WILLIAMS & JENSEN, PLLC

Fr: Rebecca Konst, Luc Rogers, and Alex Barcham

Re: SEC Investor Advisory Committee

Dt: January 21, 2016

Summary
On January 21, the Securities and Exchange Commission (SEC) convened a meeting of the Investor Advisory Committee (Advisory Committee or IAC) to discuss: (1) fixed income market structure and pre-trade price transparency; (2) a draft letter to the Financial Accounting Standards Board (FASB) regarding materiality; (3) an update on crowdfunding; and (4) a discussion of NASDAQ listing standards-shareholder approval rules. The Advisory Committee approved the minutes from their previous meeting, and approved the draft letter to FASB (with two abstentions, but all other members in support).

The Investor Advisory Committee was created by section 911 of the Dodd-Frank Act. It is authorized to provide recommendations to the SEC on issues relating to the regulation of securities products, trading strategies, fee structures, disclosures and other investor protection matters. The SEC is not required to adopt any recommendations of the Advisory Committee, but the Commission must provide a public response that discusses "the action, if any, the Commission intends to take."

Commissioners/Opening Remarks:

Kurt Schacht introduced the newest member of the Advisory Committee Susan Wyderko, President and CEO of the Mutual Fund Directors.

SEC Chair Mary Jo White in a statement provided an update on SEC activities since the last Advisory Committee meeting. She noted at the end of October, the Commission approved the last major JOBS Act rulemaking when it adopted final crowdfunding rules. She explained Regulation Crowdfunding becomes effective in May and funding portals can begin to register with the Commission later this month. **White** noted the Commission also published for public comment in late October the FINRA rules that will enable funding portals to begin operating. She stated at the meeting in October, the Commission proposed rules to amend Securities Act Rules 147 and 504. She noted the proposal for Rule 147 would modernize this rule for intrastate offerings by establishing a new exemption to facilitate capital formation through local and regional offerings. She explained the proposal for Rule 504 of Regulation D would increase the aggregate amount of securities that may be offered and sold in any 12-month period from $1 million to $5 million and would disqualify certain bad actors from participation in such offerings. **White** stated the proposed rules are designed to enhance especially smaller issuers' ability to engage in local and regional offerings, including through state-based crowdfunding laws, while maintaining investor protections.

Chair White noted in November, the issued a proposal to update the regulation of alternative trading systems (ATSs) that trade equity securities listed on national securities exchanges. She noted the objective of this proposal is to facilitate much needed transparency, for investors and regulators

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alike, about how these ATSs operate and the potential conflicts of interest that may be present when the business interests of the broker-dealer operator compete with the interests of market participants that access the ATS.

Chair White also explained that the Commission considered and approved proposals on the use of derivatives by investment companies and on disclosure by resource extraction issuers.

White also noted that the SEC staff published its report on the accredited investor definition. She explained the review, mandated by the Dodd-Frank Act, analyzes various approaches for modifying the definition and she stated she looks forward to receiving comments on the report.

Chair White also noted that in December, Congress enacted the FAST Act which contains a number of provisions relating to the federal securities laws. She stated that last week, the Commission approved interim final rules to implement two of those provisions, namely those allowing smaller reporting companies to incorporate future filings by reference on Form S-1, and permitting emerging growth companies to omit certain historical period financial statements from a registration statement if the information would not be required at the time of the anticipated offering. **White** stated the FAST Act also contained provisions related to reviewing and revising disclosure requirements in Regulation S-K, which the SEC will be evaluating in connection with their ongoing work on disclosure effectiveness.

Chair White added that the SEC staff also published an analysis of the events of August 24th. **White** reiterated that the SEC is closely reviewing how exchange-traded products (ETPs) trade in the secondary market with a keen focus on the events of August 24th as an important "case study" for evaluating the equity markets under those conditions. She noted that the SEC staff report provided an analysis of the events of August 24, including an overview of the performance of broad market indices, a comparison of the trading of corporate stocks and ETPs, and an evaluation of certain aspects of the opening and reopening processes at primary listing exchanges. **White** stated the staff analysis also examines the operation of the limit-up limit-down plan and the associated self-regulatory organization rules, as well as ETPs and their "idiosyncratic" trading characteristics. She explained the publication of this analysis is intended to inform the continuing public discussion on equity market structure.

Chair White noted the Advisory Committee is focused on a number of important topics. She stated one item that is particularly critical is the discussion regarding fixed income market structure and pre-trade price transparency. She noted the Commission, FINRA and the MSRB continue to consider policy reforms in the "enormously important" corporate bond and municipal securities markets. She stated the agenda today also includes a discussion of outstanding FASB proposals emanating from its disclosure framework project related, in part, to materiality and other disclosure issues. She stated since FASB's proposals are out for comment currently and they are continuing their due process, it would not be appropriate for her to comment on the proposals. However, **White** expressed her pleasure to see that the FASB plans to hold a roundtable later this year on their various outstanding disclosure proposals. She also noted the Advisory Committee's planned discussion of a recent NASDAQ request for comment regarding shareholder approvals for various corporate actions. She suggested this is another important topic for investors which she is glad the Committee is considering. **White** stated the Commission carefully reviews proposed changes in listing standards for consistency with applicable requirements as part of the SEC's mission to protect investors.

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Commissioner Michael Piwowar noted interest in the discussion of fixed income market structure. He stated he has spent a lot of his career researching the bond markets. He noted the differences between the fixed income and the equities markets. He noted the MSRB and FINRA recently published guidance on best execution and FINRA has released a proposal on markup and markdown of riskless principal. He stated that the adoption of a consistent disclosure rule would be a positive development. **Piwowar** expressed the need for pre-trade price transparency. He noted the work of Professor Larry Harris on the topic of bond market transparency. He stated there is a need for more transparency in the bond markets and he noted concerns with whether the fixed income markets are working for all investors. He stated issues related to pre-trade transparency in the fixed income markets is an area the SEC needs to focus.

Commissioner Kara Stein applauded the Advisory Committee for continuing the discussion on pre-trade price transparency and the fixed income markets. She expressed hope that increased transparency in the fixed income markets will become a reality in 2016. **Stein** noted the FASB proposal to remove the definition of materiality. She stated materiality determinations are incredibly important but tend to be opaque. **Stein** stated auditors also do not explain to investors how they undertake this charge. She stated despite the era of big data the financial crisis showed some shortcomings in transparency. She noted regulators and industry have worked to improve transparency, and that the development of a legal entity identifier (LEI) has been helpful. **Stein** noted the NASDAQ listing standards and shareholder approval rule proposals. She stated the increasing number of rules requires more investigators and staff at the SEC to review these exchange rule changes. She stated while most rules are immediately effective, a significant number were subject to notice and comment and review by the SEC staff. She applauded the work of the SEC Investor Advocate for focusing on the rule approval process. She stated these rules do not operate in isolation and she suggested a comprehensive review of exchange rules to see if they are resulting in fragmentation. She asked whether there are ways to improve the rule filing process.

Discussion of Fixed Income Market Structure and Pre-Trade Price Transparency

Kurt Schacht (CFA Institute) stated there has been a long standing debate around the functioning and structure of the bond market. He stated there is a question about the level of transparency and the fairness to investors, and he noted the fragmentation in the market.

Larry Harris (Professor, University of Southern California) stated his interest in these topics predates his involvement with Interactive Brokers. He stated exchange listed bond trading was very liquid through the 1920s for municipal securities and through the 1940s for corporate bonds. He noted a recent study which showed that the transaction costs at those times were substantially lower than they are now. **Harris** stated broker-dealers that arrange riskless principal trades are acting as brokers. He noted customers do not see the commissions before they trade. **Harris** explained that customers can see the commissions after the fact by looking at TRACE data, but that is time consuming. He stated in these markets there is a related question of who can offer liquidity, as many customers cannot offer liquidity. He stated there are no trade-through rules to protect standing orders. **Harris** noted most broker-dealers are profiting from markups or are profiting from payment for order flow (PFOF). He stated institutional traders trade at a disadvantage to dealers and that transaction costs are higher compared to equities. He stated buy-side traders cannot offer liquidity to other buy-side traders.

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Harris noted a study he conducted over the summer in which he looked at 3 million trades on TRACE and compared those to a half billion top of the book quotes obtained from Interactive Brokers. He noted there is no national best bid or offer (NBBO) for bonds but Interactive Brokers has in essence created one. He stated he used this information to look at transaction costs and the costs of trade-throughs. He stated the median bond had a bid or offer present 99 percent of the time. **Harris** stated 10 percent of the bonds had a two sided market and many looked like small and mid-cap stocks from the 1980s. He stated 20 percent bonds traded 230 times a day on average. **Harris** stated the bond markets are operating as the equities exchanges 30 years ago. He stated that the average customer round trip transaction cost was 125 basis points. He stated that would be 4 months of interest for a 4 percent bond. **Harris** explained for a $40 stock to have transaction costs like that it would be like having a $.50 spread. He noted those types of spreads disappeared in the equities markets after the Order Handling Rules were imposed. **Harris** stated these transaction costs have been declining because there is a lot of electronic dealing which is providing liquidity to the markets. He stated 47 percent of all trades trade-through a standing quote when there was a two sided quote standing for more than 2 seconds. He noted many of those are due to net pricing. He stated 31 percent of all trade-throughs had a markup higher than 10 basis points. He explained that he looked at the transaction record and identified which trades were riskless principal trades. He stated 42 percent of reported trades seem to be riskless principal trades, but some may be situations where the broker spent a lot of time finding both sides and just reported them at the same time. He stated less than 2 seconds separate the trades 73 percent of the time, and 46 percent of these have no markup. He stated the average markup was 54 basis points. **Harris** stated total transaction costs were about $26 billion and the total trade-through value was about $7 billion. He recommended FINRA should require disclosure of principal trade markups. He stated the bond markets would benefit from a NBBO facility. **Harris** suggested better market structure could be created with order handling rules for the top 200 bonds. He stated competition improves prices. He stated adoption of order handling rules would reduce transaction costs by at least 20 percent.

Craig Noble (Wells Fargo Advisers) stated he is speaking on behalf of the Bond Dealers of America (BDA). He stated the U.S. market is being shaped by technology and regulatory reforms. He stated new rules have been designed to ensure reasonable prices and reduced spreads. He stated investors are benefitting from these rules. **Noble** stated trading data has shown that markups have lessened and competition for order flow is strong. He explained out of the gross profit of a trade a bond dealer has many responsibilities. He stated bond markup is similar to a commission. He stated BDA encourages the SEC to carefully consider regulation driven versus market driven transparency. **Noble** stated pre-trade price transparency can result in traders leaving the market. He stated having a meeting place where trades could meet would help with price discovery. He noted there are far fewer QSIPs active in the bond market.

Noble stated he would prefer a market that had innovation. He noted that the volume of electronic trading is growing at a rate of 25 percent a year and three-quarters of fixed income investors now trade online. He stated it would be a mistake for the SEC to impose a Regulation NMS market structure on the fixed income markets. **Noble** stated dealers need to be able to market to a wide array of investors. He stated bonds trade less frequently so market making is more costly. He stated equity market makers operate in a faster market. He stated BDA supports pre-trade price transparency in fixed income markets but raised concerns over the methodologies proposed by FINRA and the MSRB. He encouraged the SEC to continue to engage with market participants on this issue.

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Discussion

Darcy Bradbury (D.E. Shaw & Co., L.P.) noted an interest in hearing about how a bond is priced. She noted it used to include credit ratings and comparables. **Noble** stated that it has become easier with the advent of ATSs. He stated traders take feeds from the ATSs and Bloomberg. He stated his firm carries $500 to $750 million in bonds on a daily basis and employs 120 people in the fixed income market. He stated he traded 4,000 fixed income trades a day. He noted they use TRACE and MSRB data to provide a bid price. He stated there are two pricing services which use a matrix to create prices. **Harris** asked if greater pre-trade transparency would harm investors. He stated when there is more transparency people have a better understanding of how markets work and that informed traders have an opportunity to make money if there is liquidity. He stated the cheaper the liquidity the more efficient prices are. He stated pre-trade price transparency will improve the markets, adding that there is not much credit risk for most of these securities. **Harris** stated the equity markets are far more transparent and operate with fairly good order handling rules.

Steven Wallman (Foliofn, Inc.) stated there are a couple hundred QSIPs in the bond market that could trade like stocks. He asked why such bonds could not be subject to more "equity market-like" rules. **Noble** noted there are a number of ATSs which are not interconnected. He stated there is not a unified marketplace to display a price. However, he stated he would not like to "go down the road" of having the SEC issue a rule to create one. He noted there are costs associated with dealing with ATSs. **Harris** stated dealers do post in a lot of different places. He stated most ATSs are not posting firm quotes but merely posting indications. However, he stated indications are mostly acted on. He suggested if there is no regulation someone like Bloomberg will create this NBBO if the industry allows them to. He stated transparency "is the best disinfectant." He stated the real problem is the agency problem with brokers and dealers that have no pressure to change the system. **Harris** stated the vast majority of retail investors do not have the knowledge to solve these problems. He stated order handling rules would improve liquidity in the bond markets which will benefit everyone in the market. He stated an improved bond market will improve the economy because corporations and municipalities will have more money to do more. **Noble** stated he does not pay for order flow. He stated most investment houses are talking to customers about their retirement and those strategies tend to be a "buy and hold" strategy. He stated most buy bonds and hold those to maturity.

Wallman asked about payment for order flow (PFOF). **Harris** stated PFOF is usually dealers paying for order flow. He stated retail brokers tend to sell their order flow to dealers. He stated that relationship is "cozy." **Noble** stated discount brokerage firms were the beneficiaries of dark pools and PFOF. He stated some full service brokerage firms may be accepting that order flow. **Harris** stated when bid-ask spreads are wide wholesalers pay for order flow.

Damon Silvers (AFL-CIO) thanked Commissioner Piwowar for sponsoring this discussion, as it is "right where they need to be focusing." **Silvers** stated complicated things tend to be more expensive to trade. He noted Noble stated that corporate bond trading costs are comparable for securities. **Noble** stated that equity commissions are posted on the Wells Fargo Advisers webpage, and that the fixed income commissions are similar although there is no commission schedule for bonds. **Harris** stated no one wants to set commission rates or markups just more transparency. He stated bonds are simple if they are only credit or interest rates but they tend to have additional "structures" attached which make them more complex. He stated individual investors tend to not be able to "see through" the additions which make the bond hybrid structures. **Harris** stated an NBBO for bonds

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would "greatly" improve the ability to price those bonds. He stated creating more information will be beneficial to the mutual fund industry as well.

Stephen Holmes (InterWest Partners) asked whether an NBBO for only 200 bonds is "conservative." **Harris** stated it could be extended beyond 200 bonds. He stated change is difficult so he was advocating for incremental change. He stated if "he were king" he would adopt order handling rules for the bond market like those in the equity market.

Bradbury stated the Trading and Markets Subcommittee is interested in this. She noted that these same discussions were held years ago when she was on the MSRB. She suggested some regulation may be necessary to "push" the markets. She noted the information provided by Commissioner Piwowar, which has helped the Subcommittee discuss the issue. She suggested it would be good to have some sort of NBBO for the bond market.

Roy Katzovicz (Pershing Square Capital Management, L.P.) asked about disclosing markups in advance. He asked why this would not be good for bonds held less than 5 seconds. **Noble** stated those markups should be disclosed. He stated he is a "bit of an outlier" in this regard. He stated there should be disclosure of the markup for trades which are truly riskless principal trades. He stated the issue is getting the establishment to realize that the marketplace has changed and they "need to move on". He noted some disappointment that the FINRA and MSRB proposals are not more harmonized.

Wallman asked if the market would simply start providing this information if the SEC does not require something by rule. **Harris** stated the established system benefits those who have power. He noted it has been nearly ten years since EMMA, and most dealers still do not post the last trade prices. **Noble** stated there are a minimum of five ATSs and the question is who would be the "winner." He stated there are electronic marketplaces and it will take some "thought process" about where this information is going to go because everyone else might be "losers." He noted that different services like Bloomberg provide aggregation services. **Harris** stated he is not advocating for a centralized market just more information being provided.

Consideration of a Draft Letter to FASB Regarding Materiality

Roy Katzovicz (Pershing Square Capital Management, L.P.) explained that the draft letter under consideration expresses concern about the Financial Accounting Standards Board's (FASB) proposed amendments to Concepts Statement No. 8, Conceptual Framework for Financial Reporting, and Notes to Financial Statements released in late 2015. He said much of the FASB's supporting literature describes sentiments that there is too much immaterial information in disclosures. He suggested investors do not believe there is too much disclosure and he asserted that disclosure is one of the bedrocks of the U.S. financial system. He explained that FASB views their proposed changes as harmonizing and removing inconsistencies in past guidance. He said the proposal replaces the need to determine whether information "could influence decisions" with the need to determine whether the information "would" have "significantly" altered the "total mix."

Katzovicz stated that the FASB proposal seeks to harmonize its standard to the definition of materiality developed by the Supreme Court. He expressed opposition to this action, stating that a lawyer's analysis should not be the touchstone of whether something is disclosed, and an accounting standard could be higher than a legal standard. He said the FASB proposal would require affirmative determination that something is material in order for a requirement that it be disclosed. He said

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FASB's intent was to give more managerial discretion as to whether something should be disclosed. He expressed concern that there is a serious risk that the natural incentive to avoid disclosure may overwhelm the quality and level of transparency in the marketplace.

Rick Fleming (Investor Advocate, SEC) asked if the draft letter endorses Concepts Statement No. 8 or just expressing opposition to the FASB's new proposal. **Katzovicz** replied that the letter does not endorse the status quo and instead asks that if the FASB makes a new proposal they should take their time and provide better policy backing for their proposal. **Fleming** asked if going back to Concepts Statement No. 2 would be a viable approach. **Katzovicz** said that could be an approach the FASB considers.

Joseph V. Carcello (University of Tennessee) stated that the proposal's reversal of the application of materiality to disclosures in financial statement notes was likely unintentional and FASB should not have an issue with the draft letter's recommendation to maintain FASB's current definition of materiality. He said FASB should work expeditiously to develop a framework to evaluate disclosure quantitatively and qualitatively.

Damon Silvers (AFL-CIO) spoke in support of the letter and said that disclosure is a very large issue. He asserted that the materiality standard was never intended to be the standard for what omissions would constitute fraud. He stated the issue has not been thought about carefully enough and said the draft letter urges careful thought so that the full implications of any changes are understood.

Susan Wyderko (Mutual Fund Directors Forum) asked whether making a recommendation to the FASB is out of the IAC's mandate and could have the unintended consequence of diluting other important IAC recommendations. **Katzovicz** replied that the letter was originally addressed to the SEC and it was recommended that it be sent directly to the FASB. He explained that the FASB is viewed as a subsidiary of the SEC for the purposes of the letter.

Barbara Roper (Consumer Federation of America) stated that the IAC mandate is broader than commenting to the SEC and the letter to the FASB is within its mandate. She expressed strong support for the letter. She said that the FASB's intent is to improve disclosures but she expressed concern that they did not talk to users of disclosures to see how or if they needed to be improved.

Steven Wallman (Foliofn, Inc.) expressed support for the letter. He explained that the letter does not argue that more disclosure is always better and said the goal is to get the right amount of disclosure. He said FASB's process was flawed and it is unfortunate that FASB was not more thoughtful. He commented that the general FASB process of producing a conceptual framework is a good one and said it could be helpful if the SEC had conceptual frameworks for securities law.

Silvers stated the standard should be the type of information an investor would want to see in order to make the statement fairly presented. He said the current system errs on the side of disclosure and he expressed concern that the FASB proposal would move toward a system where the default is silence.

J. Robert Brown (University of Denver) said the current definition of materiality is "elegant" and the proposed definition allows for omission of more information. He stated the proposal would be a significant change and expressed concern that users were not significantly consulted.

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Roger Ganser (BetterInvesting) said he did not like the direction of the FASB proposal.

The Committee approved the draft letter to FASB with two abstentions and all other members in support.

Update on Crowdfunding

Schacht noted that in October of 2015 the SEC adopted its final crowdfunding rules. He said the rules are designed to assist smaller issuers with capital formation while providing investors with adequate information. He explained that the rules: (1) allow individuals to invest in crowdfunding transactions subject to certain limitations; (2) limit sellers annually on how much they can raise; (3) impose key disclosure obligations on sellers about their business and the nature of the securities; and (4) set the regulatory framework for intermediaries. He commented that the CFA Institute was hoping for a stronger warning from the SEC about the risks associated with these securities.

Chris Tyrrell (Crowdfunding Intermediary Regulatory Advocates) stressed the need to proactively address concerns related to consumer protection and market efficiency. He noted that Regulation Crowdfunding (Regulation CF) will go into effect on May 16. He said the market is waiting for the SEC to finalize FINRA's rules on funding portals, so that on January 29 funding portals will be able to apply to both the SEC and FINRA. He noted that the JOBS Act required the SEC to finalize crowdfunding rules by the end of 2012, but that these rules were delayed. He emphasized that the industry worked on ways to implement and improve the crowdfunding market during this delay. **Tyrrell** said the crowdfunding industry is focused on a set of principles including job creation and fairness. He stated that the industry recognizes that consumer protection is in its economic best interest. He said if the first stories coming out of the crowdfunding industry are of "loss and woe" then the industry will not succeed. He stressed the need for a fair and cost-effective market to serve as a small company capital formation tool. He said the SEC final rules attempted to give the industry adequate flexibility, sometimes by refusing to lay out prescriptive regulations for consumer protection. He noted that the SEC provided flexibility regarding verification of investment limits. He suggested that providing room for innovation is often more effective than imposing prescriptive regulations.

Judith Shaw (North American Securities Administrators Association) pointed to the lessons learned at the state-level regarding crowdfunding. She said raising capital is a progression for most small businesses. She said Maine has been working to help businesses discern their capital formation path, which could include state-based crowdfunding. She said 29 states and Washington D.C. have implemented crowdfunding exemptions. She suggested that the other states should still consider whether state-based crowdfunding exemptions would be beneficial, suggesting that the state and federal provisions could be complementary. **Shaw** noted that Kansas, Georgia and Idaho offered state-based crowdfunding options prior the passage of the JOBS Act. She said investment limits at the state level range from $100 to $100,000. She stated that some jurisdictions permit compensation of platforms. She said there are bad actor disqualification requirements at the state level. She said limitations on the amount an investor can invest are a key consumer protection, noting that Maine sets its state limit at $5,000. She also emphasized the importance of education for both investors and issuers, adding that crowdfunding is not right for every business. **Shaw** acknowledged that there will be some fraud in the crowdfunding space. She noted that no crowdfunding offerings have been completed in Maine, stating that the two businesses which approached her found that they were

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better off utilizing the limited private offering exemption. She emphasized that the risks inherent in startup investing need to be clear to investors.

Sara Hanks (CrowdCheck) said CrowdCheck provides due diligence and compliance for crowdfunding issuances. She stated that the crowdfunding rules will work well, the market will start slowly, and there is a need for education for both investors and issuers. She contended that the crowdfunding rules are not easily understood, but that small companies will be able to comply with professional assistance. She stated that crowdfunding cannot be made into a "lawyer free" process, but that it can be made "lawyer lite." She suggested that compliance fees will be about $7,000 for startup companies, which will be difficult for companies raising less than $100,000 to deal with. She suggested that these companies might be better suited to the intra-state market. She noted that there is legislation in Congress to create "micro exemptions" for offerings under $100,000. **Hanks** said she expects a slow start in the market. She said in Europe there are only a few hundred companies engaging in crowdfunding yearly and she does not expect much more in the U.S. She contended that crowdfunding will take off after people see that it works. She said in the UK there is a process through which small businesses rejected by banks are directed to crowdfunding platforms. She said many small businesses are rejected by banks because they have not been in business long enough. **Hanks** emphasized that a slow start does not mean that the rules are wrong or that there was no need for the rules. She stressed the need to educate consumers and reiterate to them that there is no "next Facebook." She said investors must understand the differences between common shares and preferred shares. She stated that investors need to understand how valuations work. She emphasized that companies need to understand their requirements both in the initial filing and on an on-going basis.

Discussion

Schacht said both the issuers and the investors in the crowdfunding market lack experience. He said one potential solution is improving investor literacy. He asked how financial literacy regarding crowdfunding can be improved. **Shaw** said there is not robust education on what startups are and how they grow. She said crowdfunding offerings tend to be "emotional investments." She stressed the need to get more information out to investors regarding the risks from startups. **Hanks** noted that some enterprises engaging in crowdfunding provide education, particularly through "gamification." **Tyrrell** said technology is developing in this area, particularly in regards to providing information to investors after the investment has been made.

Brown asked if any of the crowdfunding portals will be run by broker-dealers. He noted that some platforms offer profit sharing instruments, which are not debt or stock. **Tyrrell** said some people are using profit sharing structures to avoid corporate investor requirements, suggesting that Title III could be improved in this area. **Shaw** said some of the portals at the state level have been registered as broker-dealers. She said these companies feel it benefits them to be broker-dealers, because it gives them more credibility.

Roper said Hanks and Shaw both suggested that the crowdfunding market will start slowly. She expressed concern that people will read too much into this slow start. She expressed concern that Congress will take the slow start to mean that the rules are wrong and need to be loosened. She said she has no confidence that investors will understand issues like dilution or how shares grow. She suggested that investors have no understanding of the costs they pay in mutual funds, which are less complex than crowdfunding. **Shaw** emphasized the importance of investment limits, which reduce

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the potential losses for investors. She said investors must understand that their investment is at risk. She stressed the need to give federal and state-based crowdfunding an opportunity to succeed.

Silvers questioned whether an appropriate regulatory balance has been struck. He stated that some issuers will engage in wrongdoing. **Hanks** said there are going to be people who cut corners. She stressed the need for the industry to collaborate with state and federal regulators to report on scammers. **Tyrrell** said regulators, industry, and participants will need to work together to identify bad actors. He noted that there are technological solutions which can be used to identify and stop fraud earlier.

Discussion of NASDAQ Listing Standards-Shareholder Approval Rules

Brown said Commissioner Stein mentioned that there are 1,750 SRO proposals per year, of which 500 need to be approved by the SEC. He said listing standards a critical source of governance for public companies. He said NASDAQ and NYSE require the solicitation of proxies. He noted that the NYSE asked to do away with voting rights for early stage companies for certain issuances. He noted that SEC Investor Advocate Rick Fleming opposed that change. **Brown** said on December 31 the Division of Trading and Markets announced that it would approve the change, against Fleming's recommendation. He said the NASDAQ Listing and Hearing Review Council have issued a request for comment regarding shareholder approval rules.

Stanley Higgins (NASDAQ) noted that the solicitation is not related to a rule proposal. He said NASDAQ is looking for provisions of the shareholder approval rules which are burdensome and no longer provide the benefits they did when they were implemented. He said in the years since the rules were implemented companies have become able to access the capital markets more quickly. He emphasized that the rulebook and listing standards should not be static. He said the solicitation does not request comment on the equity compensation rules. He noted that since the rules were implemented other investor protections were put in place, suggesting that there are areas of the shareholder approval rules which no longer serve their intent. **Higgins** said the common themes in the comments include the disparate effect the shareholder approval rules can have on smaller companies. He said the questions regarding acquisitions relate to thresholds. He said it was suggested that the 20 percent threshold is too restrictive. He noted that NASDAQ rules do not specify what constitutes a change of control. He said the request for comment asked questions about establishing a bright line test. **Higgins** noted that NASDAQ also asked questions about private placements, particularly in regards to the use of book value. He requested that the Advisory Committee or its individual members submit comments. He noted that NASDAQ has not decided whether or not they will make changes, and urged the public to comment on whether or not changes are necessary. He said the comment deadline is February 15, but it could be extended.

Arnold Golub (NASDAQ) emphasized that no decisions have been made about changes NASDAQ wants to make. He said NADSAQ is looking for areas where rules do not benefit investors, but are burdensome to issuers. He said NASDAQ is looking at whether there are disparate impacts on smaller companies.

Discussion

Schacht asked who suggested examining the rules mentioned in the solicitation. **Golub** said these potential changes came from the NASDAQ Listing Council.

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Silvers said the rules being examined by NASDAQ are important to maintaining a strong corporate governance system. He suggested that the solicitation is based on the notion that disclosure is adequate to deal with conflicts of interest without giving shareholders the right to vote. He suggested that the solicitation is also based on a view that 20 percent is no longer a controlling stake. He said he does not see any evidence to support these notions. **Golub** said NASDAQ recognizes that there is an appearance of conflict when an SRO approves rules, which is why they adopted the Listing Council model, which he suggested works very well. He emphasized that NASDAQ has not reached any conclusions on changes which should be made. He said NASDAQ is examining whether there are some areas where disclosure is adequate without shareholder votes, but has not made any determinations.

Carcello asked if the proposal was moved forward by NASDAQ staff or if it was approved by the NASDAQ Listing Council. He asked why NASDAQ views book value as now being "a flawed measure." **Golub** emphasized that NASDAQ is only requesting comment and has not issued a proposal. He said the Listing Council did approve of the solicitation being put out for comment. He said any proposal coming out of the solicitation would go through the Listing Council, the NASDAQ board, the SEC and the public comment process. He said during the crisis many companies were trading below their book value.

Katzovicz said he expects that NASDAQ will move forward with a proposal to ease standards and eliminate votes. **Golub** said NASDAQ has not reached any conclusions. **Katzovicz** said he anticipates NASDAQ moving in a more lenient and less stringent direction. He said NYSE and NASDAQ no longer operate to aid the public benefit. He suggested that the current balance in the rules is appropriate and should not be changed. He expressed concern that there is a race to the bottom on listing standards. He raised concerns with issues of dilution and changes of control. He said it will be difficult for the Advisory Committee or the public to comment on the solicitation, because it lacks specific proposals to comment on. He expressed support for retaining the 20 percent threshold.

Brown said future solicitation should also ask if there are any places where voting requirements should be tightened. He suggested that if NASDAQ loosens its regulations NYSE will follow suit. He said the solicitation noted that one of the changes in the market has been the requirements for independent directors. He noted that the *Wall Street Journal* recently published an article suggesting that independent directors still have ties to the company. He said the presence of independent directors is not sufficient to justify the elimination of material investor protections. **Golub** said the NASDAQ director independence standards include objective measures examining issues such as social relations between board members and company leadership.

Fleming said many people have commented that the solicitation is difficult to find on NASDAQ's website. He urged NASDAQ to make the solicitation more easily accessible. He asked if NASDAQ's existing rules have "emergency valves" for cases where a company is in trouble and needs to raise capital quickly. **Golub** said there are some rules which include exceptions for cases where the only options are for the company to engage in the transaction or enter bankruptcy. He said these provisions require the approval of NASDAQ and the company's own audit committee.

Wallman said rules written in the 1990s are likely imperfect and need to be updated, but said there are concerns that NASDAQ has already made up its mind about what changes are needed. He urged

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NASDAQ and the commenters to be more specific about the rules being referenced. He suggested that the shareholder approval process rules are "quite good." He expressed support for moving away from the use of book value.

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