WILLIAMS & JENSEN, PLLC

Fr: Rebecca Konst and Alex Barcham

Re: SEC Advisory Committee on Small and Emerging Companies

Dt: March 4, 2015

Summary

On March 4, the Securities and Exchange Commission's (SEC or Commission) Advisory Committee on Small and Emerging Companies (Advisory Committee) convened a meeting to focus on ways to increase the opportunities for investors in small and emerging companies to resell their shares as well as consideration of recommendations to the SEC regarding the definition of "accredited investor." The Advisory Committee agenda included the following topics:

- Consideration of Written Recommendations on Accredited Investor Definition
- Discussion of State Preemption in the Context of Regulation A+
- Secondary Market Liquidity Generally/Formalizing Section 4(a)(1½)
- Secondary Trading Venues/Venture Exchanges.

In the discussion of next steps, **Advisory Committee co-chair Stephen M. Graham (Fenwick & West, LLP)** said the notion of a venture exchange is a good idea, and he suggested that the Committee should consider issuing more specific guidance to the SEC. He said the Committee will further consider this issue at its next meeting on June 3, 2015. He noted that the Committee will also work to draft final recommendations on Regulation A+ and Section 4(a)(1 ½).

Opening Remarks:

Advisory Committee co-chair Stephen M. Graham stated facilitating shareholder liquidity has always been a priority. He noted the growing importance of this issue. He stated small and emerging companies often have difficulties attracting investors and he noted these issues are a main focus at the SEC.

Advisory Committee co-chair M. Christine Jacobs (Theragenics Corp.) thanked the Chair and the Commissioners for attending and for providing a platform for discussion of these important issues.

SEC Chair Mary Jo White in a statement noted that today's agenda addresses several important topics, including Regulation A+, secondary market liquidity, and recommendations regarding the definition of accredited investor, all of which are quite timely topics for the Commission's ongoing work in these areas. She explained the SEC's Regulation A+ and crowdfunding rulemakings are designed to facilitate smaller companies' ability to access capital and to provide investors with additional investment opportunities. **White** stated that in making investment decisions, investors may naturally consider whether they will have the ability to resell their shares in the future. She stated there is no doubt that secondary market liquidity is an important factor impacting the availability of capital for small businesses as well as investor protection.

Chair White stated SEC staff in the Division of Corporation Finance and the Division of Trading and Markets have been looking at various means to facilitate the secondary market trading of securities issued by small businesses. She explained among a number of other possible avenues, the

staff is considering whether the development of appropriately structured venture exchanges could provide more liquidity for the securities of smaller companies. She noted some earlier exchanges have not been successful, so the reasons for that should be carefully studied along with other issues. **White** stated smaller companies are important to the economy, and it is important to appropriately support a market structure that promotes the capital formation of smaller companies while also providing robust investor protections.

More generally, **Chair White** noted she has emphasized on several occasions that one market structure may not fit all and that the Commission must concretely focus on how to enhance the market structure for smaller companies. She expressed an interest in hearing perspectives and ideas from this Committee on what obstacles and possible solutions there are for the development of secondary market liquidity venues for privately-issued securities.

SEC Commissioner Luis A. Aguilar expressed his interest in the discussion of secondary market liquidity. He stated this topic is increasingly urgent following required rules from the JOBS Act. He stated these registration exemptions are supposed to also provide for lesser reporting requirements. He stated companies will be able to sell their securities to a wider "swath" of the public. He stated investors acquiring these shares may be unable to sell them. He stated another suggestion is for the Commission to approve one or more venture exchanges. He stated venture exchanges may be a viable alternative but have failed in the past. He stated the SEC must carefully examine the reasons for the failures of prior venture exchanges. **Aguilar** stated the issues raised by the demise of prior venture exchanges can provide guidance; however, he noted there are other areas where lessons can be learned such as European "junior" exchanges and Canada's TSX venture exchange. He noted that venture exchanges have in the past suffered from low liquidity and high costs. He asked how the SEC can encourage use of venture exchanges rather than off-exchange trading. He noted the valuable insights which can be learned from the proposed Tick Size Pilot Program. He stated venture exchanges are more likely to succeed when they focus on investor protections. He noted some experts have suggested that certain listing standards are more important for success than others. He stated venture exchanges are a possible solution to a looming problem. **Aguilar** noted an interest in revising Exchange Act rule 15c2-11 or the "piggy back" rule. He suggested there are problems with this rule and he urged the Advisory Committee to discuss this rule. Finally, he discussed section 4(a)(1 ½) and noted his interest in this discussion.

SEC Commissioner Daniel M. Gallagher in a statement expressed his excitement that the Committee is taking up the "vitally-important" issue of secondary liquidity in the shares of small and emerging growth companies. He stated this is an issue he has been "pounding the table" on for years. He suggested secondary trading "implicates" all three prongs of the SEC's tripartite mission to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. **Gallagher** stated if the Commission takes steps to enhance these markets, they will make them more fair and efficient. He suggested the SEC can increase the ability of an investor to exit his or her investment in these markets and decrease the illiquidity discount of the investment, and they can enhance oversight of and transparency into issuers, thereby promoting investor protection. He stated that in turn will increase investors' willingness to participate in the primary issuance of securities, which enhances capital formation for these small companies that are the lifeblood of the economy.

Gallagher explained that the SEC needs a positive, proactive capital formation agenda for small business that encompasses all phases of growth, in both the private and the public markets. He

stated today the Committee is discussing two pieces of that agenda. First, he noted it will focus on enhancing secondary trading in private shares, both in general and through a focus on Rule 4(1½). He suggested if greater certainty, for example, through Commission guidance, in this area would help participants in these markets, then the SEC should make that a priority. Second, he stated the Committee will examine secondary market trading of small company shares, particularly through venture exchanges. He expressed his view that venture exchanges are a vital bookend to the SEC's JOBS Act rulemaking on Regulation A+. Gallagher stated in thinking about these entities, he has been envisioning them as national securities exchanges, with full state law preemption, but with tailored periodic reporting and listing requirements that are more appropriate for small businesses. He suggested they would be exempt from the National Market System rules and Unlisted Trading Privileges requirements so as to concentrate liquidity in the listing venue, and they would be free to structure trading however they see fit (e.g., periodic auctions instead of continuous trading). He suggested these principles would create liquidity in Regulation A+ shares. He noted these same principles could be extended to the shares of the smallest public companies, currently traded over-the-counter, to facilitate liquidity for them as well. Gallagher urged that they "must embrace change." He stated the SEC must depart from the failed policies and feeble ideas of the past in order to pursue critically needed innovation like venture exchanges. He suggested this Commission has the "courage and leadership" to do so.

SEC Commissioner Michael Piwowar stated this meeting will focus on a number of important issues such as the definition of accredited investor and Regulation A+ offerings. In addition, he noted an interest in secondary trading liquidity. He noted a recent Harvard Business School report suggests that most jobs were created by small businesses. He stated small businesses have been faced with reduced access to credit following the Dodd-Frank Act (DFA). He stated bank-based financing has become too costly and politicized. He stated the SEC must continue to work to promote access to capital market financing.

Keith Higgins (Director, Division of Corporation Finance) stated the issues on the agenda are extremely current and of interest to the Division as they are currently working on them.

Consideration of Written Recommendations on Accredited Investor Definition

Graham stated the Advisory Committee approved a set of recommendations on the definition of "accredited investor" and since the last meeting they have written down what was agreed to.

Sarah Hanks (CrowdCheck) asked for a few wording changes. She noted in recommendation 8 they use the term "laudable" and she suggested using the word "understandable" instead. In addition, she suggested adding to recommendation 1 the phrase "tax treatments in net worth should be disregarded." She stated this is attempting to get at retirement assets in the consideration of net worth. **Graham** asked whether this change is actually required. **DJ Paul (Propellr)** stated the rationale for the second recommendation is to keep things simple if there is a tax change in the future. **Hanks** stated how these are treated under the tax code is irrelevant to its treatment as an asset. **Graham** expressed his view that the tax treatment of a particular asset should not play a role in achieving accredited investor status. He stated they would work on the language.

The recommendations on "accredited investor" were approved by a voice vote.

Committee Discussion of State Preemption in the Context of Regulation A+

Graham noted the SEC is working hard on recommendations for Regulations A+ (Reg A+) and one main concern is over state preemption.

Michael Pieciak (North American Securities Administrators Association) stated Regulation A+ is sort of a mini-registration process. He noted there is also state registration for Regulation A filings. He explained that the state regulation was a type of registration by qualification. He noted the decrease in Regulation A filings and the question was raised about why this regulation had declined in use. He noted the GAO study on this issue. He stated it found that Rule 506 filings are used more, there is no limit under Regulation D like there is for Regulation A, and compliance with state Blue Sky laws are complicated. He explained under the JOBS Act the cap was raised from $5 million to $50 million under Regulation A+ offerings. He stated these offerings are also preempted from state action when traded on a national exchange and by qualified purchasers. He noted that the North American Securities Administrators Association (NASAA) laid out their views on what was intended. He stated the SEC has proposed a qualified purchaser as everyone doing a Regulation A+ offering. He stated in the Fall of 2012 NASAA conducted a coordinated review initiative. He explained now only one state needs to be communicated with and inconsistencies are to be worked out. He noted 46 states have signed up for this coordinated review program thus far. He noted they are also working on electronic filing but this is not available for Regulation A yet.

Hanks asked about the first filer through the system. She asked whether they are completed yet. **Pieciak** stated they are cleared through the process but are waiting for comments by the SEC.

John Borer (Rodman & Renshaw, LLC) asked about "smoothing" inconsistencies. **Pieciak** stated NASAA and SEC are working to streamline the process even more. **Borer** asked if there were inconsistencies how those would be reconciled for an issuer if there is no formal coordination built into the system. **Pieciak** stated businesses and the SEC have dealt with discrepancies for a long time. He stated in addressing comments issuers are allowed to fill in what comments were received from other regulators.

Charles Baltic (Needham & Company) asked whether the 46 participating states are able to amend or withdraw their participation. **Pieciak** stated the states have agreed to a memorandum of understanding (MOU) that they will participate in this program. He stated they agree to a lead examiner and if that lead examiner approves the offering then the other states agree to that offering as well.

Greg Yadley (Shumaker, Loop & Kendrick, LLP) asked about the local character in regards to larger offerings. He asked why the filers using Reg A+ would be local in character. In addition, he asked about the lead examiner not being local to that particular offer. **Pieciak** stated the lead examiner depends on workload. He noted there is a flexible process which allows the lead examiner to be local. He stated not all offerings will be large and registering in all 50 states. He stated offerings will remain local in character.

Sonia Luna (Aviva Spectrum) asked about the process of naming a lead examiner. **Pieciak** stated Washington State receives the paperwork and determines who will be the lead examiner. He noted it is a collaborative process.

DJ Paul stated Regulation A was created in the 1934 Act. He stated this regulation has never really worked well. He noted that Regulation D has made Regulation A less necessary but he suggested the state Blue Sky requirements are the biggest obstacle. **Paul** noted appreciation for the coordinated review process but he noted that every previous attempt at state coordinated review has failed. He noted that NASAA has never gotten all 50 states to participate. He stated there needs to be either all jurisdictions participating or it will not work. **Paul** noted that NASAA does not have enforcement authority over their members. He suggested a proof of concept of only one company which took three moths to go through the process does not undo the 80 years of misuse. **Paul** stated congressional intent is always a hard thing to determine. He stated at the time of the JOBS Act there was not much consensus on this issue and it was determined that this should be left to the experts. He stated there is no question that state preemption is crucial to a successful Regulation A. **Paul** stated the fact that NASAA is attempting a coordinated review highlights the fact that this is an issue.

Baltic stated confusion is always a negative for capital formation. He noted the steps NASAA has taken but he stated this is not a certainty, there is no mandatory nature to the program, and no laid out guidelines for choosing the lead regulator. He suggested a broad definition of accredited investor is appropriate.

Yadley stated this is a "nifty" idea but he asked what is really to be gained by it. He stated Regulation A is an exemption and it has been a problem in the past. He noted the difficultly of using Regulation A in some states. He stated with the increased dollar limits in Regulation A+ this is now a more regulated type of offering than Regulation D and it needs to be given a chance. He suggested the SEC needs to move forward with their proposals and preemption is needed.

Pieciak added that if Regulation A+ does "take off" whether or not any states are removed from the process, whether the SEC has enough staff to review these offerings is questionable.

Borer stated the potential differences and disparities in the various state commissioners can impact the type and quality of the review. He stated the Division of Corporation Finance at least has a consistent application of the regulations. **Pieciak** stated the lead examiner acts as a go between the states. He stated all of the states will review the offering and give their reviews to the lead examiner. He stated the lead examiner is less important in the overall review.

Timothy Reese (Forge Intellectual Capital LLC) stated it is interesting that NASAA is looking at this issue. He suggested Washington seems like more of a clearinghouse. He asked about the clearinghouse aspect of the State of Washington and how they will handle case loads. He asked about volume projections. **Pieciak** stated the practical reason behind the State of Washington being the lead is they have a strong background in corporation finance, and they have the man power and expertise. He stated there are two other offerings in the "pipeline." He stated there is enough staff to handle quite a number of offerings and the ability to rotate the lead examiner also helps with that.

Dan Chace (Wasatch Micro Cap Fund) stated the comment letters to the SEC are always informative. He asked whether the SEC review would be as thorough as for a public filing. **Higgins** stated the review would be similar. He stated they would give it the same review as any filing.

Commissioner Gallagher stated there has been a discussion of the process. He stated there is an issue of merit regulation versus non-merit regulation. He raised the question over certain states withdrawing from the MOU.

John Hempill (Sheppard, Mullin, Richter & Hampton LLP) stated this seems like an all or nothing process. **Pieciak** stated the issuer is free to withdraw from a state and have the other states to continue on with the review. **Hempill** asked whether there is an ability to determine which states the comments come from. **Pieciak** stated there is the ability. **Commissioner Gallagher** asked whether a state can withdraw. **Pieciak** stated it would be up to the issuer to withdraw an application.

Luna asked whether the SEC should have a rule for all 50 states. **Paul** suggested that Congress gave the SEC authority to decide this issue and the recommendation of this Committee should be for the SEC to finalize their proposals.

Hanks stated it is twice as much work to go through two registration processes as it is to go through one. She stated these are small companies who are cash constrained and are "under the gun." She stated Regulation A is burdensome and companies are then choosing Regulation D. **Paul** noted the fees still need to be paid even with coordinated review. He stated these additional costs make Regulation A prohibitive as well.

Yadley stated NASAA is an organization who has done wonders in coordinating 50 jurisdictions. He stated if there is going to be state review it is difficult to coordinate all of the comments. He stated the comments will be useful but for the smaller offerings there is not that much benefit from receiving another review. He stated the SEC is able to conduct these reviews in less time and with fewer burdens.

Reese stated Regulation D was chosen because of its convenience. He stated the due diligence process is costly and time consuming. He stated there is a cost impediment right now that needs to be simplified. He suggested a venture exchange is needed which is simpler than the current process.

Hanks stated there is a compelling public policy reason to make Reg A workable because it is transparent and adds to investor protections. She stated the only way to do this is with state preemption.

Milton Chang (Incubic Venture Fund) stated the NASSA coordinated review looks "good on paper."

Borer stated state preemption is needed in this area.

David Bochnowski (Northwest Indiana Bancorp) expressed his support for state preemption. He stated the congressional intent is for federal preemption. He noted this works well in the banking sector.

Baltic stated in this setting a national standard would be important in reinvigorating Regulation A.

Jacobs agreed with the consensus of the Advisory Committee. She asked about the additional protections this two-tiered system brings to investors. She stated in this case the additional cost of the coordinated review is not useful for capital formation.

Commissioner Gallagher stated the NASAA process will be important "one way or another." He noted the importance of Regulation A. He stated these are not the millionaire markets and one thing the SEC does not do enough is bring democracy to the markets to ensure that everyone can invest. He noted the need to ensure investor protections. He stated they cannot lose sight of the fact that these are the "every man and woman" markets.

Graham stated the preemption in this context makes a lot of sense. He noted the consensus of the committee and expressed his desire to issue a recommendation on state preemption. The Committee voted by voice vote to issue a recommendation to the SEC on state preemption.

Presentation and Q&A on Secondary Market Liquidity Generally/Formalizing Section 4(a)(1½)

Presenter: Annemarie Tierney, Executive Vice President – Legal and Regulatory, General Counsel, SecondMarket Holdings, Inc.

Annemarie Tierney (SecondMarket Holdings, Inc.) explained that SecondMarket's premise is to find liquidity for highly liquid assets. She stated they entered the private company space in 2008. She stated most private companies have no interest in having unrestricted selling of their stock. She stated their product has morphed since 2011 in that they only provide liquidity through private tender offers. **Tierney** noted the impacts of the JOBS Act in this market and the increase in the thresholds of holders of record. She noted the company controls the entire process, and they can decide how often they will provide liquidity and who can purchase the stock. She stated some companies will do a private tender offer to "clean up" their capital table before an IPO.

Borer asked why there was a move from law firms handling these. **Tierney** stated SecondMarket has lower prices and law firms are always interested in saving their clients money. She noted that their products are completed electronically and there is a secure method of letter transmittal. She stated their fees are significantly less and they market through law firms.

A Member asked whether sellers are typically employees. **Tierney** stated they typically include employees but also include the full range of investors.

Javier Saade (Small Business Administration) asked whether these have always been "up rounds." **Tierney** stated these are always priced off of another valuation metric. She noted that these are always voluntary. **Saade** asked whether they also trade on warrants. **Tierney** stated they only do tender offers. She stated they are only a service provider to close private tender offers. She noted most people are not looking to purchase warrants.

Tierney stated over their history they have been active at the 500 thresholds. She noted that during the JOBS Act they focused on the fact that there are not federal exemptions for secondary transactions. She stated they started focusing on private community banks and how to create liquidity. She stated one issue they faced was the Blue Sky requirements of the 50 states. She noted community banks desire investors who are local and SecondMarket could not create liquidity for those community banks because of the Blue Sky requirements. She stated based on this they had to give up this market. Since that time, she explained SecondMarket has been focused on a codification of section 4(a)(1 ½). **Tierney** stated the "rank and file" community bank employees cannot exercise options because of the requirements of Rule 144. She stated SecondMarket has been discussing this

issue with NASAA but there is the view that they will not be able to issue regulations in all 50 states. She stated the current "patchwork" is unworkable. She stated there needs to be a federal exemption for shares held less than 12 months and for affiliates. **Tierney** noted there have been bills introduced on this issue and she noted the possibility of a JOBS Act 2.0. She noted section 4(a)(1 ½) can only be used by accredited investors so investor protections are present.

Committee Discussion of Section 4(a)(1½) and Secondary Market Liquidity

Commissioner Piwowar asked whether this needs to be handled by regulation or whether it can be handled by the SEC. **Tierney** stated the SEC can handle this but she noted concern over the length of time the SEC takes on regulations.

Hempill asked about some requirements on whom the seller is. **Tierney** stated the seller received the shares so they had an accreditation requirement. She noted these are employees who have worked for the company at least 4 years and had to receive some disclosures before getting their shares. She stated protections for the seller against their own employer are already worked in. **Tierney** stated the sale is covered by all of the anti-fraud provisions of the 1933 and 1934 Acts. She stated they have not seen any bad actions by the companies. **Hempill** asked whether there should be some sort of disclosure requirements. **Tierney** stated the idea of imposing disclosure requirements does not make sense. She stated they are protected under Rule 701. She noted the companies provide disclosure at the initial sale. She stated the company is looking out for the best interest of the employees in doing the tender in the first place.

Reese stated the sophistication of employees has grown over time. He noted that this is not a liquid asset but is an important incentive. He stated if there is no ability to exit from these options then the employee base can be lost. He stated this is an important regulation that needs to be solved because it can free up a lot of liquidity.

Tierney stated this is not a new concept and the legislation codifies what is already standard practice. She stated this allows easier location of buy side interest.

Yadley asked who this would apply to and what the current protections are. **Tierney** stated there is always a chance for bad behavior but SecondMarket has not seen problematic practices.

A member asked what the typical financial disclosure is. **Tierney** stated they require 701 disclosures which includes corporate documentation and two years of audited financial statements.

Chang stated it seems like currently if an employee wants to sell they go to the company and explain they want to sell. He asked whether SecondMarket is doing anything new. **Tierney** stated these stocks are not eligible for Rule 144. She noted companies do not allow employees to simply sell these stocks because they do not want to be a part of a distribution chain. She noted when IPOs are a ways off employees need more access to that liquidity.

Luna asked about the top two changes in this new proposal from prior proposals in the House Financial Services Committee. **Tierney** stated the House Financial Services Committee proposal had included a general solicitation provision. However, she noted it was determined that provision was unnecessary. In addition, she noted some of the language was "tightened up" to make sure that those participating in this are not seen as underwriting.

Reese asked about venture capitalists and their preferred returns. **Tierney** stated this is a private tender and shareholder approval is typically received. **Reese** asked whether this causes a valuation of the company. **Tierney** stated the number that is used for the tender is also used for the company's valuation for the year.

Chang stated it seems like the next step is to help companies raise money. **Tierney** stated they used to help companies raise primary capital; in order to make that effective they need to be more of a traditional broker-dealer that is phone based.

Shannon Greene (Tandy Leather Factory) asked whether the companies get anything out of this. **Tierney** stated the benefit the company gets is making their shareholders happy and controlling who the next owner is.

Saade asked how big this market is. **Tierney** stated she does not know. She explained they got into this market by accident and now they close a large number of these transactions.

Luna asked what the Advisory Committee should address. **Tierney** stated this is a change that's "time has come." She suggested this legislative change is needed for any type of venture exchange to be successful.

Higgins asked about the reliance on the accredited investor definition. **Tierney** stated the vast majority of these sellers will not have the ability to provide information to third party buyers. She stated the goal of the legislation is to codify current opinion practice. She noted she is not certain how to include a disclosure requirement.

Presentation and Q&A on Secondary Market Trading Venues/Venture Exchanges
Presenters: **David Weild**, Chairman & CEO of IssuWorks and Weild & Co. and **Vincent Molinari**, CEO & Founder of Gate Global Impact

David Weild (IssuWorks and Weild & Co.) expressed concern with the degradation of the small capitalization company economy. He said the problems in this area trickle down to the startup economy. He stated that IssuWorks discovered that the bottom of the small cap market "fell out" in 1997 and 1998, suggesting that Regulation ATS is partly responsible for the problems in the small cap market. **Weild** stressed the need for a market model focused on small cap stocks. He expressed support for creating venture or small cap exchanges. He said the U.S. has fallen from first to twelfth in small IPOs, and from first to second in large IPOs. He noted that the U.S. has fallen from 9,000 to 5,000 listed companies.

Weild said there has been a decline in middle market institutional distribution and fundamentally-based retail distribution. He pointed to the sharp decline in small IPOs beginning in 1998 following the implementation of Regulation ATS. **Weild** said there has been a severe decline in venture funded companies going public. He said the testing the waters provisions have been a boon to biotechnology companies. He stated that the primary causes of the decline of small cap IPOs are capacity and cost to issuers. He suggested that the one size fits all market model works for naturally liquid stocks, but fails for illiquid stocks.

Weild contended that venture exchanges are the solution to this issue. He suggested that in the 1970s and 1980s NASDAQ was the "de facto U.S. venture exchange." He recommended creating

"Regulation Venture Exchange" and establishing a venture exchange division within the SEC. He stated that these exchanges should be member owned and permit listings up to $2 billion in market value. **Wield** suggested that venture exchanges should be exempted from a number of rules including Order Handling Rules, Regulations ATS and NMS, Unlisted Trading Privileges (UTP), decimalization, Sarbanes-Oxley, and State Blue Sky laws. He stated that exchange traded funds and index funds sap liquidity from the system. He expressed support for requiring basic disclosures and requiring a consolidated tape in the private markets.

Vincent Molinari (Gate Global Impact) stated that the secondary private equity market is growing dramatically and new market infrastructure is needed to support this expansion. He stated that general solicitation enhances the incentives for companies to remain private. He said there is now more than $1 trillion in unregistered securities being done annually and suggested that this number will continue to grow. **Molinari** stressed the need to view secondary liquidity as a "cornerstone of investor protection." He stated that there is a window to amend Regulation ATS to facilitate the secondary market for unregistered securities. He stated that secondary trading in private equity has developed quickly to the point of electronic quotation through online bulletin boards that allow members to post bids & offers. He said with direction and guidance from the SEC ATSs could eventually become venture exchanges. He stressed the need to streamline the process for a broker-dealer to become an ATS, which currently takes about 12 months. He expressed support for standardization of disclosures and allowing straight-through processing. **Molinari** said general solicitation under 144A should be available to accredited investors. He suggested that accredited investors should be able to participate in the market for 144A secondary securities.

Committee Discussion of Venture Exchanges and Secondary Market Trading Issues

Hanks suggested that there is a tension between companies who want to "keep trading close" and encouraging the development of venture exchanges. **Molinari** said there should be an "issuer solution."

Graham said the Committee issued a recommendation on these issues a year or two ago. He said he is attracted to the idea of developing markets for smaller companies. He stated that there are practical issues which still need to be addressed. He asked how member-owned exchanges could be created. **Weild** stated that member-owned exchanges could be created quickly if facilitated by the SEC. He suggested that there would be robust membership if the right incentives were in place.

Jacobs asked about the differences between for-profit and non-profit venture exchanges. **Weild** said publicly traded companies, like NASDAQ and NYSE, have a primary mission to create shareholder value even if it is a detriment of the market. He suggested that venture exchanges should be non-profit entities focused on nurturing the ecosystem.

Mott expressed interest in how venture exchanges would affect the market for angel investors. She expressed support for increasing the liquidity in the market. She suggested that the timeline for venture investments is discouraging investments. She suggested that one problem with relying on mergers and acquisitions is that many companies are acquired not to expand and create jobs, but to take competition out of the market. She said she is very supportive of examining venture exchanges further.

Paul asked about the process for a broker-dealer to become an ATS. He asked what the impediments are and what can be done to eliminate them. **Molinari** expressed support for fixing

Regulation ATS for small cap stocks. He said the SEC and FINRA should work to streamline the process for broker-dealers to become ATSs. He noted that currently the application process only applies to a single asset class and recommended widening the approval set.

Paul said the Regulation D market is more than $1 trillion. **Weild** responded that there is a lack of good Regulation D data. He stated that it is inaccurate to suggest that Regulation D is replacing investment activity. **Paul** said the goal is to encourage more liquidity in the middle market area. He asked if loosening Regulation D, expanding the definition of an accredited investor, and using Regulation A+ could be simpler solutions than creating new exchanges. **Weild** said Regulation A is more focused on disclosure. He stressed the need for a holistic solution, rather than a piecemeal approach.

Chace asked about the issue of adverse selection at venture exchanges. He asked how "quality companies" can be attracted to these markets. **Weild** said he recommended increasing the limit to $2 billion in order to attract quality companies.

A committee member asked about the acceptable financial disclosures for smaller issuers. **Weild** suggested that there should be reduced disclosure requirements for smaller companies, as they present less systemic risk than larger companies.

Yadley asked how the ATS model could be adapted to allow for the creation of venture exchanges. He said there are fewer than 200 ATSs and some have multiple assets they are allowed to deal in. **David Shillman (SEC Division of Trading and Markets)** said ATS was designed to be a "lighter touch" regulatory model. He said Regulation ATS requires the ATS to be a broker-dealer. He stated that nothing in Regulation ATS restricts it to registered securities. He said there is design freedom for ATS operators and non-profit business models are not precluded.

Yadley asked what the SEC could do to facilitate the creation of venture exchanges. **Molinari** said it is clear that unregistered securities could be transacted on an ATS, but raised concerns with the timeline of the approval process. He stressed the need to make this process more efficient. He suggested that an approval set for unregistered securities could be created.

Borer said four or five years ago NASDAQ rolled out the BX Venture Exchange for companies which did not qualify for listing on the exchange. He asked what happened to this exchange. **Weild** said NASDAQ could net get an exemption from Regulation NMS and was concerned that the exchange would be unprofitable.

Borer said the SEC and FINRA have different mandates. He suggested that FINRA is not expansive in its desire to create greater flexibility and ability raise capital. He pointed to the length of the FINRA approval process. **Molinari** said his experiences with FINRA following the passage of the JOBS Act have been encouraging.

Commissioner Gallagher said NASDAQ front ran the regulatory structure in creating the BX Venture Exchange. He said impediments like the Order Handling Rules need to be addressed before venture exchanges can be successful. He suggested that the Amex venture tier had problems because it was not Blue Sky exempt.

Baltic said there has been a significant decline in the number of companies going public for decades. He stated that the idea of venture exchanges is appealing. He pointed to the growth of ETFs and index funds. He suggested that it would be very difficult to ban ETFs and index funds from venture exchanges. **Weild** said venture exchanges could mandate that ETFs and index funds put out standing orders. He emphasized that ETFs and index funds are "information mining strategies" and not "information additive strategies." He said Vanguard has "preached" the benefits of index investing and the lack of value of actively managed portfolios.

Commissioner Piwowar noted that **Weild** was an active proponent of widening tick sizes for smaller company stocks. **Piwowar** suggested that issuers could be allowed to hire their own market makers and pay them directly. He asked for **Weild's** views on this suggestion. **Weild** said he strongly prefers that market makers have affirmative responsibilities, but that he is pragmatic. He suggested that the support should come from the market itself. He noted that the UK has had some success allowing issuers to hire and pay market makers.

Greene noted that there are publicly traded companies who are looking for ways out of it, because they do not see any benefits to being public. She suggested that Tandy Leather Factory is looking at going private. She noted that NASDAQ is going to an all-inclusive listing fee, which will increase Tandy's fees significantly without any benefits. **Weild** said the improvements for companies up to $2 billion should be applied to existing public companies. He emphasized the problems with the for-profit exchange model.

Discussion of Next Steps/Future Topics

Graham said the notion of codifying Section 4(a)(1½) is a good idea, describing it as a small but important step. He suggested issuing a recommendation to codify Section 4(a)(1½). **Paul** suggested that the recommendation should be worded to clarify that the SEC has the necessary authority to codify Section 4(a)(1 ½). **Graham** offered a motion to draft this recommendation, which was approved.

Graham said the notion of a venture exchange is a good idea, noting that the Committee has already issued a recommendation in this area. He suggested that the Committee should consider issuing more specific guidance to the SEC. He said the Committee will further consider this issue at its next meeting on June 3, 2015. He noted that the Committee will also work to draft final recommendations on Regulation A+ and Section 4(a)(1 ½).

Mott expressed interest in hearing from the SEC staff on what would be necessary to implement venture exchanges, to which **Graham** agreed.

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