshold at which investment bankers will even talk to small companies from what it used to be to two or three times that.

My second comment is really a question. Is -- and Dan touched on this -- is there any evidence that some of these changes in communications regulations and practices will result in a resurgence of a healthy independent analyst industry? Do the economics start to change again where you would be supporting knowledgeable analysts, providing research to prospective buyers, or is that just a guess?

Kate Mitchell: Yeah, the economics don't change, and that was an important part when we -- you know, and, again, not -- some folks wish we could impact that -- our view was, again, we wanted to build on sort of the existing structure because, I mean, we talked earlier, the SEC went through sort of the genesis of a lot of this, so there isn't -- there is no change to the economics in terms of how a research analyst gets paid. They do not get paid from investment banking fees. They don't have -- you know, they're not in the same physical locations. All the aspects of Global Settlement still exist. So there isn't any increased compensation. It allow -- I mean, they're doing the work and they wait until that 40th day to publish. It allows it to happen earlier if they decide to publish. It very well may be the investment bank takes it public and that research analyst, who has an independent decision to pick up the company or not, may or may not pick it up. So those are still completely independent activities, and still that management team has to go to that research analyst separately, and make their pitch, and be accepted or not, and get a good, you know, research opinion or not on their own merits. So we're actually not doing that.

And I think it's really the combination of allowing this communication to investors, particularly I will say, by the way, to note, small investors who don't have the internal research capabilities, let's say, a Wasatch or certainly a T. Rowe Price would have, you know, the smaller funds, because there are a lot of much smaller funds than those that were on our Task Force that don't have the same access and for whom this is really important. So it allows us to get long term buyers into the initial offering. And to Dan's point, if you're picking a breadth of firms -- banking firms to be your joint book runners, and some of them have relationships with smaller and longer term holders, that combination gives you a much better chance of having a successful IPO.

Joel Trotter: On the economics point --

Kate Mitchell: Yeah.

Joel Trotter: -- we did talk about that, and, for example, we -- and in our meetings we talked about whether maybe you could nickelize [spelled phonetically] the smaller stocks --

Kate Mitchell: Yeah.

Joel Trotter: -- stocks or -- and we concluded we could sooner boil the ocean than to try to turn back the clock on decimalization, so --

Kate Mitchell: Yeah.

Joel Trotter: -- that was one of many examples of things where we were not so ambitious. We were trying to be targeted and build on existing regulation, and in every single aspect, the

recommendations do build on some form of existing regulatory balance that has been struck by a regulator in the area, so with each and every recommendation that we came out with.

Paul Maeder: I know a lot of small merchants that would support just getting rid of pennies altogether.

[laughter]

Maybe it'll happen now.

Stephen Graham: Any other -- yes, Leroy.

Leroy Dennis: I have several observations or comments, and I'll -- I guess I'll just start down the list, but first I echo Paul's comments. Thanks a lot for your hard work. I know you spent a lot of time on this. On the definitional aspects of this, I would ask you to think about have we addressed the -- what I'd call the "asset based group of companies"? You know, a billion dollar bank, David, is probably, what, $15 to $20 billion in assets, which seems like a pretty big company to exempt from filing. And maybe there's something to deal with, FDICIA or something like that, that we could piggyback on, you know, real estate investment trusts and those kind of companies. On SOX, just a point of clarification, you made a comment that the internal cost of compliance would be drastically reduced, I think is what you said. As I understand the proposal, this only relates to the external compliance aspects of --

Kate Mitchell: It actually is -- our point was that there are two aspects to being ready for an external audit of internal controls. It's the bill you pay the auditor, plus it's the extra staff, and the systems, *et cetera*, internally that you need to get prepared to do that. So it was a combination of the two.

Leroy Dennis: But the cost to actually -- I mean, you -- management's still going to have to do a certification on their own --

Kate Mitchell: Absolutely.

Leroy Dennis: -- which needs to be robust and --

Kate Mitchell: They have to have internal controls.

Leroy Dennis: -- documented and those -- okay.

Kate Mitchell: And that's why when we came back, that all of our recommendations said a 30 to 50 percent decrease in cost, it -- they're not -- you're not getting rid of most of the cost.

Leroy Dennis: Yeah.

Kate Mitchell: Yeah.

Leroy Dennis: The one thing I would suggest -- I had a partner tell me that, you know, since SOX 404 came into place, they see a marked difference in how the governance of a company works, and so I think some kind of robust plain English disclosure that, you know, isn't something like the company doesn't comply with some subsection of a code, but actually so the general public would know what that is.

Since I am an accountant, I'm going to comment on the accounting and auditing aspects. First off, I'm concerned when Congress gets involved in both of those aspects, and we've seen instances where the politics start to play in both accounting and auditing, and I would be very

cautious about dictating what the accounting standards should be. I think the FASB is established for that purpose. I think the FASB clearly has the ability to have a different phase-in for private companies, and public companies, and emerging growth companies. And I think it's very difficult to anticipate all of the potential emerging issues that may come down the road that may not apply to a private company because you're dealing with a different set of users than a public company or an emerging growth company. For example, you know, what comes to mind is a segment disclosure, probably irrelevant for a private company, but certainly relevant for an emerging growth company. So I'd ask you to think about that as you go down the implementation of those things.

On the auditing side, I believe -- and, Jim, correct me if I'm wrong -- I believe the SEC already is required to review anything that the PCAOB publish -- or proposes to issue.

Jim Kroeker: Yeah, it's not review. The SEC has to approve.

Leroy Dennis: Yeah.

Jim Kroeker: It's not just a sort of a static or a passive activity. It's -- has to go through an affirmative approval by the Commission.

Leroy Dennis: And it's also published for comment and --

Jim Kroeker: Yeah, so at the PCAOB level as well as published by the Commission.

Leroy Dennis: -- so I question whether this provision is even necessary other than to say to the SEC, "We'd ask you to consider the impact on emerging growth companies."

Kate Mitchell: In essence, we're just connecting the dots of those two. It doesn't change that.

Leroy Dennis: You know, so the other thing I'd comment on, I find it interesting that the law would prohibit things that aren't in existence yet, like rotation or ADNA, but the rotation piece is probably -- I mean, I can't imagine an audit firm being changed out in the first five years anyway, so I kind of think that's a -- I'm not sure I care one way or the other.

So, you know, and, again, the same comment about Congress setting auditing standards, I think you get into politics involved with -- there's enough politics between the FASB, and the PCAOB, and the SEC to pull Congress into it I think is a dangerous road. And so I'd just be very cautious about -- they established the PCAOB for a purpose. Let them do their job, and, you know, give them a mandate as to what we want to see, but I'm afraid of the political influence of Congress in setting accounting and auditing standards for the U.S. companies.

Jim Kroeker: Steve, may I just follow up briefly. Could I just --

Stephen Graham: Oh, please, please, yes.

Jim Kroeker: -- just brief follow-up, is, one, find myself very closely aligned with those comments, not that FASB taking account of emerging growth companies wouldn't be a wonderful recommendation. I actually think it comes from the last small business Advisory Committee, and so, you know, whether there could be some more accountability to that recommendation at the FASB, but to be proscriptive, for example, in legislation, and I think the way it's actually written right now would be almost a nuclear option in that if FASB ever deviated a emerging growth company, not only would that standard not be effective, but no standard that the FASB had ever written would be recognized. So it's effectively -- if you deviate once, then the FASB standards are no longer effective for any company for any purpose. So it's a pretty broad proposal.

Stephen Graham: Okay.

John Borer: Steve, if I could just weigh in from the broker-dealer perspective for a second, because it's a little bit different, and it's getting very lonely up on Wall Street.

[laughter]

Within the last two weeks, two more firms that really made their business out of providing independent research, sales, trading, and investment banking closed their doors, and it's going to continue. I think that trend will not stop, which I think unless it does, it doesn't matter what other rules that are changed down here because it's like putting raindrops back in a cloud. The industry will be gone.

To Dan's point, I think a lot of these IPOs -- I forget the ones that Goldman and Morgan are doing -- they're being bought by traders. There was a point made in your presentation that this is -- you know, if it goes up 50 cents, they've sold it. If it goes down 25 cents, they've sold it, because they don't want to have the mark on their books. They don't -- it'll never show up in their holdings, et cetera. And as a result of that, a lot of the people who historically -- and I'm -- been in -- again, been in this chair over 20 years -- bought these transactions, in their business said, "I want to watch the deal get done. I fundamentally like the business, and then I'm going to buy in the aftermarket, because I won't have to take a 20 percent markdown, and if I think it's worth at least a 25 percent run per year for the next five years, and I'm a holder, then I'll do it on that basis. It's much better for my clients that I'm running money for."

And I spend a lot of my time -- because I think in the last three or four years, we've probably done as many, you know, under $20- or under $25 million IPOs as anybody on Wall Street -- talking CEOs out of it by explaining to them what the process is, the cost, the uncertainty. And in many cases, they'll say; "Okay, with all the things you need to do, including preparation, SEC review, cleaning up your management team," and all you say is, "You're looking at getting your deal done between nine and 18 months from now. Predict where your company will be, how you will do, because if you stumble at all between now and then, you will not get your deal done,' and at that point, if something bad happened in the market, Italy defaults or something else happens, it will not get done. So do you want to put your management team through that, and to the point of the confidential filings, and have all your employees being poached, all your customers, all your competitors knowing your margins, your hot new products, and all that, because confidential treatment orders are great, but oftentimes you can't get it on everything you want." And the exciting growth companies are being run by people who were in college three, four, five years ago. They can't think 18 months into the future. And so a lot of the companies that should be coming out, they come into our office because we do a lot of these things, and they say, you know: "Thank you very much, you've just talked me out of it."

So I wouldn't mind getting a comment on that, but especially whatever comments or thoughts you guys had, and discussions about the demise of the boutique investment banking industry. You had some good bankers on your Committee, and they can't be as optimistic as I am about what it is to bring small companies through IPOs.

Kate Mitchell: Well, you know, interestingly enough, I think they in the end got optimistic when you read the recommendations, because they did follow on Dan’s comments of there's a real role for boutique banks to play, and they do -- and are particularly important, given some of the electronic training decimalization issues that Steve brings up earlier. So I think, if anything, they walked away feeling there's a greater sense of mission, and, you know, we need to get the word out about the world they can play, in connecting up IPOs with longer term investors in the market. So I think in some ways it was good to shed some light on that topic.

John Borer: That hasn't translated into transactions getting done, though, to the drinking the Kool-Aid thing --

Kate Mitchell: Interestingly enough, I -- in a couple of the deals that are on file in the joint books, there are -- they were boutique banks on it, which was actually really good, including one in our portfolio, where they brought into the mix and shared economics with folks that would have accounts with the smaller longer term holders of shares. So that's a small change emanating out of a smaller group of people, but why getting some education out would make sense as well to support that. So I think we can make a difference because I think what -- because particularly standing back -- and when you're an issuer -- you know, I'm looking at Karyn because of Zynga having recently gone through an IPO -- you want to have the long term holders, kind of that long tail, if you will, to be holders of your shares. You want liquidity as well, so having trading in it is a positive, that's the point of going public, but you want some of those long term holders that really understand your growth plans and are aligned with you about really developing long term value. So there's a real -- I mean, once the knowledge gets out there, there is sort of the, "Aha," you know, it makes perfect sense. So I think, again, a heightened role for boutiques within syndicates is I think a very reasonable, you know, discussion to come out of this as well.

John Borer: And just one last point because at the time of the Global Settlement, which we weren't a part of, but the adoption of 2711, I went through, and commented, and went to the hearings on these various things, and to Paul's point earlier about Casablanca and gambling, you know, two lines after that, the line is: "Round up the usual suspects --"

[laughter]

-- which is -- I think the reason they did these things wasn't because they made sense. There are obviously conflicts, and investor protection, and all this, but it was to punish Wall Street, and that has been very effective in what it's done.

Charlie Sundling: If I could weigh in.

Stephen Graham: Sure, Charlie, go ahead.

Charlie Sundling: So I'm the CEO of a small tech company, so if we did something, it would be in the -- how many others, CEO, small tech, do we have in the room? Okay, so when I listen to this, and we've looked at the public option, and as I hear even some of the -- and, by the way, I'm trying to be part of the solution, okay -- but it just screams, "Going public is not the right direction," right? Until you hit a certain critical mass, and I think that, that number's getting bigger and bigger every year, it's just not something we do. And when you look at the statistics and how essentially the market flat lined for small tech IPOs in, what was it, 1999, I honestly just don't see that being fixed by anything being mentioned. It's got to be something absolutely revolutionary in the way a small company can get public, because it's frankly not worth the risk, all the things mentioned, right, the -- effectively, your open kimono for the whole period by which you go through the process. And in a competitive market, especially in a high tech, this isn't something that anybody would want to do. And on top of that, the M&A market is hot and liquid, and that's the way I've seen everybody going. It's frankly the main option that we're looking at in terms of eventual investor liquidity. So, again, not trying to be overly pessimistic, but I'm just not sure how this gets fixed when you add up the supply side problem, the demand side problem, the regulatory issues, the personal liability for the executives. I mean, why would anybody want to do this until you hit a certain scale which, of course, is an entirely different game?

Paul Maeder: I don't share your pessimism, but you're right. We're in a -- we live in a world now where the companies that don't have to go public -- where companies that want to go public

can't and those who can don't want to. It's become literally unpopular to think about becoming a public company CEO, but I feel we have to reverse that from a public policy standpoint as a country. If we don't, the venture industry is going to further consolidate, if not disappear, our national competitive advantages in developing technology that people everywhere use and benefit from will shrink and disappear, and we'll be in a much less exciting world for our children's careers than we were in 10 years ago, 15 years ago. A lot of the promise of America will evaporate, and I think it's a challenge to fix these things, but it's certainly not impossible. After all, we broke them.

Charlie Sundling: By the way, I 100 percent agree with everything you've said, and we have a running joke that there's going to be four large software companies in the world, and that's it, right? So the rate of acquisition and roll-up, and as they get bigger, you compete eventually with something they have, because their portfolios are massive. We do, right? Our smallest competitor's got a market cap of $55 billion, right? So it's not fun, and, you know, how can you -- and we did break it, and how can you fix it? I think everyone shares the same sentiment that you -- you know, to have competition. I mean, it gets -- to the competition factor, you've got to have a lot of companies, and they've all got to be healthy and, you know, providing some of the same products in the same spaces, but now this scale has tipped so wildly, and the difficulty of getting access to public markets and raising the money you need to compete with the big companies, it becomes much easier and frankly more sound business decision to sell, right?

Stephen Graham: Okay, Charlie, I think, again, I would agree with you and Paul as well. I think that's -- that makes good sense. I want to move onto the next phase, so if someone has a comment or a question that they're dying to ask -- Tim?

Timothy Walsh: One quick one. Sentence two, "To qualify, a company must have less than a billion dollars in annual revenues, and following the IPO not more than $700 million in public float." I support everything you're doing. As a pension fund, we buy a lot of IPOs, and we tend to hold them too, not flip them. Those numbers seem -- you know, don't seem to make sense to me. I'm not going to tell you which one I agree with and not. I want to hear your opinion here. Where'd those numbers come from?

Kate Mitchell: Sure, I mean, first of all, the $700 million was looking at the well-known seasoned issuer standard that the SEC uses, so we picked -- that's how we picked that off the shelf. The billion dollars in revenue -- again, I used my example of a company that's growing 50 percent a year, which is slower than some of the companies -- the large companies that are going public now. You'll see Facebook grade that low. If you're a $150 million IPO, and you're doubling every year, $300, $600, by that, you don't even make the full five years as it is. And it's lowering that bar right now. The standard to go public's even higher. And remember, it takes three years to prepare for a lot of these things. You don't do them right away. You don't decide you qualify and, at the end of the quarter, qualify. You have to get the accounting systems, the staff, everything else ready to go. So we picked it so that it was a reasonable enough. If it's too small, it's going to influence too few people, and they'll blow through it too quickly, and if I still have to be prepared before I go public, and I still don't know if I can -- back to the advice that Rodman & Renshaw's given some of their -- appropriately, some of their CEOs -- then it's -- continues to thwart people's interest in going public. So we wanted it to be long enough for companies that were higher growing, enough time to get prepared, but not so large. So it was a good test to say that a number of the -- you know, that a Ford Motor Company or a Facebook wouldn't qualify. It shouldn't be for folks like that, but it gives enough runway for a company -- again, $150 million, doubling, they wouldn't even last five years. It would be somewhere in their fourth year that they would fall off the on-ramp. That feels right because it will begin investing right after their IPO if they're smart.

Milton Chang: Just curious, why didn't you give more thoughts to smaller companies that have lesser growth? Those are the ones that really need help, whereas the $150 million, doubling every year. They don't need help. They are hot.

Kate Mitchell: Well, $150 -- there are $150 million revenue run-rate companies that are still broaching profit -- that aren't profitable yet or just crossing over to profitability. We didn't limit it to -- it can be a smaller company that's growing more slowly. We were looking those -- I mean, the objective, though, was, we do want to include companies that are growing at a rate that really create jobs and economic growth. I mean, those are the, you know, the kind of companies that Paul was referring to, but we don't exclusively limit it to that.

Milton Chang: I understand that, but what I meant to say is that is there any more we can do for those companies that would--?

Kate Mitchell: All of this would apply.

Milton Chang: I know, but maybe something a little more for them?

Stephen Graham: Well, we'll think about that, too, Milton. Thank you, Kate and Joel. Let's move on to the next part --

Joel Trotter: I just wanted to make one parting comment, and it's a follow-up to a telling statement that Charlie made. We agree, it may require a revolutionary change, but that's not what we set out to do as a Task Force. What we set out to do is to try to tip the scale back, and you said that, as it is right now, there's a certain economy of scale that you need to reach where -- to have an IPO option present itself credibly to you as a company, and you then said -- this was the very telling remark that I completely agree with -- it's not getting any smaller. That burden is increasing year by year, and so this was an effort to dial it back a little bit with the hopes that at the margins -- at a minimum, at the margins, a company that's close to that tipping point will be more likely to select the IPO option because we think IPOs are job generators, and M&A -- the M&A option in the short term is not so positive. And there are household name companies that exist today that started off like -- as not credible enterprises by today's standards, and they've changed entire metropolitan areas. You know, you can think of Seattle, you can think of Austin, Texas, and --

Kate Mitchell: Cupertino.

Joel Trotter: -- Cupertino, California, where entire metropolitan areas have been -- have seen their landscape change just based on the growth that these companies bring because they went public rather than being sold.

Paul Maeder: "Journey of 1,000 miles begins with a single step," if it's okay to quote Chairman Mao at the SEC.

[laughter]

Kate Mitchell: Oh, Paul, you’re getting way out there.

Charlie Sundling: Oh, and as I had mentioned, I do want to be part of the solution. Please keep my name if you have any --

Kate Mitchell: Yeah.

Charlie Sundling: -- I'd love to be part of your survey, and it sounds like --

Kate Mitchell: Great.

Charlie Sundling: -- everything that you've collected is probably exactly what most sensible folks would have responded with.

Josephine Tao: Could I say a few words just in response to some of what's been said here? I --

Stephen Graham: Sure, Josephine, go ahead.

Josephine Tao: That on -- sorry about the last minute part -- but I think, you know, we're listening to what you're saying here, our goal with these research rules, and just on the research rules, is that if you are providing research, that the person who's receiving it, the investor, has a right to unconflicted research. Whether we can prove that investor is, retail or otherwise, did actually rely on the research I think is not really the point. Even if it's just advertising, advertising should be accurate. The FTC would go right after you if Ford was saying that they're number one when they're not number one. And it's a little unfair to say it's "round up the usual suspects." I think what happened here was this illustrates that -- these were 90 percent in the market, and it illustrates that there were incentives out there, and that people acted on those incentives, and it may be that they had to because everybody else in the market was acting on it. So having some rules in place to try to reach that, nobody else can do this either. It's a level playing field. Even if you as a firm didn't want to do it, if everyone else is doing it, you feel like you have to do it. So having those rules out there was, I think, intended to try to level that off as well so that we didn't have to go after everybody for fraud, too. But, you know, just having -- I think we need to have some baseline rules to make sure that what's out there that you call research, or even if it's considered advertising, is what you're saying it is and not something else. I don't know if that helps.

Stephen Graham: Thank you. Well, we just plowed right through our break, so we're not going to have one. So does -- did I see another hand? So everyone got in what they wanted to get in? Okay, so once again, thank you, Kate and Joel. It's good work, and we look forward to collaborating.

Okay, let's just keep going because, you know, this ends kind of the structured part of the agenda. You know, thinking about what our next steps are going to be, we have one recommendation that we came up with this morning. We will work with the staff in formulating a draft, and then we'll probably circulate it just to get confirmation from everyone that they feel that it does reflect what we did at this meeting. Hopefully we'll get that out within the next week. Our next meeting, I guess, will be in San Francisco, so --

Lona Nallengara: Steve, not to -- I know you're in Seattle and --

Stephen Graham: Right.

Lona Nallengara: -- we're trying to work out logistics of having a public meeting, webcast, all of the things that the rules require us to do.

Stephen Graham: Right.

Lona Nallengara: So we're working on making San Francisco work, but we'll come back to you as quickly as we can to tell you what we can do.

Stephen Graham: Okay.

[talking simultaneously]

Paul Maeder: There are few technology companies out there that probably --

[laughter]

-- have the capability -- I think that's [inaudible] where all this stuff was invented?

Lona Nallengara: No, but it's not their technology. It's the SEC's technology that we're trying to back into, so it does pose some challenges.

Paul Maeder: Okay.

Meredith Cross: And we have -- we have a limited budget so we can't --

Paul Maeder: Got it.

Meredith Cross: -- we can't go hire a convention center or a really fancy tech company to go do it for us. So we have to find a way to do it in a way that we can afford.

Paul Maeder: And you can't have Zynga do it for free?

Meredith Cross: No, I'm afraid we can't let a registrant put it on for us, but thank you.

[laughter]

Paul Maeder: Well, there are lots of private companies to choose from.

Meredith Cross: Oh, and it would be lovely, but we're not allowed to do that either. Thank you, though.

[laughter]

Stephen Graham: Okay, well --

Male Speaker: We have the dates, Steve --

Stephen Graham: I'll tell you what. We're going to have a meeting in May, we'll figure out where it is later, but it's -- but hold May 2nd, so that's the date that we've established.

There are a number of issues that we haven't talked about, and I think one of the things that we'll try to do is begin to kind of develop that list that we kind of talked about this morning when we kind of talked about the notion of developing a more comprehensive strategy in terms of what we're trying to accomplish, and -- as the Committee's objectives, and then just kind of think about -- just to make sure that we're being sufficiently thoughtful with the recommendations that we do come up with, and I guess decide from that. Again, I'd like to thank the staff. They continue to be extraordinarily helpful, keeping us mindful of the rules and where we can and cannot meet. And thank you, all, to the Committee members for participating today. I thought it was a good meeting.

Christine Jacobs: One of the things that we were going to do at this particular session is to talk about next steps, and I wanted to throw this out to the Committee. You know, if you go back to our roots, the small business advisory, the IPO on-ramp in this discussion and that document, we all said the last meeting was incredibly valuable, and I think we might have had some tweaks and opinions, but we generally think it was brilliant. In fact, I remember us saying, "Hey, that was from the finance group, could they come and be our guests?" And everybody laughed

because it -- we weren't sure if we were crossing any barriers, but I'd like to ask the Committee to consider the day two here, which are the companies that are already public, that are suffering every bit as much as the pre-IPO company under the burden of scaled regulations, and we've touched on it a couple of times before. I don't think we need to reinvent the wheel on the pre IPO group, but there's an entire climate of existing small and mid-cap companies, who, yes, we have exemptions and reprieves, and as I said to Chairman Schapiro when we chatted about this Committee, I mean, I just thought that was brilliant. But we're a year or so into it, and there's uncertainty on this January 2013 date, and there are issues that I think need to be reconciled between the IPO on-ramp and the existing public companies so that we're not sending mixed signals, or we don't create an un-level playing field for the existing public companies, because if you were new and went through an IPO, you've got four or five years to comply, well, what about the folks that are currently suffering? And I say, "Suffering," because I've used that phrase before.

[laughter]

So anyhow, so as far as next steps are concerned, I think existing public companies -- and, Shannon, I know you're not devoid of opinions on this either -- and the second issue I'd like to bring up for discussion, that I hope the Committee and the staff want to talk about, is research, because the reality is, if you don't need to raise money, you're not going to get research coverage. And I'm going to disagree with Dan that there isn't much out there in our worlds, okay, that the guys that don't need money, that have managed our balance sheets, and are quite strong, nobody's going to write about you, and you find that in the court of public opinion, all you have is ISS and Glass Lewis, and that is a sad commentary. So I would love the fact that perhaps the Committee would put that up as an agenda item and discuss it. If I'm a lone wolf sitting here alone, that's fine.

Stephen Graham: No, no, you're not alone at all, and I think it's something that I think you and I, Kate, had discussed briefly over the telephone. It's -- and I think that we're going to be careful not to work at cross purposes, but it's -- you raise a good and valid point. I mean, we talk about costs associated with becoming newly public, and how it'd be helpful if things would be calibrated and gradual, but, again, what about the company that's similarly situated that's not newly public? And I think -- and so -- you know, a lot has been done, and obviously that's the whole purpose behind the small reporting company framework, and I think that, you know, one of the things that we have, you know, as one of the things we've been tasked with is kind of understanding just, in general, the regulatory burden and -- on small and emerging companies, which I think is the -- exactly the point that you're making.

Paul Maeder: So I assume, Christine, your point applies to companies that are small and public, but have been public more than five years and, therefore, wouldn't qualify for Kate's approach? That's what you're talking about? I totally agree, totally agree.

Christine Jacobs: Correct. Yeah, let me give you what I think is -- and no offense to the coming rule and Reg -- conflict minerals, right, okay, I make -- now, I'm going to give you just a small example here of why there's these unintended consequences, and I think they should be explained. I make gold markers for women with breast cancer so the doctors can find it when they do x-rays and treatments. It's the size of a pencil lead, but it's gold. My disclosure's going to cost me more than my inventory. And, yeah, and -- well, but to the point -- I just -- I don't want you all to suffer through one-on-one examples, but I do think this issue of disclosure, scale, *et cetera*, I mean, the $75 million market cap is great, but what's next? And so, yes, sir, and please can we?

Paul Maeder: Yeah, I think we should. Has -- Stephen, has any thought been given to this Committee endorsing the IPO Task Force recommendations in any way?

Stephen Graham: It's -- we haven't given a lot of thought to -- well, we haven't fully thought through anything along those lines, whether it's endorsing another group's work, whether it was getting behind a particular piece of litigation, that sort of thing, to just want to be -- think pretty carefully about [inaudible] --

Christine Jacobs: Would it help? I mean, perhaps --

Stephen Graham: I think collaboration will help. I think coordination will help.

Paul Maeder: It doesn't sound like there are a lot of people in this room that think -- that there are a lot of people in this room that think it's all wet. There may be some people who think it goes too slowly, but as Kate said, she was trying to balance the perfect with the possible. But if it would help, I think it's something that ought to be taken up perhaps at our next meeting if there's any kind of a tailwind this Committee could provide, because this is such a central issue at this point for small businesses and emerging businesses.

Stephen Graham: Would it help, or is it like a political endorsement where it's the last -- the last nominee endorses you, and it really doesn't matter so [inaudible].

[laughter]

[talking simultaneously]

Leroy Dennis: Is it going to be law before our next [inaudible]?

Kate Mitchell: We had talked about that. Pardon me?

Leroy Dennis: Is it going to be law before our next Committee meeting comes into play anyway?

Kate Mitchell: That's -- I mean, that is hard to know.

Male Speaker: I understand the president's endorsed it, and it's --

Meredith Cross: Just to be clear, that what the president endorsed is about two or three sections of it, I think. I mean, there's been different --

Kate Mitchell: Versions.

Meredith Cross: -- different -- everybody has a different version of -- it's not -- nobody has picked up this and made --

Kate Mitchell: A hundred percent, right?

Meredith Cross: -- yeah, right, the Senate bill is parts of it and then some additional things. Everybody has parts of it. I'm not making a qualitative statement here, I'm just saying nobody has picked up the thing and said --

Kate Mitchell: [inaudible]

Meredith Cross: Right.

Joel Trotter: I understood the White House statement to actually endorse both the [inaudible] 1933 and the House companion version. It's true that the bullet points in the White House release don't track every recommendation. So --

Meredith Cross: And I'm not going to comment.

Male Speaker: Yeah, my only point for Stephen, if we are going to go down the road of endorsing or having our recommendation, I don't think we can wait till May.

Stephen Graham: Okay. Let's -- I am of the mind of thinking things through, and so I'm not going to do anything at the last minute like that, so…

Gregory Yadley: Okay, can I -- just adding on to what Chris said, our conversations this morning about 12(g), and companies then having the ability to no longer be public, and some of the obligations companies may feel to their shareholders to provide information, you know, some of these rules will be the same for them, too. It goes beyond the existing smaller reporting company regs that -- you know, just a broader look at. And I'll just say-on-pay, you know, institutional investors love it, but I just don't -- I don't personally represent any public company -- smaller public companies that have that complicated of compensation, and it's really not that great either, although that's everybody's opinion. So, you know, now that we've done it, it's not really going to cost me anything extra next year to do it again, but again, maybe these were the straws that Paul was talking about, and if you can lift a couple of them off, in the end, it'll have some impact.

The other point goes along with endorsing or not endorsing the IPO on-ramp, but just -- Meredith, as the Commission comes out with releases, be they proposed regs or more of these study sorts of things, as an Advisory Committee, are these things that we should have views on as a group, or are we still more of a discussion resource, or is that up to us, or what would be helpful to you? I mean, I think we're here because we care about what the SEC does and we want you to get it right, so, you know, can you give us maybe a look ahead on that point?

Meredith Cross: I don't know a lot about rules for the Advisory Committee, but I would imagine we'd -- I think, you know, certainly we appreciate the views of the Committee throughout the process. We are taking them into consideration in preparing things currently, and we would appreciate the views once our materials are out there. I don't think there's any question about that.

Lona Nallengara: Right, and there's a -- as a formal matter, your charter says that you're supposed to give us advice and recommendations, so if we put some -- if we propose something and -- or we ask -- or we ask everyone for questions, you are part of that "everyone." You should -- you can as a Committee put a formal response back to what we proposed or what we've asked for input on and give us your views, and that's the best way to do it. The best way would be a -- in the same way your recommendations are written recommendations that are delivered to the Chairman on behalf of the Commission. Your responses should be that way as well.

Stephen Graham: Okay, anything else? Can I get a motion? All those in favor? I assume no one is opposed.

[end of transcript]