U.S. SECURITIES AND EXCHANGE COMMISSION

SMALL BUSINESS ADVISORY COMMITTEE MEETING

Amended: 12/5/2024

Wednesday, November 13th, 2024

9:00 a.m.

U.S. Securities and Exchange Commission

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

APPEARANCES:

Gary Gensler, SEC Commissioner, Chairman
Mark Uyeda, SEC Commissioner
Hester M. Peirce, SEC Commissioner
Jaime Lizarraga, SEC Commissioner

SEC Staff from the Office of the Advocate for Small Business Capital Formation
Timothy Collins
Courtney Haseley

Committee Members
William Beaty
Stacey Bowers
George Cook
Marcia Dawood
Greg Dean
Bart Dillashaw
Herbert Drayton III
Erica Duignan Minnihan
Jennifer Newton
Laura Niklason
Jasmin Sethi

APPEARANCES (Cont.):

Committee Members (Cont.):
Aren A. Shari
Marc O. Sharma
Rose Standifer
Wendy Stevens
Dennis Sugino
Emily Underwood

SEC Staff
Brandon Hill
Holly L. Hunter-Ceci, Counsel to Commissioner Mark Uyeda
Diem-Mi Lu, Counsel to Commissioner Lizarraga
Barbara Roper

Panelists
John Cavanaugh, SEC Private Funds Branch of the Investment Adviser Regulation Office, Division of Investment Management, Senior Counsel
Robert Holowka, SEC Private Funds Branch of the Investment Adviser Regulation Office, Division of Investment Management, Branch Chief
Sabrina Howell
Karen Kerr

C O N T E N T S

P R O C E E D I N G S

MS. MINNIHAN: Good morning and welcome to today's meeting of the SEC's Small Business Capital Formation Advisory Committee. I now call this meeting to order.

I want to extend a warm welcome to everyone. We also appreciate members of the public who've tuned in to watch the meeting via webcast on SEC.gov.

Courtney, do we have a quorum for the meeting?

MS. HASELEY: Good morning, Erica. Yes, we do have a quorum.

And I'd also just like to add for any SEC staff that speak today, any views we provide are in the own speaker's official capacity at the SEC, but they don't necessarily reflect the views of the Commission, the Commissioners or other members of the staff.

So, thanks for humoring me with your SEC disclaimer. Back to you.

MS. MINNIHAN: Thank you so much, Courtney.

So, first I'd love to take a moment to extend a very warm welcome to the

Committee's four newest members: Jennifer Newton, Rose Standifer, Wendy Stevens and Emily Underwood.

Jennifer is the founder and managing attorney of Start Smart Counsel in Miami. Rose joins us as a partner at the Law Firm Foley Hoag in Denver. Wendy is a partner at the accounting firm Forvis Mazars in New York. And Emily is a Clinical Professor of Law and the Director of the Innovation Clinic at the University of Chicago Law School.

Really amazing backgrounds and I think they'll be so incredibly additive to the committee. We're really looking forward to having them participate. These four members were appointed to the Commission only two weeks ago. So, we really appreciate them making the time to join us today on very short notice. On behalf of the rest of the committee, we truly look forward to working with you and we appreciate your commitment to service.

Stacey, would you like to say a few words?

MS. BOWERS: Sure. Thanks, Erica.

Good morning and welcome everyone.

Thanks for being here at this slightly early hour. I'd also like to extend a warm welcome to our four new members, Jennifer, Rose, Wendy and Emily. We're excited to have you on board and look forward to hearing from all of you.

Lastly, Commissioner Crenshaw asked me to extend her apologies for being unable to attend today's meeting and looks forward to meeting the new members at the next committee meeting.

With that, I will turn it back to you, Erica. Thanks.

MS. MINNIHAN: Thank you, Stacey.

So, today we're going to continue exploring ways to support early stage capital raising with a focus on investors and managers. We have a full agenda anchored around understanding how certain investors raise money and the challenges facing emerging fund managers which are managers on their first through third pooled fund vehicles. We'll begin by discussing how venture capital fund managers are raising capitals, including, the limits of arm's length fundraising.

We'll hear from Dr. Sabrina Howell

who just published a paper regarding her research on funds VC fund managers under Rule 506(c), a capital raising exemption that permits general solicitation. Dr. Howell's report assesses how VC managers use Rule 506(c) exemption as similar to the more commonly used traditional private placement exemption, Rule 506(b). The report also compares the types of fund managers that choose to use this pathway. I had a little chance to dig into this report before this meeting and the data is very interesting. I'm excited for Dr. Howell to present her findings and hope she'll discuss some of the advantages and challenges of public advertising for traditionally under represented managers.

Next, we'll hear from SEC staff members from the Division of Investment Management who will provide an overview of the registration framework applicable to private fund advisers and their funds. Including, exemptions from registration requirements. Both of these topics will help provide us with a better understanding of how funds raise capital and the regulatory environment they operate in.

By learning how different types of venture funds are accessing capital, including emerging fund managers, we can better assess how the regulatory pathways for capital raising are functioning and whether any improvements could be considered to reduce merchant and improve efficiently.

After a short pause in programming, we'll further explore emerging fund managers and consider how they can better be supported including through fellowship and fund of funds programs. We've spoken before about this and most of us are familiar with accelerator programs for entrepreneurs, but not everyone is aware that these sorts of programs also exist for fund managers. We'll hear more about this afternoon are promoting fund manager development and growth by offering guidance, resources and networking opportunities to develop emerging managers and their funds.

As we know, the entrepreneurial ecosystem relies on a variety of investors to be available and interested in investing in different companies at varying stages.

Emerging fund managers play a critical role in investing early stage companies as they all manage a small business working in smaller early checks needed get a start-up off the ground. A larger and more diverse pool of technical factors lead to a greater investment in a wider variety of founders. So, helping these investors find their footing and successfully raise funds is important to our economy.

But before we get to this exciting agenda, we are so pleased to have Chair Gensler and the Commissioners joining us.

Chair Gensler, thank you so much for being with us this morning. Would you like to start with your remarks.

CHAIRMAN GENSLER: Thank you so much, Erica, and good morning everybody. And I'm pleased to be with you. And, it was already said that I'm speaking on -- on my -- on behalf of myself in my role as chair and not for my fellow commissioners or staff.

I do want to welcome the four new members, Jennifer, Rose, Wendy and Emily, to the committee. I thank each of you for your willingness to serve. You'll find that advisory committees you get together and you network, but also, together you can give some really important advice and -- and thoughtfully sort of weigh in on what this Commission is doing. And so, I appreciate that and I wish you well in your tenures.

Look, the committee is focused on three topics ranging, as you heard, from venture capital fundraising to exemptions from private fund advisers and the challenges faced by new managers. It all kind of boils down to access to capital. And access to capital particularly for start-ups and small businesses that are at a different stage of their development. And with regard to the first topic, venture capital funds play a really important role in alternative capital raising. I think it's one of, you know, the United States's comparative advantage that we have. Such a deep and -- and -- and I would say long history in the venture capital field, but their advisers also give advice to the start-ups and entrepreneurs themselves. So, it's both the capital and the advice.

Small and early stage funds often start out raising money from friends and family. These are the funds themselves. Not the companies. The funds themselves starting out try and raise money from friends and family. Success though often means eventually out stripping those friends and family for the fund managers. And that's why it's important just to hear from you all whether it's relationship-based fundraising, public advertising, how these can play critical roles at different stages of the funds raising money so that they can invest in, you know, start-ups.

These fundraising methods have helped develop a vibrant private markets alongside our robust public markets. I often talk about how, you know, our public markets are -- are large. Our public equity markets are approaching $60 trillion dollars, but our private funds is deep and -- and is larger than our entire banking system. And venture capital and private equity and private credit all play an important role in that.

I think that Congress understood

this. They included it in the Investment Advisers Act of '40 and Investment Company Act of '40 certain exemptions from adviser registration from being an investment company and that included venture capital. In addition, I understand the committee is also going to hear about the challenges facing new -- new fund managers. A fund manager starts up, how do they proceed and be successful. And a core principal of our securities laws is about fairness and access regardless of anyone's background, color, gender, geography.

Anyone who wishes to access our capital markets, whether it's to start a fund, or to actually get one of those funds to invest in them, should have the same opportunities to do so. And I look forward to hearing about how the SEC can best support those who are just starting out in the fund management business, but I -- I thank you. I look forward to hearing your advice. And I think I'm supposed to probably turn it over to Commission Peirce.

COMMISSIONER PEIRCE: Thank you.

MS. MINNIHAN: Thank you so much,

Chair Gensler. We really appreciate that. And thank you, welcome Commission Peirce. I would love to hear your remarks.

COMMISSIONER PEIRCE: Thank you, Erica. And thank you Chair Gensler.

I'd like to extend my congratulations to the new members of the committee as well. Welcome to Jennifer, Rose, Wendy and Emily. I look forward to your individual contributions to this committee and appreciate your willingness to serve. And thank you to the rest of the committee and our guest panelists for being here today.

A belated thank you to the committee for your recommendation that the Commission increase the crowd funding offering threshold which reviewed financial statements are required from 124,000 to 350,000. Such a change could help make a crowd funding -- crowd funding a viable fundraising avenue for more small companies. And thank you also for your observations at the committee's last meeting on the state of small business capital raising. I found those to be very illuminating and would welcome similar discussions at future meetings.

To be effective capital markets must be able to get money into the hands of good managers regardless of whether they have rich friends and family. Only then will investors funds find their ways to the companies that can put those funds to their best use. Today's panels about emerging fund managers will help us explore ways we can lower barriers to entry for such managers and thus insure that their expertise is being drawn upon to deploy capital.

The first panel will discuss the under-utilization of Rule 506(c) under Reg D which allows issuers, including funds, to publicly advertise private offerings provided each purchaser is accredited and that the issuer takes reasonable steps to verify that accreditation status. Most recently, issuers raised around 169 billion under Rule 506(c) which compared to 2.7 trillion under 506(b) which does not permit general solicitation.

I have a few questions for your consideration during today's meeting.

According to Professor Howell's paper, an average of only 8.4 percent of venture capital funds have used general solicitation since 2013. Based on her paper, one of the reasons for the lack of interest in 506(c) seems to be the cost and legal risks that's associated with the reasonable steps to verify requirement. How could the Commission mitigate these costs and legal risks? Should we allow an investor to self-certify for an accredited investor status?

Professor Howell's paper also suggests that the use of 506(c) may send a negative signal to investors that the fund is incurring the cost of 506(c) only because it doesn't have the requisite personal net worth to fundraise without general solicitation. Would reducing the cost of verification sufficiently address this negative signal?

The paper posits that referring -- that reforming Section 3(c)(1) of the Investment Company Act could expand these to Rule 506(c) because the 100-investor cap that applies to 3(c)(1) private funds creates a regulatory barrier to 506(c) manager's act list small time retail accredited investors. Where should the cap be set to address this regulatory barrier?

Congress in the Economic Growth Regulatory Relief and Consumer Protection Act created a new exemption for qualified venture capital funds under Section 3(c)(1) of the Investment Company Act. Those funds can raise capital from up to 250 investors and 12 -- and -- and up to 12 million of aggregate capital contributions and uncalled committed capital. What types of businesses and investors to qualified venture capital funds typically serve? Would a higher cap on investors or capital raise increase the usefulness of Rule 506(c), expand access to investing opportunities for smaller or less connected investors or help fund managers access the capital they need? If so, what should those caps be? And what else can the SEC do to create a regulatory environment in which talented, emerging fund managers, including those who don't have wealthy net worths, can get a competitive toehold.

Thank you so much. And I'm looking forward to today's discussion.

MS. MINNIHAN: Thank you so much,

Commission Peirce. We really appreciate your thoughts.

And I'd love to invite Commissioner Uyeda for remarks.

COMMISSIONER UYEDA: Well, thank you, Erica, and good morning.

First, I would like to echo Erica and my fellow commissioners to extend a very warm welcome to the newest members of the committee. I appreciate your commitment to public service and look forward to your contributions to the committee's work which in the past has included recommendations on the accredited investor definition and regulation crowd funding, as well as, looking at changes to the small business investment company program.

Today, the committee continues to discuss important issues, including, how venture capital funds raise capital. The Section 3(c)(1) exemption under the Investment Company Act of 1940 and the challenges that emerging managers face in raising capital and finding investment opportunities.

As you will hear about in more detail from Commission staff, Section 3(c)(1) permits a private fund to raise capital without registration provided that there are 100 or fewer beneficial owners and the fund is not making a private offering. Section 3(c)(1) also provides under certain conditions that certain venture capital funds with less than 12 million in aggregate capital contributions and uncalled committed capital are not required to register so long as there are 250 or fewer beneficial owners.

Private and venture capital funds can provide nontraditional funding to small start-ups and help them innovate and grow. I wonder, however, if Section 3(c)(1)'s 100-investor limit for private funds remains appropriate. This limitation dates back to 1940 while the venture capital exception was promulgated by Congress in 2018.

Much has changed since 1940. In some ways it may be easier for smaller funds to raise capital considering that they may engage in general solicitation by using the internet or other means if all purchasers are accredited, among other things. However, the 100-person investor limit may be too small to effectively contribute capital to small businesses or to be successful as an ongoing fund. I look forward to hearing about the committee and guests insights about smaller, private and venture capital funds, emerging managers and how to facilitate capital raising for small businesses.

During my time here at the Commission I have been particularly concerned about the lack of an appropriately tailored and the potentially disproportionate compliance burdens placed on smaller advisers that are starting out. This can be a significant barrier to entry and a hurdle for emerging fund managers. So, I appreciate that you put this on your agenda today.

Thank you again to the committee for your continued commitment to small businesses and I hope you have a successful and productive meeting.

MS. MINNIHAN: Thank you so much, Commissioner Uyeda. We appreciate your thoughts.

And I'd like to invite Commissioner Lizárraga for remarks.

COMMISSIONER LIZARRAGA: Thank you, Erica. And good morning to everyone. Thank you Chair Gensler and to my fellow commissioners, thank you as well.

It's a pleasure to welcome the four new members of the committee today, Jennifer, Rose, Wendy and Emily. As you know this is one of the two committees created by Congress to advise the Commission. And through your membership in this committee, you will take on the important responsibility of advising the Commission on matters relating to small business capital formation.

With access to capital being an enduring challenge for millions of small businesses, particularly in our country's most challenged, underserved areas, this advisory committee has a unique opportunity to inform and to improve the Commission's ongoing work in this space.

Encouraging to see that you will hit the ground running with discussions on how we can better support emerging fund managers that do not have access to the traditional relationship-based networks that the larger VC fund managers regularly make use of. This is -- this is a priority that warrants greater attention especially in light of the unique challenges that are involved.

I think we share the common goal of promoting capital formation in the broadest, most inclusive way possible. So, your service on this committee is an opportunity to advise us on how best to leverage our resources and our legal authorities to meaningfully achieve this goal.

The presentations on the limits of arm's length VC fundraising and relationships forward and promoting emerging fund managers for fellowships, particularly for women and racially and ethically diverse managers, will be especially helpful. A fostering and inclusive investment fundraising environment for emerging fund managers and by doing so also helping diverse, under represented fund managers and the entrepreneurs and the start-ups they fund, I encourage you to bear in mind the importance of protecting retail investors in our private markets.

That said, I look forward to the

fresh, thoughtful prospectives that each of you will bring to today's discussions.

Thank you again for your service and for your contributions to the advisory committee.

MS. MINNIHAN: Thank you so much Commission Lizárraga. And I want to thank Chair Gensler and all of the Commissioners for these very helpful remarks.

So, jumping into our first topic today, I'm really excited to introduce Dr. Sabrina Howell who will present her recently-published academic paper on Venture Capital Fund Manager use of relationship-base versus arm's length public advertising venture capital funds.

One of our goals will be to try to understand more about how venture -- and capital and reliance --

At the National Bureau of Economic Research. Dr. Howell's research focuses on entrepreneurial finance, private equity, innovation, Fintech and China. A theme across her work is relevance to policymaker and -- policymakers and practitioners. She received her BA from Yale University and her PhD from Harvard University.

While regulatory policy now permits public advertising in certain exempt offerings, it's my understanding that most VC funds are still raising capital the old fashioned way, by relying on their personal networks, but not all talented managers have a personal network to draw capital from. So, I look forward to learning more about the benefits and challenges of public advertising and the committee's discussion on this topic.

Welcome, Dr. Howell.

PRESENTATION ON THE LIMITS OF ARM’S LENGTH VC FUNDRAISING, BY PROFESSOR SABRINA HOWELL

DR. HOWELL: Hello, everyone. Can you hear me okay?

MS. MINNIHAN: Yes.

DR. HOWELL: Terrific.

Well, it's really great to be here and I'm excited to share my research with you which was funded by -- by the SEC, but conducted entirely independently. And as I go through the presentation, I hope folks will jump in with questions. I'm not sure what your normal process is, but in academic economics, seminars we interrupt all the time. And so, please just -- just, like, shout out if you have a question and I'll stop -- I'll stop speaking or if there's like a hand raise process, you know, Erica or someone else can -- can go ahead and interrupt me if I don't see it.

Okay. So, without further ado --

MS. MINNIHAN: Okay. Thank you for that permission. I'm sure the members of the committee will be happy to do so.

DR. HOWELL: Great. Okay.

Now -- oh, hold on a second. I'm sorry, I am a little bit new to Webex. I've got to show -- close all of my PDFs other than the ones I want to share. Let's see. All right, hold on one second.

Okay, let's see.

Here we are.

All right. So, I'm going to present a project called VC Funds and Regulation D's Rule 506(c), did permitting general solicitation open the door for emerging and under-represented managers. And my co-author here is Dean Parker who is a PhD student at NYU.

So, the -- probably the most important friction or problem that economists think about in capital marks is information asymmetry. That is, one participant in a transaction knows more, for example, about the quality of his company than the other participant who might be an investor. And -- so, because you can't perfectly observe, for example, the quality of a new venture, participants rely on imperfect signals. And those signals kind of take two forms. One is what we call soft information which mostly comes through personal and local relationship networks. So, think about this as like the trust you have in someone you went to school with that you think that they're kind of considerable.

The second is track records. So, this is hard -- what we call hard information that you can project across space to strangers. So, if you have, you know, successfully brought a company to IPO, that's the type of hard information that everybody, even far away who don't know you, can observe as a, kind of, signal of your quality.

So, there's sort of a perception that these don't fully address the problem. Like, you can't -- these sort of imperfect signals don't allow all investors all the time to, for example, see what -- which projects are scams. And that's, you know -- and, of course, that's especially true in private markets which, by definition, have limited disclosure.

And so, this brings us to what I consider the key tension in securities regulation which is a desire to protect investors, but also to enable broad and inclusive capital formation. And -- so, the key, kind of, how does this -- like, let's translate this to kind of policy on the ground. So, the key policy context that I'm going to be working with is the private market regulation where to avoid having to register securities with the SEC and undergo a lot of disclosure, issuers use the -- what's called the Reg D typically Rule 506(b) exemption. And this 506(b) exemption is really important. I suspect a lot of you know it accounts for more fundraising than all public U.S. equity and debt offerings combined in recent years.

It bars issuers from publicly advertising requiring them to rely on -- on personal networks. So, essentially it's going to protect -- try to protect investors by preventing public advertising. And essentially require participants to use soft information, personal relationships.

So, this was seen as perhaps limiting that broad capital formation goal. And, in 2013 Congress created this new exemption, 506(c), and to try to achieve this broader capital formation, it said, Okay, you can publicly advertise, or it's called general solicitation, but we're also going to -- you know, as we take one step along one of our goals of capital raising, we'll also take another step towards the other goal which is protecting investors. And it had -- it had some additional requirements relative to 506(b). One is that all investors had to be accredited, whereas, in 506(b) 35 can be unaccredited. And it also required issuers to take a reasonable -- reasonable steps to insure accreditation versus in practice the way 506(b) works is that issuers take investors at their word.

So, the main findings of the -- the -- of -- of our project, and I'm going to go into -- go into a lot of detail later, but this will give you kind of the high level, is that take-up of 506(c) was pretty -- has been pretty low. Just 8.4 percent of VC funds since 2013. Further, there were higher take-up rates, and we don't see any worst performance, among under-represented managers. We show that personal and particularly local networks matter in fundraising. We do this in a couple of different ways. One is that -- one is that we show in a survey that --

MS. MINNIHAN: I'm going to take advantage of your offer.

DR. HOWELL: Go ahead.

MS. MINNIHAN: Can you tell us how much higher was the take-up rate in under-represented managers?

DR. HOWELL: Let me come to that in a few slides, okay? Let me come -- I'm going to -- I'm going to show you exactly those -- those figures. It's very significant once we control -- we'll control for where the state and the time and then we find very, very large results in terms of higher take-up.

So, however -- there's a big however, which is, that even though take-up rates of 506(c) was higher among under-represented managers, the actual overall sort of needle didn't move much. That, you know, managers, for example, who, you know, didn't go to elite schools, like, haven't actually increased that much as a share of all managers. And -- and the reason is, basically, that 506(c) take-up is overall low, right. It's just 8.4 percent. And even though -- even within 506(c), the share of these under-represented groups are far below population benchmarks.

So, even though -- so -- so, basically, even though they use 506(c) more, it doesn't actually, sort of, move the needle overall of, sort of, manager diversity in private markets. And we'll present three -- you know, three possible mechanisms that may all be -- we can't really say which one is the most important or -- and there may be others, but these are three, sort of, mechanisms that we find some evidence for in the data.

The first is what we call a track record paradox which is that 506(c) relies on hard information, right. You're publicly advertising. So, by definition, if you're relying on public advertising, you're projecting your quality signals across space to strangers. And that means that you need a track record because how else are you going to show that, you know, you have -- that -- that you're high quality as a prospective fund manager, but it turns out that -- and I think that everybody will know this intuitively, track records and personal networks co-develop. There are just few -- relatively few people who have a track record and didn't develop a personal network along the way. And -- so, there's not that much -- as much demand for 506(c). It's not necessarily solving this -- this problem of -- of allowing emerging managers to enter at scale.

The -- the second mechanism are regulatory barriers to accessing what we call the crowd or small-time retail investors. And I'll talk more about those later. And then, the third is investor verification costs. So, as I mentioned, there's a little bit more of a buried on the issuer to verify accreditation in 506(c). And this deters managers who don't need C from using it. And that, in turn, leads to a negative signaling equilibrium. So, any manager who could avoid using C would do so because they don't want to signal that they essentially lack these personal relationship networks that would allow them to fundraise.

We think there are two insights from this work that are actually broadly relevant to securities regulation and financial intermediation beyond this 506(c) particular context. One is that efforts to protect investors from fraud can come at the expense of higher barriers to entry for issuers. And, two, that track record matters at arm's length, that is, when you're not, you know, using personal, preexisting relationships to identify -- to identify counterparties, but strong -- and strong networks matter in relationship financing. And so, what that means is that publicly advertising on its own is only helpful to the small fraction of perspective issuers who do have a strong track record, but also have weak personal networks. So, thus, can't do relationship financing.

Are there any questions so far?

All right, I'll go ahead with the policy context.

So, I'm going to start with kind of just background on the securities laws.

And by the way, Erica, I have -- I thought I had an hour. Do I have -- how long do I have until? Is it still 10 or --

MS. HASELEY: I'll jump in there and say that I think presenting through -- through 10 works. You have kind of about 10:15. Just want to make sure that we all have time for Q&A.

DR. HOWELL: Okay. So, that's -- that's a little bit -- thank you. Thanks so much. That's less than I expected. So, I'll probably skip -- skip some of this, but happy to come back during questions.

So, the securities regulation, as you know, in the U.S. is mostly through mandating disclosure which creates burdensome costs for issuers. And so, the longstanding comprise is you can either go the route of registering with the SEC, which applies lots of disclosure, or you can rely on an exemption which applies no disclosure. And there was some regulatory uncertainty during -- after -- after this 1933 compromise about what -- what it meant to -- to not register with the SEC.

And so, in 1982 Reg D 506(b) was implemented which provided this sort of safe harbor for using an exemption. And, today, that is the basis for the entire private equity, venture capital real estate, hedge fund industry which is raising the bulk of the capital under this -- these exemptions. And then, also for a lot of direct issuers, companies, start-ups, et cetera, with about 50 billion.

Now, there are some conditions in 506(b). So, resale is a bit restricted. You have to notify the SEC. You don't disclose, but you notify them with this Form D that you're doing the offering. You're not allowed to publicly advertise and public advertising has a pretty broad remit. It includes, like, mentioning at a conference where strangers are present that you're doing a fundraise. So, what it means is that you have to have a preexisting and substantive relationship with a prospective investor. And the concern is that this may entrench well-networked incumbents creating barriers to entry.

Then, the last initiative is there's limits on who can invest. So, the Supreme Court establishes this as, like, people who can fend for themselves are the ones who should be able to invest in these private markets with limited exposure. And in practice what that means is -- is -- is that you have to have a certain amount of wealth or income which has not been updated in a long time. And so, now there's -- there's like, 20 million Americans who would meet this accreditation threshold. And this is one reason -- we have more about this in the paper, but we don't think that there's, like, a limited supply of accredited investors which is -- you know, that doesn't seem to be -- that doesn't seem to be the problem.

So, 506(c) was trying to reduce the sort of incumbency benefit, expand capital formation to support small business. It was -- became effective in late 2013. And it has these two additional restrictions relative to 506(b), you have -- you can only raise from accredited investors and you have to take some steps to verify investor accreditation.

When we read the rule carefully, while it's pretty complicated, it doesn't mean that onerous. The issuer doesn't have to represent the investor is actually accredited. They just have to show that they, like, took some steps. And the step could be as simple as an e-mail from another accredited investor you've worked for that says, Oh, yeah, you know, Erica is accredited. And if I had that e-mail from my other investor Gary then I can go ahead and accept Erica as an investor.

Okay. So, we are going to study -- I think you've -- you've probably gathered this so far. We're going to study -- focus on venture capital fundraising. So, not start-ups that are raising money to fund their operations, but rather fund managers who are financial intermediaries raising money from investors in order to then go invest in start-ups.

Why are we focusing on VC fundraising? It's a far larger volume of capital relative to direct issuers or start-ups. VCs are key gatekeepers who determine which innovations progress that are commercialized in the economy. So, who gets to be a gatekeeper actually matters for thinking about innovation.

Third, managers are even less diverse than start-up executives. And, finally, it's relatively understudied in the academic literature. We're going to use the Form D data as a starting point which -- and we think essentially all VC funds use Reg D. So, this is, like, a good -- good proxy for the universe. And then, we're going to match it to Pitchbook data which is the best commercial -- excuse me, commercial data source for -- for VC funds.

And we think by limiting our balances to Pitchbook matched funds, we have essentially a proxy of legitimate economically relevant VC funds that have raised meaningful capital. And there are -- there are a fair amount of Form D funds that are -- call themselves VCs in the Form D, but are definitely not actually VC. And so -- so, we think that if you're really entering the VC market and you're raising meaning capital, you're going to be in Pitchbook. And so, that's the -- that's the data set we used.

We also collect managers LinkedIn pages and -- and -- and conduct surveys of venture capital -- capitalists lawyers who provide counsel to VC funds.

So, let me talk a little bit about what I have -- I've mentioned the word under represented. So, like, what do I mean by that? How are we going to get there.

So, the background is, we think, you know, personal networks, as I said at the beginning, are this mechanism to reduce information asymmetry, but we also have a lot of evidence that there's a taste-based dimension to personal networks driven by things, like, homophyly. We all like people who are more similar to us, for example, or biases. And this could create a barrier to prospective managers from less well-represented backgrounds. They may have -- they are thought to have weaker networks.

There's evidence that VC managers are overwhelmingly, like, more than 90 percent white and male and also, you know, mostly graduates of elite schools and that's going to affect what innovations get funded.

So, we're going to argue that -- we're going to use four different characteristics which we think are, kind of, proxies for having weaker networks. And we actually show that these characteristics are correlated with having fewer LinkedIn connections which is a course -- course proxy for, you know, your network.

So, the two demographic characteristics that we will consider are being female or black/Hispanic. And the two background characteristics we'll consider are going to a non-elite school or being a first time manager.

So, the first thing we show is that the take-up of 506(c) is pretty low, 8.4

percent, and -- and the share -- and this is not just about VC actually. We do look at direct issuers, at companies in Pitchbook, and their share of -- is even lower. And then, the share in the raw complete Reg D with all of this, like, little real estate funds and tons of -- tons of kind of nonsense was still only ten percent 506(c). So, take-up has not -- this has not come in and, like, taken over -- over as a big exemption at all.

This shows first how the fundraising has increased in recent years pretty dramatically and that the share of 506(c) has, you know, increased moderately. There have been some large funds that use 506(b) which means that when you volume weight it, the increase is -- is larger. So, there has been sort of accelerating take-up in recent years. And we'll kind of see if it continues.

So, here is some summary statistics. So, in the -- in the raw data you can see that take-up by under-represented managers which are down -- down here in this bucket is larger at 506(c) in the second column. For example, the -- the share -- the -- probably the most --

the most extreme difference is the raw data is the black share is at 1.5 percent in B and 3.9 percent in C. And so, the difference is highly significant which is what the stars mean, 2.4 percentage points.

So, now we're going to do that a little bit more -- a little bit more rigorously in -- in regressions which allows us to control for trends over time where these different groups have been trending over time and will control for where -- where the fund is. And what we find is that 506(c) funds tend to be a lot smaller. They're a lot more likely to be outside a top ten city. They're more likely to be a first VC -- VC firm's first fund. And they're more likely to have non pension fund limited partners and more individual LPs.

And so, this is kind of consistent with not having relationships with the traditional, sort of, stalwart LPs of the VC industry and fundraising more from the crowd. We actually find that 506(c) funds don't perform worse. They perform better when you look at returns. We don't have -- we only have return data for a small --

MS. MINNIHAN: Sorry, could I ask a quick question on the --

DR. HOWELL: Yeah.

MS. MINNIHAN: -- three times more likely to use intermediary. Could you explain that?

DR. HOWELL: Yeah. This -- this is column number five, and this is actually the only variable I think here that's from the Form D data which says whether they use a commission or a broker. And they are -- 506(c) funds are much more likely to use -- to -- to pay a commission or use a broker which means that they're actually using somebody to help them fundraise. And so, with that -- that's consistent with being more what we call at arm's length. Like, you don't have -- you know, like, if -- if I know Erica from school and she's sort of been in my network, I just go to her directly. I don't use an intermediary to find her, but if I'm going to be -- if I'm going to try to reach people like her who I don't know, then I can potentially make use of a broker intermediary who might have those -- have those connections. And so -- so, we find that 506(c) funds are more likely to do that.

MR. DRAYTON: Hey, Sabrina, I've got a quick follow-up question. Are you finding that those are retainer-based relationships or success fees based?

DR. HOWELL: I don't know. We only -- all we have is the facts in Form D that says whether they pay a commission or use a broker.

MR. DRAYTON: Thank you.

MS. MINNIHAN: It would be interesting to think about, you know, necessarily how much that cost and, you know, how that potentially impacts expected returns. I have a little -- little knowledge as to these data around how much these things cost, but I think particularly for much smaller funds, you know, wondering what, sort of, bite does that take out of the apple. Thank you.

DR. HOWELL: Uh-huh. Yeah, that would be fascinating. I don't have any data source about that.

Okay. Now -- oh, go ahead.

MR. DILLASHAW: I'm sorry, Sabrina. One other, sort of, follow-up question just while we're, sort of, on the topic of, sort of, like, the general outreach.

Do we have any indication of, like, when they are taking advantage of their general solicitation ability what they are doing in terms of a general solicitation? Is that public advertisement, radio, is it just speaking in more public forums? Do we have any clue of what the end game for that taking advantage of it is?

DR. HOWELL: You know, that is a great question and in terms of, like, what medium did they use to publicly advertise, you know, I -- I think that was -- that's -- that's a great question. And we -- I don't know. It's actually something we could have used -- we could have asked in our survey, but we -- but we didn't. So, I don't -- I -- I -- I am not sure.

My expectation would be in most cases it's -- it is mostly posting on a website --

MR. DILLASHAW: Okay.

DR. HOWELL: -- would be -- would be -- is what I've heard kind of from -- from folks in the industry, but I -- it would be nice to -- to have some data on that. It's a great question.

All right. So, let me go to kind of Erica's question about --

MS. UNDERWOOD: I've got a quick question. Apologies to interrupt.

Did you collect any data about, like, the investment thesis of these funds? Like, I'm in VC fund world right now and there's sort of a turn away from the generalist VC fund and also somewhat a turn away from funds that sort of claim to be, like, ESG generalists as opposed to saying, like, we're going to do renewable energy specifically or deep tech and renewable energy. Like, do you find that the -- what the investment thesis of the fund is drives it towards using B or C and are you -- when you think about the lack of uptake of C, are you also seeing a downturn in funds overall being formed? Because I know there's a lot of contraction in the VC industry occurring right now. There's not a lot of new fund managers emerging, kind of, overall. And so, is this kind -- is this really, like, a lack of uptake of C in terms of less fund managers or we -- you know, or I guess the question is, are we seeing less fund managers overall, does the investment thesis impact whether we're going to use B or C?

DR. HOWELL: That's another great question. Unfortunately, we don't -- we don't know -- we don't have data on -- on how the -- the thesis affects what fund -- what exemption they use or if perhaps the need could go the other way too, right. The need to raise at arm's length might lead you to have a different type of thesis. And what we do find, and is -- here I've kind of, you know, had skipped over a few things that you guys have now have zeroed in on.

So, here in column six and seven we do have indicators for whether the fund has what we call a DEI target which is -- and then you can kind of imagine what that is. And then, an ESG target which is, like, more of a climate -- climate type goals. And 506(c) funds are much more likely to have these than other -- than -- than 506(b) funds. So, actually in both cases an average of 1.5 percent of all funds have a DEI target or ESG target. And 506(c) funds are about 2.4, 2.6 percentage points more likely. So, that's like, you know, 75 percent more than the -- than the mean. So, it's a big -- it's -- it's definitely a big -- they're much more likely to use these.

I think -- this is a bit speculative, but part of what you're -- like, what you're doing is you're able to kind of overcome that -- some of that information asymmetry by having a preference -- an investment preference that matches sort of non-pecuniary preferences of the investor. So, for example, if I'm a -- if, you know, I am a -- you know, interested in funding, like, female-lead start-ups and Emily's the manager and she's a woman, I have homophyly with her as a woman which I can tell across space. Like, I don't have to have a personal network with her to know that. And she's declared that she's going to fund female-owned start-ups, that kind of homophyly and investor preference can pass through at arm's length and maybe compensate for the -- for the fact that I have less information about her quality and her -- you know, whether -- you know, how committed she is to putting in effort into her fund, right, which I would if I knew her personally. And so, that's kind of a way -- a little bit of a way to overcome information asymmetry.

All right. So, if we look at the fund managers and here race, we get race from LinkedIn pictures, which I actually have another paper that's published that shows that the algorithms that regulators use to predict race is -- for fair lending purposes is, like, really, really problematic especially for -- for black people. And so, I only -- am now only using -- using coded -- images coded by American coders to -- to measure these things.

And so, we find that -- that 506(c) funds have a higher share of female managers. Here that's 5.7 percentage points which is 39 percent of the mean, about 14 -- almost 15 percent of the fund managers in the overall detail are female. Much higher share as I showed you in the raw data of black/Hispanic managers. 506(c) managers are less likely to have gone to an elite school and are more likely to be first time managers.

And I told you at the beginning that I think this -- this proof that fund managers are -- matters for which innovations get funded, right. And so, it has what we call -- we call it real effects in economics. And so, here's some evidence of that. So, when we look then at the portfolio of companies that they fund, we see that the 506(c) portfolio companies are more likely to be outside the top industries for VCs. So, it appears that the VCs are kind of herding into particular hot industries. 506(c) is potentially creating some, kind of, diversity -- diversity across industries.

They're more likely to be far from the manager and they're more likely to have a first-time or female entrepreneur. We don't see any results for -- for the elite school. And we didn't collect race for the -- for the portfolio company executives because it's too -- it was just too -- too -- too -- too difficult.

Okay. So, to sum up, we see that C funds tend to be smaller than their 506(b) counterparts, more often located outside of the big VC hubs, are -- seemed to be used by less networked managers and have portfolio companies that are more likely to be in, sort of, unrepresented industries and tend to have more underrepresented leaders. So, these are all characteristics that we think are associated with weaker personal networks and more likely to use general solicitations.

We conducted a survey of fund managers and lawyers to kind of try and validate this in the data. And we do see that in 506(b) 90 percent of managers who only use B report using their personal network to raise funds. Whereas, in 506(c) 40 percent of managers say they used 506(c) because they lack the personal network. And I think that's actually a really large -- large share especially since there's probably some bias against admitting that you lack a personal network.

All right. So, let me show you some changes relative to kind of the pre-506(c) period. So, this -- this graph shows -- each bar is the change in that year relative to 2009 when our data starts. And -- so, if we look, for example, at female in the yellow bars, the share of female managers has increased a lot. Like, 2022, 2023, there's like 100 percent more female managers than in 2009. And a lot of that increase is coming in the -- in the recent -- in the more recent period post -- post 2013. And -- and -- and, you know, for the other groups maybe a little bit less clear.

We also see an increase in non-elite school mangers and an increase in first time managers in the darker -- in the darker colors. And then, in post -- I would say, post 20 -- like, in -- let's see, the -- the light blue is the black/Hispanic managers. And that -- starting in 2015 you start to mostly see increases. Not in 2016, but especially in -- in 2023. There's been -- it was much larger relative to 2009. So, it's pretty noisy because the numbers are so small.

So, a few -- a few people here and there can kind of move things a lot, but then what I want to highlight is that, like, what looks like thin bars there when we look at the change relative to 2009, they're not that significant at a, sort of, macro level. So, the top -- this top graph here shows the share of black/Hispanic managers. The -- the fully shaded bars are 506(b) and the little bitty hatched bars here 506(b). And we see that the share overall of black -- black and Hispanic managers has grown from about four percent to kind of, like, maybe seven percent recently. And then there was a pretty big jump in -- in 2023, but the line up here at 26 percent is the -- is the share of college graduates who are black or Hispanic. And you can see that, sort of, relative to that benchmark there's not been a ton of increase.

Similarly, here this is also about 60 percent of college graduates today are female and the share of female -- the share women among fund managers has -- has increased. It's almost doubled as I noted, but, you know, still isn't close to that kind of college educated benchmark.

Elite school has kind of the same pattern. Obviously, almost all college graduates went to a non-elite school. And elite schools, there's like ivy-plus. Whereas, the share of managers from non-elite schools has kind of inched up a little bit, but not that significantly.

So, what I take away from this is that there seems to be some entry barriers. Like, there could be higher take-up of 506(c) without a quality -- a quality decline. And -- so, we look for three mechanisms and I -- I'm going to show you just one -- kind of, one cool graph and then I'll wrap up. And happy to talk about the other -- the other mechanisms -- the other mechanisms in the Q&A if you're interested, but the basic idea of this track record paradox is that managers with a track record kind of developed personal networks along the way. That is, a network and track record are usually coincident, so.

And so, we have -- this leads us to two predictions, which is, one, 506(c) fundraising success should be more sensitive to the record track than 506(b) which we find to be the case in regression analysis. And, second, that few fund managers are going to have this kind of sweet spot ideal profile for C which is a weak network, but a strong track record. And I'll show you what that looks like, kind of, in the data.

So, what we've done here is we've put on the Y axis an index of how well networked you are and here on the X axis your track record, basically. And then, the red lines are the mid points of each distribution. And we even -- and the -- the blue bubbles are 506(c). And the -- sorry, the blue bubbles are 506(b) and the orange bubbles are 506(c). What you see overall is that 506(c) is weighted towards having a track record. So, 81 percent of all 506(b) funds have managers that have a below track record. Whereas, only 54 percent of C funds are, like, to the left of the red line. And so, it's true that, like, 506(c) relies more heavily on a track record.

Now, down here in this right -- bottom right quadrant is the group that has a weak record, but a strong track record. And 506(c) is way more represented. 30 percent of this quadrant is composed of 506(c), but the little circles are very small. It's a small share of funds. There just aren't that many managers who live here. And that's kind of the main point.

MS. MINNIHAN: Can I jump in with a question?

DR. HOWELL: Yeah.

MS. MINNIHAN: So, you know, as a venture capitalist who's raised money from -- from institutional LPs I know that one of the very first questions that investors ask, whether it's, you know, a larger endowment or just, you know, a regular individual accredited investor is, where will you get your deal flow. And there's a lot of emphasis put on, you know, do you have a large network.

So, you know, I guess the question here is that for -- from my experience it seems that one of the, you know, major qualifications to be able to do this job properly is to have a large network because, you know, that's how you get exposed to investment opportunities. So, you know, how do you kind of think about that, that it seems to be, you know, something that is a little bit historically considered an important qualification for your ability to successfully do the job?

DR. POWELL: Uh-huh. Yep. I think that -- I think you're absolutely right that

that is how it's seen. It's how I -- you know, when I teach entrepreneurial finance I -- you know, we focus a lot on -- on thinking about the value of networks as in all different -- in all different dimensions. And so, I think there's a couple of implications.

So, one, if being a good VC requires having a strong network in entrepreneurial ecosystem then it's not clear that public advertising -- that allowing public advertising is going to broaden capital formation. Like, it just may not be -- if that's the goal is to allow people who didn't go to top schools to become funding managers, it's just not clear that the right hammer to hit that nail is general solicitation, okay. So, that's, like, the take away, but maybe instead you want to help people build networks or provide -- you know, create -- try to create these, you know, more hubs at state schools for new venturers. And that if you broaden the diversity -- you know, innovation hubs around the country, like, then you'll get more -- start to get a -- ecosystems and VC funds building up in those areas. Like, something that we've seen in, you know, sort of what happened around Austin or Boulder to some degree.

So, it may be that that's kind of what's necessary. This is -- just isn't the right, like, tool for -- for that, but I'm not --

MS. STANDIFER: Can I -- can I interrupt real quick. I think that that also presumes that the networks that you need to raise from LPs are similar or substantially overlapped with the networks that you need for deal flow. And that may be one of the reasons why we're seeing really congested -- sort of, the herding as you put it, of which innovations are getting funded where you can have two different networks. You may not have a strong network to raise from LPs, but you may actually have a strong, non-top-ten city, unique perspective deal flow network over here, right. So, I think you have to think about not all networks overlap for similar purposes.

DR. HOWELL: Yep, that's absolutely right. And I think that if -- I think that there are -- I think that when we think about, like, who is using it, right, I think, like, to the degree you have -- and -- and this -- actually, I love that you raise this because I think it goes to this question as, like, why is it more taken up by perhaps DEI target type funds is it may be that you have a network that is strong in -- when it comes to deal sourcing. You know a lot of entrepreneurs, but you don't know a lot of rich people. And so --

MS. MINNIHAN: So, I guess that the data that we're looking at here when people are categorized as low network is -- is that only in relation to, you know, I guess accredited investors or, you know, rich people as we say? I guess we would have to differentiate.

DR. HOWELL: So, here we are proxy-ing -- we are thinking about -- when I say people who we think have weaker networks, I'm focused on those four characteristics, first time managers, non-elite schools, woman, black/Hispanic, right. And then, we also show that those are correlated to fewer LinkedIn connections. We show that some of our -- the results, like that -- the graph that I just showed you, my bubble graph which I like so much, is -- is -- like, looks pretty similar.

If instead of -- if you have LinkedIn connections here on the Y axis versus having this index for our four characteristics.

So, that's what I mean by network. Unfortunately, I would love to see it. I don't actually see who, you know, who you know. That would be very cool if we could see -- in our LinkedIn data we don't -- we don't see who someone's connections are, but it would be super cool if you could, right, 'cause you could -- you could start to see how elite somebody's connections are. So, that would be -- that would be awesome. If anybody here, you know, works with LinkedIn then, you know -- and can connect me with them for data -- better data, that would be super.

So, the second tension, I'll just talk -- I'll --

MS. BOWERS: I'm sorry to interrupt, Sabrina. I think Emily has her hand up.

DR. HOWELL: Go ahead, Emily.

MS. BOWERS: You're muted, Emily.

MS. UNDERWOOD: Thank you very much. That's embarrassing, the tech professor who doesn't use her tech correctly.

So, I wanted to bring us back to something that you -- you talked about at the top of -- since you kind of opened the door to talking about C and the -- this sort of procedural steps.

I -- you mentioned that under B a lot of fundraisers are kind of taking investors at their word as opposed to undertaking reasonable steps to confirm that they are in fact credited investors and that maybe this accredited investor diligence, I guess you could say, is, like, a bad signaler from funds that are trying to use C, but I'm wondering, maybe I'm -- I'm thinking about this the wrong way, but could you give some examples of those reasonable steps that C -- C managers are required to take that you think that B managers are not taking.

And the reason I ask is, like, typically in -- in our, like, fund formation process we would require investors to, like, fill out an accredited investor questionnaire. They would have to give us some information. They would give us a bunch of reps and warranties in the investment docs that they are in fact accredited investors and, therefore, they are taking all of the financial and legal risk in many ways if they are not in fact an accredited investors. And I would think those are the kind of steps that you're thinking about when you think about reasonable steps. And if that's the case, it doesn't seem like the delta between what C fund managers are required to do and what B fund managers are actually doing could be moving the needle that much.

DR. HOWELL: Okay. So, the question is that -- is that B fund managers are required -- that C fund managers are required to do more on the -- in terms of -- of --

MS. UNDERWOOD: Well, I'm asking -- I guess I'm asking is it actually the case that C fund managers are required to do more than B fund managers are actually doing? Because it seems like the delta between the two would be part of what is causing a bad signaling affect for C managers, but in if fact B fund managers are actually doing those things anyway, I question how strong that negative signal actually is if these same high net worth individuals are used to doing these things for

B fund managers which I sort of suspect that they are.

DR. HOWELL: Yes. I think -- I think that it is hard to -- so, I -- I don't know what is going on entirely in the background. What I can show you is that we -- we asked 506(b) managers why they didn't use C, right. Because I think what you're getting at a little bit is that, like, if -- if C is no more -- if C were exactly the same as B, but just said, oh, you can publicly advertise, it seems like everyone should use C because it just creates an option. It's like there's always option value. You can go to a conference and talk about your fund. Like, it just seems like that would be better for everybody. And so, a question is why don't they use it.

And what this shows is -- the green is major influence, some influence is gray, no influence is red. And B managers were concerned about the time and the money to verify investors and the legal risk and the negative signal. So, all of those were kind of roughly equal in terms of nature and some influence. And what we think it implies is that there was a bunch of kind of uncertainty about the verification and a sense of liability that was greater than in C which I think, you know, if you're comfortable -- especially if you're a manager who's already used B and is comfortable with it, it means that you -- there is -- there is some switching cost.

And -- so, only -- you know, only funds that kind of really needed to use C would use it. And so, in turn, that then signals to -- something to the market that you're using C and that you need to do this verification. And so, we think that this is a -- this is kind of a -- a one -- one mechanism. And so, even if -- as you said, like, even if B investors are sometimes doing the same things as C investors in terms of their -- in terms of perhaps making sure their investors are -- are legitimate, they might not want to use C just because of the kind of regulatory -- the chill -- the, sort of, liability chill, if you will.

Does that -- I don't know if that answers your question a little bit.

But -- but the one thing I'll just

mention, the -- now the last mechanism is the fact -- and this is I think a direct -- this is -- this is a policy lever that you could easily adjust.

So, public advertising is most relevant for reaching retail investors, many small -- you know, many small investments, like, the crowd. And most smaller VC funds are restricted to 100 investors which means that it's going to be harder to raise a fund where everyone -- where you can make meaningful investments in portfolio companies, but everyone is investing, like, 50 grand or something because you're trying to target retail investors. And -- so, this could actually constrain use of 506(c).

And we use an experiment where in 2018, if you had less than ten million in assets under management you could have 250 investors instead of 100. If you were raising -- if you had more than ten million AUM you're still capped at 100. So, we hypothesize if this cap is constraining, if it's binding, then we should see that VC funds with less than ten million AUM are going to be more likely to use 506(c) than larger funds. And that's exactly what we find.

After the policy, there was a big increase in take-up of 506(c) among smaller -- for smaller VC funds. So, what it suggests -- and we would -- we would imagine if you could observe it in a causal way, the cap would be even more constraining for larger funds just because they'll tend to have more investors. So, this investor cap does seem to be something that is limiting take-up of 506(c).

Okay. So, let me just conclude and -- and kind of recap the main findings here.

So, we show that permitting general solicitation does help level the playing field for underrepresented managers allowing them to escape the limits of their own geography in particular. And if you can reduce dependence of private fundraising on local conditions you could potentially reduce kind of the geographic concentration and disparities in VC. However, the policy did not dramatically increase the ranks of UR managers. And we present three channels to help explain why 506(c) was not widely used enough to, like, really move the needle. One is that track record paradox. The second is barriers to accessing the crowd via this 100 investor cap. And the third is investor verification costs which seem to lead to some signaling problems.

So, let me -- let me stop there and I'm happy to take -- take any questions.

MS. MINNIHAN: Great. And, Courtney, I just wanted to check, I know we're a little bit over time. Do we have time for a couple more questions or do we need to move on to the next?

MS. HASELEY: I think we should wrap fairly quickly. If there's one or -- one or two quick, pressing questions I think we could take it, but we'll just want to schedule as best we can.

MS. MINNIHAN: I think Karen had her hand up for a while.

MS. KERR: I appreciate the presentation. I wanted to come to this paradox of track record and ask about how you think about attribution because that's also a challenge for -- for some emerging managers who may not be new time to venture, are coming from other places, and may be challenged in how much of that track record they can bring with them.

DR. HOWELL: Usually that's a lot of emerging managers don't have a track record, right.

MS. KERR: Not that they don't have a track record, but how much of it can be -- how do you attribute in a -- in a -- in a general solicitation if you have some restrictions on your ability to take that track record with you?

DR. HOWELL: Oh. Oh. Okay. So, I'm not entirely sure what you mean by, take the track record with you, but I think that it might help to explain what we -- how we measure track record which is -- our -- our preferred measure is previous successful exits of portfolio companies. So -- and you see that -- like, if you go on Angel List and you look at the -- at the fund managers, they'll say -- like, you know, if they have had exits they'll be, like, Oh, I brought this company to IPO. That's the -- you know, that's just, like, as clear as -- as clear as day. Like, that's what

we're looking for, successful exits, big
liquidity events that create returns for VC
investors.
We also look at people with a
background in finance as -- as a -- or who were
previous entrepreneur is a much broader measure
of track record. And then, finally, we look at
previous -- at -- at previous funds at the VC
firm level. Like, how many funds has your firm
had which is another -- another signal.
And so, those are what were kind
of -- those are -- those are what we're using.
And so, I think, like, what you maybe kind of
raising is somebody could have relevant
experience that doesn't -- isn't widely
recognized as a measure of quality by
prospective LPs. And so, it's sort of hard to
translate that past experience.
Like, for example, if I -- you know,
I might say, Oh, I could be a good VC because
I've studied -- you know, I've done all this
studying and teaching of -- of entrepreneurship
and venture capital. So, you know, you should
invest in my fund, but you might be, like,
Well, you know, Sabrina, all that teaching is

very nice, but I don't actually think that you have on-the-ground experience. So, that is not a -- you know, a -- it's not a useful track record.

MS. KERR: No. Actually, I'm making a different point, but we'll -- we'll move on. I -- I do think a lot of venture capitalists come from other firms and sometimes they're limited in their ability to take that attributable -- that track record with them.

MS. MINNIHAN: Thank you, Karen.

MS. KERR: Yes, but that's fine. That's okay. Good. I'm done.

MS. MINNIHAN: Yeah, we can talk about it definitely in -- in your -- your portion. I think that's a great point to bring up.

And, Sabrina, I think you would be probably be very successful in raising a venture capital fund with your experience. So, just keep me posted on your future endeavors. And I want to thank the committee for all of these really thoughtful questions. This is an amazing set of data for us to look at to give us inspiration and guidance on making recommendations.

So, Dr. Howell, thank you again for joining us and showing your paper. And we would love to continue exploring this information in regards to policy considerations later in the day. So, thank you very much.

DR. HOWELL: All right. Thank you so much. Good luck with the rest of the meeting.

MS. MINNIHAN: Yes, thank you.

So, continuing our focus today on funds and fund managers, I'm excited for us to spend a little bit of time getting up to sped on some of the securities regulations that are relevant in the space. Namely, a handful of regulations under the Investment Company Act of 1940 and the Investment Advisers Act of 1940.

Companies that are required to register as investment companies under the '40 Act are subject to reporting and other regulatory requirements. Many private investment companies rely on one of the exemptions from the definition of investment companies set forth in Section 3(c)(1) of the '40 Act to qualify for an exemption from registration. Now, I'm no expert in these roles which is why I'm delighted to welcome the SEC's Robert Holowka, Branch Chief, and John Cavanaugh, Senior Counsel of the Private Funds Branch of the Investment Adviser Regulation Office, Division of Investment Management.

Rob and John will provide a brief overview of the registration framework applicable to private fund advisers and their funds. Including those exemptions from the registration requirements of the Investment Advisers Act of 1940 and the '40 Act which may be replied upon by emerging fund managers. We think that learning about this framework will be invaluable for us as a committee and provide some great context as we continue to explore ways to support -- support and promote emerging funds managers.

Rob and John, welcome.

PANEL ONE: 411 ON SEC.ON 3(C)(1) OF THE INVESTMENT COMPANY ACT OF 1940 (THE “40 ACT”)

MR. CAVANAUGH: Thank you.

MR. HOLOWKA: Hello. Thank you.

MR. CAVANAUGH: Hey -- hey, everybody. It's -- it's nice to meet you all. And Robert and I are excited to be here.

Now, before I begin, I'll -- I'll start with the standard SEC disclaimer that Robert and I are each speaking on behalf of ourselves. So, a corollary, we're not speaking on behalf of the Commission or any of the Commissioners or the staff. I'll go so far to say, I may not even be speaking on behalf of Robert. He can chime in and let us know if he disagrees with anything here.

So, again, super excited to be here. The purpose of our segment of the agenda is to provide a brief overview of the regulatory and registration framework applicable to private funds. And so, our approach to the conversation will be three-pronged. We have the fund, we have the adviser and we have the capital raise. We won't spend too much time on the capital raise, but it does seem to be a nice seg-way from the conversation that you all just had with Professor Howell.

And so, the only point I want to underscore here -- and again, I presume that it was established at the beginning of your last segment in today's meeting, but just -- just as a reminder, the offer and sale of securities has to either be registered with the SEC or subject to an exemption thereto. It applies to public companies. It applies to private companies. It applies if you're selling, you know, private fund shares to a big VC fund or if you're selling to grandma. And so, the, sort of, primary regulatory exemption that private funds rely on is Section 4(a)(2) of the Securities Act which essentially creates like a private transaction exemption. And then, Reg D which, you know, constitutes 506(b), 506(c), those items that you just discussed, are safe harbors thereunder. And so then, that gets into all the different requirements that -- that you just covered.

So, 506(b) no more than 35 non-accredited investors. 506(c) which permits, you know, broad solicitation, general solicitation. You have the -- the verification standard that -- that I know you discussed at the end. Okay. So, that's the capital raise.

Now, we have the fund and we have the adviser. And so, again, we're dealing with a broad spectrum securities laws. Whereas, the capital raise dealt with the Securities Act, the fund will look at the Investment Company Act, the adviser will look at the Investment Advisers Act. And so, I'm not going to bury the lead. Private funds are not required to register with or -- or otherwise be regulated as investment companies under the Investment Company Act.

So, the question is: What's a private fund? And, in short, a private fund is an issuer of securities that would be an investment company, but for sections 3(c)(1), 3(c)(7) of the Investment Company Act. So, sorry, I don't mean to overly complicate things, but we're looking at the Investment Company Act to determine whether or not a fund qualifies as an investment company. If it does, then the sort of rigorous structures of the Investment Company Act apply. If it doesn't, which is the case with private funds, then -- then it does not -- it's not regulated under -- under the company act.

So, again, private fund defined as, you know, you would be an investment company, but for 3(c)(1) or 3(c)(7). So, the analysis starts with, what's an investment company. And again, we're not going to dig too deeply into all of this. This is not a college lecture or -- or anything like that, but just by way of introduction, an investment company is an entity that holds itself out as being engaged primarily in the business of investing or reinvesting or trading in securities. So, so far it sounds like a private fund.

So, we look to the exemptions under the Company Act to sort of carve out private funds from Investment Company Act regulations. And, we had two -- we have two prongs, we have 3(c)(1) and 3(c)(7). I think we'll spend most of our time looking at 3(c)(1), but I'll just say by way of background, if there were 3(c)(7) funds which are -- which don't have a restriction on the number of beneficial owners you can bring into the fund, but it does have certain wealth or investment experience qualifications.

So, for an individual, a qualified purchaser, right -- so, 3(c)(7) fund you have -- it's limited to qualified purchasers. That's the threshold I just mentioned. So, for an individual to qualify as a qualified purchaser, you have to have $5 million or more in investments. For an entity that jumps up to 25 million.

So, perhaps less applicable to the -- to the universe of funds that you all are focused on, but I just wanted to highlight it particularly if you look at, like, really large asset managers and their funds, they tend to rely on 3(c)(7).

Okay. So, that's 3(c)(7). Now, we have 3(c)(1) -- sorry.

So, 3(c)(1) there are -- there are two prongs. So, there's what I'll call the traditional 3(c)(1) prong and then we have the -- the venture capital prong. So, under the traditional 3(c)(1) prong, the fund is limited to 100 beneficial owners. Can't have more than 100 beneficial owners. Fairly straightforward. And presumably many of you are familiar with this -- with this -- this framework.

Then you also have the -- the qualifying VC fund prong. And there you're limited to 250 beneficial owners. So, the -- the threshold jumps up, which is helpful, but you're limited to $12 million in capital raise. And you also have to qualify as a VC fund. I do want to get into what exactly that entails.

And so, among other things to qualify as a VC fund, you have to represent to investors that you're pursuing a VC strategy. There are sort of general limitations on redemption rights, use of leverage, but then also perhaps, pertinent to today's conversation, you hold no more than 20 percent of your investments in non-qualifying investments. So, that's a double negative.

So, essentially 80 percent of your investments have to be in qualifying investment. And a qualifying investment generally refers to direct equity investments in private companies, all right. So, to the extent you were thinking of, like, a fund of funds example that's -- you know, that's -- that's not necessarily included.

I realize I'm speaking to a computer screen, but -- but does all of this make sense so far? I'm happy to -- yes? Okay. Stacey is giving me a thumbs up, okay. All right. Great.

So, we have capital raise, adviser fund, within fund in order to not be regarded as investment company so that you're subject to the Investment Company Act. There are multiple prongs to be accepted. There's the 3(c)(7). That's the really large funds limited to qualified purchaser. And then you have the two prongs for 3(c)(1). So, under the traditional prong, limited to 100 beneficial owners. Under the VC, 250 beneficial owners, but you have the $12 million cap and you have this qualifying investment, you know, rubric that applies, okay.

MS. MINNIHAN: And so, I just want to confirm, under 3(c)(1) if you're in the traditional bucket, you're also must -- must be investing in these qualified venture capital assets and there's no limit on --

MR. CAVANAUGH: No. Great. Thanks for asking. And I know I'm throwing a lot of information at you. So, under the traditional bucket, it's VC agnostic. You know, you can --

MS. MINNIHAN: Okay. So, it could be anything?

MR. CAVANAUGH: That's right.

Only once you get into the qualifying VC prong do you start having restrictions over your investment strategy. Make sense? Okay, cool.

All right. So, that's the fund. And then we have the adviser, right.

So, recall that, you know, funds typically have an investment adviser with whom they're in some sort of contractual privity to provide investment advice to the fund. Now, investment advisers are subject to the Advisers Act, right. The -- the statute -- one of the, sort of, pillars of the -- of the securities laws, Investment Advisers Act of 1940, but the extent to which the Advisers Act applies depends, in part, on the size of the adviser.

So, typically small advisers, right, those with less than 25 million AUM, they're state registered. We'll get to what parts of the Advisers Act apply, but they're not registering with the SEC. They're registered at the state level, subject to state securities laws, et cetera.

Mid-sized advisers, so those between 25 and 100 million, are also typically registered at the state level subject to certain exceptions if they're not otherwise -- if they're not otherwise required to be registered with their state or subject to inspection thereto by the state then in that case they would register with the SEC, but most of the time these mid-sized advisers are registering at the state level.

And only once you get to the largest advisers, those with over 100 million in AUM, are you required to be registered with the Commission, the SEC.

Okay. So, that's not -- that's not the end of the conversation. Sorry if I'm moving this paper around. We also have certain exemptions that apply to those advisers who would normally be required to register with the Commission, right. So, we're thinking the -- the largest advisers. We have the private fund advisers exception and we have a VC fund adviser exception.

So, for the -- on the private fund side of things, if you -- if your AUM no more than 150 million and you're solely advising private funds, you're exempted from registering with the SEC. And then, if you're -- now, separately, as a distinct matter, if you are a VC fund adviser -- so, you're solely an adviser to VC funds, and no limitation on AUM here, you're also -- you're also exempt from registering with the SEC.

So, why is this pertinent? Because that -- that definition, that second, right, scenario, we've got two prongs under this exemption to registering with the SEC for the largest advisers, private fund adviser exemption and VC fund adviser exemption. So, this is sort of analogous, you know, discussion to what we were talking about on -- on the fund side under -- under the Investment Company Act in 3(c)(1) and under the Advisers Act we have these two prongs. And VC fund exemption, in order to qualify as an adviser, you have to solely advise VC funds.

The definition of VC fund is the same that we discussed earlier. So, again, general limitations on redemptions and leverage. You know, you'd have to, you know, mark it yourself essentially as being a VC fund. And then, you had that qualifying investment rubric that we discussed. So, typically direct equity investments in -- in your portfolio companies.

Does that make sense? I know I'm asking too much. Generally speaking? Okay. So --

MR. DILLASHAW: John, just to -- I think as, sort of -- can you maybe give a little bit of insight as to, like, what it means if you are not exempt what it means to -- to register or to have to, you know, abide by the compliance regime for a -- for an investment adviser.

MR. CAVANAUGH: Yeah. Thanks -- thanks for the question, Bart. And that is a direct seg-way into one of the final aspects I wanted to touch on.

So, to extent that you are a large adviser and you are not otherwise exempt under the private fund adviser exemption or the VC exemption or a number of others that we haven't -- you know, we're not -- we're not covering here, you've got to register with the SEC and you're subject to its regulation. And so, you know, the -- the breadth of its regulation, you know, we're not intending to cover here because that would take way more than nine more minutes, but I should say, and I'm glad that you brought it up because I did want to highlight that for investment advisers that are not registered with the SEC, right, so those small and midsized advisers perhaps that you're -- that you're taking a look at, they are still subject to the federal anti-fraud laws, right.

So, under the Advisers Act, you know, there are anti-fraud provisions. And so, those are still applicable, as well as, state anti-fraud laws for that matter. And then I would also underscore the fact that advisers are fiduciaries whether SEC registered or not -- you know, SEC or state registered or not. And so, you still have the, you know, duty of care, duty of loyalty that apply to your -- I mean, your -- I mean, the adviser's relations with its clients.

So, yeah, I think -- I think that's the -- that's the broad scope of what we intended to cover. I know it's technical and -- and we threw it at you quickly, but if you all do you have any questions, we're

happy -- happy to answer. And I'll leave it at
that.
MS. MINNIHAN: Thank you so much,
John. That was actually incredibly helpful.
And given the complexity, we probably can't go
over this enough times. So, definitely want to
open it up for Q&A from the committee.
MR. CAVANAUGH: Well, I -- I will say
to you on that end, and before we open up to
Q&A, which we're of course welcome to, the one
part of your -- of your introduction that you
didn't mention with respect to my background is
that I used to be with OSB, the small business
advocates office that's -- that's hosting this
meeting. And so, on their behalf I will point
out that they do have really good informational
materials on the SEC website that go over this.
So, to the extent that you're
scratching your head afterwards and -- and
wondering what is he talking about with the
Company Act and the Advisers Act and the
capital raise, how does that all fit together,
there are a number of materials on line that --
that should hopefully be a good primer.
MS. STANDIFER: Can you maybe talk

very briefly just to educate the committee on 100 is not 100, 250 is not 250, you know, look through rules just so as we're thinking about, you know, the number limitations.

MR. CAVANAUGH: 100 is not 100?

MS. STANDIFER: Right. So, I may look at a fund that has 100 LPs, but each of those LPs has different beneficial owners, it's going to give me over 100.

MR. CAVANAUGH: Oh, I see. I see. Right. Okay.

So, that gets into pretty particular facts and circumstances that I don't necessarily want to cover in detail right now just because I don't want to, you know, give you any sort of technical information that -- that, you know, later proves needs to be tweaked, but I will say that, you know, to the extent that, you know, you have an LP coming in and it was formed for the purpose of investing in your fund and it itself otherwise has a number of LPs, then you're right that there would be a look-through mechanism in order to, sort of, clamp down on the, like, clearer circumvention of the roles.

So, I'm not -- I'm not going to provide, like, tons of specifics on that, I -- I do think it's a great question because it gives an opportunity to underscore for everybody else that, you know, this is something that the securities laws are generally aware of and -- and attempt to -- to mitigate, right. So, point being that you can't have a fund that comes in and says, Oh, I'm only one LP, but that in itself has 100 LPs just as a way to get around the rules just to be clear for everybody.

MR. DILLASHAW: John, just one quick question on the -- the $12 million limit for the -- for -- for the -- the -- that you -- under (c)(1) that you could go up to 250 if the fund is less than 12 million, how did you guys come up with the 12 million number? Like, where is the origination as, like, that is what was set as the threshold.

MR. CAVANAUGH: That's statutory. Robert, that's right, right? The 12 million 250 limit is found in the Investment Company Act itself. And so, you know, to the extent that, you know, you want to push and pull there, it would typically require Congressional -- Congressional action.

MR. HOLOWKA: Yeah. I'll add that I think it used to -- I need to double check this. I think it used to be ten million and then it was recently adjusted up to 12 million. I need to double check whether that was just to reflect inflation for the statute or if there's another reason. I can double check that real quick.

MS. NIKLASON: And what's -- what's the origination of the statutes? In other words, how outdated are those numbers.

MR. HOLOWKA: I think the original one was 2018. Is that right, John?

MS. NIKLASON: Oh. So, it's pretty -- pretty recent?

MR. HOLOWKA: Yeah. I think that's right.

MR. CAVANAUGH: I'm actually -- I'm actually not sure the vintage of the statute. Though I will say it is -- it is -- it is recent. And I -- I just -- I just checked while we were in that brief reprieve and -- and it is found in the Company Act. So, I did want to highlight that.

MR. DRAYTON: Just real quick -- just real quick, under the qualified VC funds, you've mentioned limits on redemption, guys. Can you just at a high level summarize what some of those are.

MR. CAVANAUGH: That is -- Herbert, thank you for the question. It's a -- I'd have to -- I'd have to go back and -- and take a look --

MR. DRAYTON: Okay.

MR. CAVANAUGH: -- at the particular rule, yeah.

So, as a -- I don't want to necessarily speak to my experience in private practice before coming to the Commission. So, to the extent that I give you information on the -- on the specific structures, I'd want to take a quick look.

MR. DRAYTON: Okay. Thank you.

MS. MINNIHAN: And as the -- John, this VC fund exception of 3(c)(1) as something that we're exploring, do you have thoughts on pros and cons of raising the 250 beneficial owner or the 12 million AUM limit?

MR. CAVANAUGH: Sure. I love that you ask, and thank you for asking, and I anticipated that somebody would in fact ask. Either by means of formal preclusion or -- or just a matter of general prudence given my position at the Commission, I don't think I can weigh in on -- on that, yeah. I'm sorry -- sorry -- sorry to give that as an answer, but, you know, we want to provide --

MS. MINNIHAN: You're like, thank you for asking, but --

MR. CAVANAUGH: I figured that you'd ask. And while I was taking the subway in this morning, I was -- believe it or not, that's the best -- that was, like, actually la rehearsed response and that was the best I have.

MS. MINNIHAN: Well, I'm glad I gave you a chance to do it. Well -- well played.

Jennifer, I think you have a question.

MS. NEWTON: Yeah, I do -- I do have a question. Thanks so much, Erica.

So, John, on the smaller -- for the smaller advisers, is there a scenario where there's -- of course there's no registration requirement under the SEC, but there's no registration required under, you know, the state regulators as well? Because, oftentimes, the states also have their own exemption exceptions. And so, for some of those smaller advisers that don't really have that many fund clients, it's -- is there a scenario where they are not subject to either or.

MR. CAVANAUGH: Thanks for asking.

MS. NEWTON: Or have you --

MR. CAVANAUGH: No. No. Thanks for asking. I understand the question. I'm -- I'm checking my notes here because that is now outside of our direct purview. So, for example, it would be a great question for NASAA, the one with two As at the end, not rocket ships. So, North American Securities regulators.

I want to say, and I'm going to caveat this by saying, it needs to be confirmed, but almost entirely -- I'm going to say, almost entirely -- now, I don't remember how you phrased the question, but -- but almost all small advisers will be registered at the state level. I think there were one or two states that did not necessarily have inspections. And so, that's part of the rubric when we were looking at the midsized advisers, but that may have changed. And being that that is outside of the purview of -- of what we do at the Commission, I don't want to, you know, give you any --

MS. NEWTON: Okay.

MR. CAVANAUGH: That would be a great question for them. Thanks.

MS. MINNIHAN: Great. Any last question? We are approaching --

MS. DAWOOD: I have a quick question.

I'm just going to rephrase Erica's question. So, if you want to use the same response, that's fine.

MR. CAVANAUGH: Okay.

MS. DAWOOD: But I'm just curious. I'm going to ask it a little bit different way.

MR. CAVANAUGH: Sure.

MS. DAWOOD: From the raising of the 100 to the 250 --

MR. CAVANAUGH: Yeah.

MS. DAWOOD: -- were there any implications that were negative that were a reason to look at to say -- to make us pause if we were going to think about breaking the 250 to a higher number? Has anything happened because of the raising of 100 to 250 in the past?

MR. CAVANAUGH: You know, I -- I think not as far as I'm aware of, but -- but you'll have to take that for what it's worth.

MR. HOLOWKA: Maybe I can jump in here too. I think specifically -- and actually, we were just kind of looking at this at the prompt of one of the Commissioners, those specific thresholds, and I think, you know, we're of the opinion that those are set by Congress. Just like the 100. Just like other thresholds in this -- the -- the statutes. And usually when it comes to something like that, we don't really try to make a policy determination one way or the other because we don't really see it within our authority to change those thresholds.

So, I -- I think that's kind of where John's coming from is that, you know, certain things are decided by Congress and we're -- we're left to implement them, but I don't think we have it within our purview to change those thresholds on our own. And so, I don't think we really have a policy view one way or the other.

MR. CAVANAUGH: You know, it's -- it's -- look, there's a bit of a process and a substantive answer to it. So, Robert laid out the process answer which is that it's, you know, typically within the purview of Congress and also the -- the substantive answer which is what I'll repeat from earlier which is that -- that sadly, I suppose, that we're -- we can't, perhaps just by -- by kind of prudence, weigh in on the pros and cons.

MS. MINNIHAN: All right. Well, thank -- thank you so much, Robert, and, John. We really appreciate your -- your time today. And I think, you know, we all learned a lot from this. And we'll continue to peruse the amazing information that's also available on line to further deepen our understanding. And I want to thank everyone on the committee for these really great questions.

And with that, we have the opportunity to take a short break before we resume our discussions at 11 a.m. Eastern.

MR. CAVANAUGH: All right. So long. Thanks everybody.

MS. HASELEY: I'll just remind everyone that the webcast is continuing to live stream. So, make sure you mute yourself, go off camera. And we will begin again at 11 o'clock sharp.

MS. MINNIHAN: Thank you, Courtney.

(Whereupon, a short recess was taken.)

MS. MINNIHAN: All right. So, welcome back to everyone who's rejoining virtually and on the SEC webcast.

We heard this morning a little bit about how challenging it can be for some fund managers, including, under represented fund managers and emerging fund managers, to raise their first funds. We know that not all investors have access to the same network of peers, mentors and professionals who can serve as potential LPs or provide guidance and support when launching a fund. Yet, we also know that emerging fund managers play a key role in the U.S. capital markets by funding start-ups everywhere.

Emerging managers consistently report challenges raising investment funds and women and other diverse managers’ report facing disproportionate challenges in raising capital. We hear similar challenges when we talk about entrepreneurs. Particularly, women and other under-represented founders. And in that context, conversations can sometimes include considering what can be done to bolster entrepreneurial support organizations like incubators, accelerator programs and other entrepreneur support centers.

Similarly, some of the challenges facing emerging fund managers, particularly as it relates to building out their networks and providing resources and support as they seek to raise funds and refine their investment strategies, are challenges that could be addressed, at least in part, through fellowship programs and accelerator programs for fund managers, as well as, fund of fund programs that provide support services. And they do exist.

For example, I am a member of the Kauffman Fellows Program which is an amazing two-year fellowship program for venture capital fund investors, as well as, those who have either recently started their new funds or are thinking about starting a fund in the future to really build out those networks in a very scalable way. I have had such an amazing experience from that program and it's really improved my ability not only to manage my fund efficiently, but also to understand how to access the LP community that funds venture capital investors.

So, to facilitate today's discussion to promote and support emerging and small fund managers we are going to begin by hearing from an experienced fund manager and fellow Kauffman Fellow, class number one, about how new fund managers can be supported through fellowship programs.

So, I'm so pleased to welcome Karen Kerr, PhD. Karen is a Kauffman Fellows board member and was a member of their charter class. I won't say when that was, but she's been doing it for a while. She's also managing director at Exposition Ventures. She was previously executive managing director at GE

Ventures and is an early-stage venture capital investor.

I look forward to hearing Karen's insights as we explore how to address some of the challenges facing fund managers and consider whether regulatory or other solutions could be implemented to further support these managers and, in turn, the early-stage companies in which they invest.

So, Karen, it's so great to see you. Thank you for joining us today. We're excited to hear about your experience and your thoughts on potential market recommendations.

PANEL TWO: EXPLORING WAYS TO SUPPORT AND PROMOTE EMERGING FUND MANAGERS

MS. KERR: Thank you so much, Erica. And thank you so much for giving me this platform to talk about a -- a program that's near and dear to both of our hearts in the Kauffman Fellows Program.

So, let me see if I can share my screen. I do have a couple of slides and hopefully folks can see the slides.

In the time that we have I want to talk a little bit about the program -- the

Kauffman Fellows Program and some of our outcomes. And then, maybe a little bit around the current environment for -- for capital formation for emerging managers. And maybe a -- a couple of thoughts around additional support.

MS. MINNIHAN: And, Karen, just wanted to really quickly mention, I know that one of the topics that were -- we were also kind of thinking about exploring is if fund of funds could be helpful to supporting emerging managers. And we know, you know, you guys have had some experience there. So, if there's anything there you want to chime in on that topic as well we'd love to hear it.

MS. KERR: Fantastic. Thank you.

So, in -- in -- really in the -- the -- to hit the highlight of what the program is, the -- the program was -- was funded -- was formed about 30 years ago as a leadership program in venture capital. It was founded by the -- at the Kauffman Foundation in Kansas City and it has since spun out and become independent of a program, but at its highest levels, over those 30 years we've gone from focusing around capital formation in one country, the U.S., to globally. We have well -- almost one billion fellows. And what's very intriguing to me is that the program has really from its foundation supported diverse entrepreneurs and diverse fund managers.

A third of our fellows today are female. I remember in the charter class -- so, that's, like, 29 years ago -- we had three women out of 13 and two African Americans. And so, from a percentage-wise, that was far exceeding what you tended to see in the venture industry at that time.

We've been a convener of both established and emerging funds in the program. Funds like Venrock and NEA and Canon were parts of those beginning classes. And Venrock and Canon are led by Kauffman Fellows today. Kleiner, which is a partner, is led by a Kauffman Fellow today, but we -- we've seen that our fellows have gone on to found really the next generation of leading venture firms, firms like Emergence and 1350 and MaC Ventures were all lead by -- by VCs from the Fellows Program.

So, this is a snapshot of what our

Fellows class 29 looks like. We have about 66 fellows and on an average that's about what we've got per year. Kind of that 60-ish up from 13 when we first started. And I think that really mirrors the -- the rise in the -- the venture capital asset class, but what I point out here is the gender diversity. 45 percent of the class is female and the -- the high representation of under-represented minorities, that's 21 percent of our U.S.-based fellows are -- are either black or Latino. And so, we've consistently done that through the years.

We've got -- so, in class 29 if we look at it, we have over 50 percent of our fellows are coming from emerging funds. And this is actually relatively consistent over our lifetime, but we're just looking at here the last five funds or so. You can see that emerging funds tend to represent somewhere between 40 to 60 percent of the -- of the class. We do have established funds. Over the years we've added some corporate funds. We've added some limited partners as well and will be expanding the limited partner network. Really, all in an effort to -- to really expand the range of -- of types of firms that are in the network. And actually having access to LPs I think has been one of the things that our -- our fellows coming from some of these emerging funds, and even some of the established funds, have valued.

And then, we also are looking a little bit at what's the AUM of the -- the funds that we have in the program. This is for class 29, but you can see sort of median average of where they are from both of the emerging funds. So, some -- we do have a couple of fellows who are -- we call them fund zeros either because they're just starting off in their process or haven't fully closed the fund yet, but you can see that, you know, the very median fund sizes are -- are kind of 50-ish. And -- and that may be -- have some relevance to our -- our later discussion around the limits around some of these general solicitation funds.

So, let me just talk a little bit more in detail about the program now that we know, sort of, who is coming into it. Really this is meant to be a platform for lifetime learning in venture. I view it as a graduate level education in -- in venture. Obviously, like a -- like any graduate program, we spend a lot of time recruiting the best of the best and we think we've done that.

Then, there is a formal two-year program which consists of both in-person and virtual modules where we'll do a structured curricula with experts and practitioners. We'll do a bunch of peer-to-peer learning as well. And then, we spend a lot of time focused on this network component and bringing our fellows together even post the program. And that's been an important part of getting value added as well.

So, in terms of -- of maybe some of the -- the networking and life-long learning components of it, we have started special interest groups where fellows both in program and alumni are able to come together to share best practices and deal flow in specific topical areas. We also provide an infrastructure for more regional support of our fellows. Whether that be -- we've got a lot of fellows in the Bay Area, but we increasingly have fellows in the midwest, the -- the east coast and -- and Europe and internationally. So, we're creating forums for them to convene there. And then, we are doing some regional gatherings and global gatherings as well. We do an annual summit that's bringing together 300 plus fellows out of our networks that we move around the globe to look at venture capital in different regions.

This is just an example of -- people make a lot of use of the virtual aspect. It's a great way to tag up with folks on -- on topics.

As you might imagine at 30 years old the program has evolved in that 30 years. I would say in the first epoch of the -- of the program when it was run by the Kauffman Foundation we tended to focus more on fellows who were early in their careers in venture and were looking to -- we were matching fellows with firms and the foundation itself was paying all of the freight and -- and the firms were paying half of the freight.

In the second epoch the program spun

out of the Kauffman Foundation and we made it more of a two-year tuition program. We also -- that allowed us to go international as well. And then, in stage three of the program, we've become more intentional about -- about the network and programming for the network.

So, the -- the -- the two-year program itself has evolved as well. Today we've got about 40 percent of that. As our managers have become more experienced they're doing more of the -- the peer-to-peer meeting and learner leading groups. And then we've got 40 percent that are more of a lecture with key notes and experts in the industries. And then, we have some workshops facilitated by experts.

And so, if we think about, sort of, what the modules tend to cover over the course of the two years, we've always focused on leadership and personal growth and development. And then, we think about some of the fundamentals of -- of doing venture: How do you source and choose and mentor companies? How do you add value to your entrepreneurs? How do you build your firm and think through success planning? Indeed, this topic is perhaps the reason that the -- that the -- the program got started in the beginning.

And then, we've also leaned into this notion of venture capital is really one of the most powerful tools for economic development and for positive change in the world. And we're -- we're really wanting to help our fellows to give them space to think through how they manage their own impact and how they can lead with purpose.

This is just a highlight of some of the -- our fellows and their journeys that they've taken. I'm just going to call on a couple of these groups. Jason Green was a -- my classmate in the Fellows Program. He started his career and his fellowship at Venrock. He went on to found Emergence. He is now retired, as it were, from Emergence, but has started a foundation where he is now investing in diverse emerging managers and in some ESG-related efforts and really has been a -- a real leader in terms of giving back.

He was on the board of Endeavor which was -- which really sought to -- to promote entrepreneurs in outside of the U.S. It's become a global network for supporting entrepreneurs.

Jennifer Fonstad was also a fellow circa my era who went on to -- to found things like All Raise and Broadway Angels. I mentioned that our fellows have gone on to now lead some of these story venture firms. Bryan Roberts is now leading Venrock. Mamoon Hamid is leading Kleiner. And then, we've got fellows who are focused on the art of leadership and Matt Mochary, he was circa my era, has created Mochary Methods to work with entrepreneurs. Ravi Mohan similarly works a ton with -- with entrepreneurs as well.

So, when you've been around for nearly three decades and have 1,000 fellows, or almost 1,000 fellows, you have a great data set from which to -- to do research. And I think some of the research that we started to do is just how well are we doing in terms of our ability to -- to train or -- or to -- to accelerate to high grade venture capitalists. And so, we're defining success really as being able to consistently find and invest in and support and exit, you know, category --

companies that are category-defining or firm-defining. And then, our metric for that is unicorns. So, a company that reaches a unicorn status is -- is what we might call category-defining. And if we manage to exit at a unicorn valuation, that's firm-defining because at the end of the day, venture capital is a returns business. So, that's kind of our methodology to it. So, we've created something that's akin to an alternative to the -- to the Midas list, but our Kauffman list.

Why we choose Unicorn for -- I think many of you are aware, Unicorn is a company that has achieved a billion dollar valuation. We choose Unicorn as the metric here because they're -- A, they're actually remarkably persistent, but they're really only one percent of the companies that get invested. So, if we look at a period from 2016 to -- to -- through June of this year, probably 250,000 companies done and less than one percent of them get to this Unicorn status. And those -- and those companies tend to be pretty consistent and that's why we think it's a great metric.

Half of unicorns are in the U.S. 25

percent of them are in -- in Silicon Valley, but interestingly enough, or perhaps not particularly surprising, is the fact that of these unicorns, 20 percent of them have at least one Kauffman Fellow on the cap table. And 20 percent of our Kauffman Fellows have been involved in unicorn-type deals and exits. There's a fair bit of deal sharing and collaboration that goes on. So, we do take into account some of that double counting, but we have been -- I think, generated excellent results for investors through our fellows. 850 total exits and two thirds of that have been unicorns and some 300 plus billion dollars. And so, I think that really just speaks to our ability or the success of the Kauffman Fellows Program has had in producing leaders in the venture capital industry.

Just in terms of some of the challenges. I think a lot of this discussion has been on capital formation and that's really no surprise. I think in more recent times we've certainly seen a -- a tail off in -- a slowdown in dollars going to venture in this post pandemic, post zero interest rate environment. I think that's disproportionally impacted first time fundraising.

Typically you might see more first time funds or early stage funds. So, funds one through three being raised in terms of number than -- than more established firms. I think this is the first year we've seen that reversed. And to the extent that LPs, whether they be institutional or high net worth, are committing dollars to the asset class, we're seeing, you know, of late a disproportionate, you know, better than 80 percent of it are now going to established managers this year. I mean, part of that slowdown has to do with the lack of liquidity in this asset class, but even though there is a lack of -- of liquidity, to the extent there is some, it is tending to go to more established managers at a disproportionate level.

I think a little bit of that is the folks might call it a -- a flight to quality, institutional investors are certainly looking to support their existing managers. And while emerging managers do outperform established managers, I do think there's a dispersion --

there's a greater dispersion, certainly post great financial craft, in -- in the performance of emerging managers. The other thing I think that it's -- driving the fact that so few dollars is going to -- to the fund ones these days is that disproportionally those dollars are coming from high net worths that are a lot more sensitive to -- to some of these liquidity issues.

And then, maybe the final thing I -- I chart that I'll say is somewhat alarming, but I do think the Kauffman Fellows Program is positioned to help here, at least for our fellows, is we are seeing a tail off in terms of the number of funds that are able to secure second, follow-on funds, but I do think that having those networks getting into great deals will help fund that more.

And then, in terms of some of the just the topics that we have been talking about here, this $12 million threshold may in fact be too low. Where we are seeing funds in these -- in the emerging managers stage that -- that -- that have higher AUMs even at that stage and then I think everybody's promoting the lack of liquidity and the challenges of getting public.

So, that's what I've got from a formal presentation and I'll stop sharing and go from there.

(Whereupon, Reporter loses connectivity and transcript is picked up by another reporter.)

MS. MINNIHAN: Thank you so much, Karen. That was really, really great. And, you know, I just want to say that this wasn't really planned, but, you know, seeing how Dr. Howell really highlighted the importance of networks, and it successfully getting off the ground, and the work that, you know, Kauffman is doing that ended up, I think, being a really useful overlap for us to think about. But I think Caretha had a question.

MS. MINNIHAN: Thank you.

MR. DILLASHAW: Karen, I have a question. I'm sorry. So I noticed that you were going over sort of the fund size limits and, you know, I know in your last point you said that you think the 12 million maybe a little bit low, can you maybe go into a little bit more detail, you know, around why probably bigger sum fund sizes are more viable given sort of the cost structure of a firm and, you know, the fees that are associated with it where you are seeing even lower size fund had a different level of critical masses?

MS. KERR: Yeah. Thanks for that question. I mean, I -- you know, I run an emerging fund. I in a fund 1 now. After years of being in other funds, I finally launched my own firm. And, you know, these funds typically have somewhere between 2 and maybe 3 percent -- emerging funds can typically get away with 2 and a half percent management fees and out of that, we certainly have, you know, personnel cost probably eat up the vast majority or at least half of that, but you certainly have a lot of expenses around audit, legal, travel. So as you think about how to build, and scale, and build in infrastructure, build in marketing, build in a lot of things, having a larger size fund just gives you a better base to go out and build your organization to be able to provide value to your investors to make better investment decisions, to see more and to attract more companies.

MR. DILLASHAW: Yeah. Thank you.
Erica, I'm sure you have thoughts on this as well, but I mean just in terms of maybe get a little bit of indication of like, you know, in terms of like how much staff the ordinary fund has. I do think that's sort of a critical point of there is a sort of like minimum threshold for which raising a fund kind of comes viable and really even a $25 million fund for an emerging first time fund advisor especially, like, doesn't leave you with maybe resources to run the fund and anything less than that is like really even harder -- disproportionately harder.

MS. MINNIHAN: Yeah. And I think, you know, Bart, one of the things that is interesting to think about with that, you know, I would say that probably like -- I don't know -- maybe 25 million might be kind of like a minimum viable fund size. Probably a little bit more if you, you know, have investor that need to audit. But there is an interesting perspective to think about the ability to even run a fund, like an MVP proof of concept fund that is smaller or smaller than 12 million means that you possibly do already have to have money to support yourself. So that might be another factor that also makes it even harder for people who are coming from not wealthy backgrounds to be able to even do that first small fund and still eat food. So, Karen, we'll love to get your perspective.

MS. KERR: No. I think that's exactly right. I mean, from -- just from personal experience, we're at about 11 million, so we're kind of at that number. Today I have one principal part-time CFO, so that's infrastructure that you got to pay for out of the management fees. I do have institutional investors, so I do have to pay auditors. And it does mean -- you know, get -- launching a fund really does require thinking about no income for 2 years to get it off the ground and if you're not at twenty five plus million, maybe 4 or 5 years of no income so that you can build infrastructure run the -- to raise a second fund. So I think that's a great point. And you still have to be out there. So there are expenses around conferences, travel, what have you that you can't push all of that into fund expenses because at the end of the day, fund expenses are also just the loan. You still have to cover that in your returns.

MS. MINNIHAN: Great. I'm sure more committee members have thoughts or questions, please jump in. All right. Great.

One thing I would just love to get your perspective on -- so two things. You know, 1 -- and I mentioned this kind of at the beginning of the presentation -- I know that, you know, we as a committee have sort of talked a little bit about the ability of, you know, potentially fund of funds to serve as a mechanism by which perhaps more, you know, sort of emerging managers can get access to the type of, you know, institutional oversight that might, you know, make it a little bit easier for them to raise additional money from high net worths. You know, one of the things that we kind of didn't talk about today is that when we look at a lot of fund 1's being, you know, largely comprised of high net worths, you know, it's relatively difficult to, you know, do as we say, herding the cats, right, which is to get many small investors to kind of all come in simultaneously to the point where, you know, you sort of have enough critical mass to support the expenses of the fund. So talking a little bit about, you know, are fund of funds valuable in that way to potentially, you know, give -- provide like more traction for these funds managers?

And then number 2, you know, I know that Kauffman has, you know, had some experience working on a fund of funds concept. You know, in my perspective it seems like Kauffman would be the ideal platform to manage a fund of funds because of the shear access to -- and, you know, very high depth of information on the managers that go through the program, you know, were -- are there any sort of regulatory changes or improvement that you think could have perhaps made that process easier for a program like Kauffman to be able to get off the ground? Or were their things that came up that, you know, maybe provided undue challenges besides that a LP demand?

MS. KERR: A couple of thoughts on that, thank you -- on the fund of funds. Thanks for reminding me to come back to that.

Capital sources for fund of funds are quite interesting. I think your Kauffman did help to stand up to fund of funds early in its -- as it was transitioning to becoming an independent fund, we helped launched Trubridge and that's helped to provide some -- both funding for the program and scholarship support going forward.

Trubridge is very much a traditional fund of funds as one might think about it where the vast majority of their dollars was raised from larger institutional investors, many of whom struggle to deploy capital into venture funds because of their need to write larger check sizes. And so that is one thing that we've helped to do in terms of launching that one. And they do -- they -- now fund of funds can invest in established managers, as well as emerging, but Trubridge certainly invested in many emerging managers and has done well there.

There is -- I have seen some of our fellows do something interesting, which maybe speaks to this 250 person limit or sub-250 limit where they have put together special purpose vehicles pooling their resources with respect to networks of high net worths and gave them access to a set of funds. And that's actually a pretty interesting idea because at the end of the day, you are trying to create a portfolio and maybe mitigate some of that risk by having a number of companies. So I do think that's a pretty interesting one.

The Kauffman fellows program itself has given some thought to running its own fund of funds and establishing its own fund of funds for the benefit of investing in our fellows. Recognizing the fellows have great performance, we're doing a lot to provide infrastructure and acceleration. Those -- we continue to explore that. We haven't taken it off the table. I think as we've gone into an environment where fundraising in general has been more challenging, that created its own head wins for us in terms of getting a fund of funds off the ground, but we continue to explore that and we think that could be helpful to our fellows.

MS. MINNIHAN: Great. Thank you. All right. Wonderful. Any other questions from the group? Okay. All right. Well, thank you so much for your time today, Karen. That was really helpful, and informative, and we very much appreciate your insights and hopefully we can help create some recommendations that will make everything, you know, a lot easier for everybody. So your input is really appreciated.

MS. KERR: Thank you. Thank you for having me.

MS. MINNIHAN: All right. Have a wonderful day. Okay. Great. So with that, I am excited to open our policy conversation and we can turn back to the topic from earlier this morning around VC fund managers use of 506(b) versus C as a capital raising pathway. So I would love to hear from the group any thoughts, ideas on, you know, how well you think the current rules are working in practice and whether or not there are some areas where we think there can be a bit more flexibility.

MS. STANDIFER: Erica, this is Rose Standifer. One thing that I didn't hear in the prior discussion around negative signaling, not the absolute sort of compliance burden of looking at tax returns to verify accredited investor or using a third-party to verify, but as part of, you know, the negative signaling is also the risk profile of using C versus B and maybe working with the gatekeeper, such as advisors or lawyers, that are talking to emerging fund managers about the risk profile of the C specifically around fraud and the fact that when you're raising within network, VC is an inherently risky business model. If you're raising within people you know, the threshold of dispute is just naturally higher. If you're raising with people that you don't know and something goes wrong, your risk profile is greater. And I didn't hear this being discussed that it's not the technical rules of how to verify an accredited investor, but instead it's having a business relationship with someone in arm's reach in an inherently -- you know, inherently risky field. And we have other tools in the regulatory, you know, schemes that deal with this. You know, certain safe harbor languages. You're never going to get rid of fraud, but is there other regulatory pathways to get people comfortable that, you know, things don't go south. They don't know these folks, they're immediately going to get sued even if -- because accredited doesn't necessarily mean sophisticated, right. So I feel like that's a missing part of the conversation that very routinely happens. I kind of had a network. I don't. Here's the risk, here's not of going 501 -- sorry -- 506(c). It's not always just the pure cost of confirming someone is accredited, but it's assessing their sophistication in an inherently risky business model.

MS. MINNIHAN: Okay. Great. I mean, do you have some suggestions on, you know, how we could mitigate that sort of information cost and the transaction or alternative methods to potentially create trust while using 506(c)?

MS. STANDIFER: I think it might be around the nature of the general solicitation that's done and perhaps borrowing safe harbor language that is used in public markets and really leaning into that around forward-looking statements around risk, right. If you can both talk to the emerging company -- emerging managers, as well as the gatekeepers that are advising those members that you're not inherently taking extra risk by doing business in a very risky sort of business model with folks that you don't know personally or that you don't know through your network.

MS. MINNIHAN: Yeah. Interesting. I mean, I think -- you know, you bring up some good points. One of the issues that I would have potentially, I mean -- and, you know, you can do things in a variety of different ways, but traditional since, you know, venture capital pooled vehicles are blind pools, so, you know, there is no forward-looking statements really, right. There is no expectation of anything that's relatively concrete, but also because, you know, the money is deployed over a lengthy period of time, it is quite a big counterparty risk for a venture capitalist to take on a limited partner that they don't know very well because they have no idea whether those people are going to credibly perform on their commitment. And, you know, if you have LP's that you don't know and they start defaulting on their commitments, especially if they're just, you know, people that you found online and didn't check into their background very well, it puts you vehicle at risk quite a bit. So that could also be, you know, a big part of why, you know, there's negative signaling. Because if I'm an LP in a fund and I know that you don't know the other LPs in the fund very well, there is now, you know, the negative signal that the entire vehicle could fail and not be able to meet its capital commitments.

MS. STANDIFER: Yeah. I mean, it's the other side the same -- it's the same issue and, you know, I'd love to hear are there structural regulatory pathways to deal with that sort of on both sides because we're looking at the network effects as not only the ability to find LPs, but the network affects the strength of those ties to actually facilitate the business model itself, right. You have confidence of the fund manager that the LP will, in fact, honor the capital call. You have confidence that if, you don't, have great exits because of macro and micro economics, you're not going to get sued, right. Like -- so how -- exploring how can we address that within the structure of the fund.

MS. MINNIHAN: Okay. Thank you.

MS. SETHI: I wanted to add on sort

of a related point. I think on the verification side that's something that -- that process is likely changing now, you know, with improved technology, with a lot more kind of platforms out there trying to help funds find LPs, help accredited investors find potential investments and my sense -- and just experimented a little bit, but I think there's others here probably know more is that this is kind of a changing space and there are probably structural barriers to those, you know, platforms working as well as they can. So you know, I wonder -- and this might be something to think about as a topic in the new year is to get a tease out like how are people -- how are these funds doing in these general solicitations? Are they relying on platforms at all? Is that of interest to have that growing? And what are the barriers? Or, you know, are they using events? Or, you know, exactly kind of what are they relying on and what could be sort functionally better to make that easier?

MS. DAWOOD: May I just add to that that, you know, I really do wonder how they're doing the general solicitation. Because if you think about -- you know, I have talk to some people who have registered as a 506(c) and if they put it out on social media and things like that, they didn't really didn't get LPs because of that, but did it give them -- I don't know how to say this -- almost like a false sense of confidence that they had -- that they could go out to a network or they could go out and start to talk to more people and then there's almost like they kind of fell in between a B and a C, but they had -- they were a C, so they felt more comfortable because they were going out and doing general solicitation. Because -- I mean, people don't buy a lot of things just because they see it once on a social media platform. So, you know, what was really the trigger of the general solicitation that did help these funds is kind of what I'm interested in knowing.

MR. DILLASHAW: I can -- Marcia, that's a great one. I can weigh in at least a little bit from my personal experience on how I see 506(c) used. It doesn't tend to be sort of like a mass advertisement. It tends to be more I want to cap into an existing social network and sort of basically send a mass e-mail out. Sort of think about like an alumni network for a university, a college, some club, or something like that that may have hundreds of folks and you want to say we're establishing the, you know, ABC University angel network and we got deals to do or something like that, that's where I've seen 506(c) start to kick in. Maybe you start to piggyback off of an existing social network and a wider one than sort of direct communication so that at least as a lawyer sort of advising sort of saying, like, that is -- that doesn't seem like there are communication -- too far and you got to go to 506(c) if you want to sort of spread the message that wide.

MS. DAWOOD: Interesting.

MS. STANDIFER: That led me to a thought when I was reading the data and the results around negative signaling. What if it wasn't this bright line, I have to choose 506(b) and it has to be very strict? Or I'm going to go 506(c) and I'm going to send out these broad e-mails, I'm going to actually put up deal rooms -- deal terms in a pitch room when I don't know everyone there? And what if it is just general solicitation is allowed under 506(b), you know, and it's adjusting perhaps the unaccredited investors that you could have in a deal with general solicitation? Would we see more uptake because you're talking away that negative signaling? Because I agree in my experience a lot of these kind of fall within 506(c) and B because of the things that Erica and I were talking about, it's rare for a small fund that you're really going to take a flier on an LP that's all you -- and you have no connection with them, but you maybe now go to third, fourth, fifth degree connections in your network by utilizing 506(c) that you wouldn't have gotten to if you really stayed center of the course under B. And so is it collapsing and then if you collapse, how do you deal with all accredited investors allowing some non-accredited in.

MS. MINNIHAN: So, Rose, I think that's a really good point. I mean -- you know, from my understanding and -- you know, Stacey, Courtney, please correct me if I'm wrong -- you know, the main difference here is that, you know, you can still do that, I mean, you know, yeah, I get it. Like, I guess the negative signaling would apply in both cases if you allowed it under B, but, you know, the main extra step is that you have to do some verification because you've now reached out to people that you don't really know and so to me, that seems like a reasonable cost to protect the investor. You know, would you be comfortable with the idea that, you know, you could now sort of reach out to people that you don't know and you also don't need to take reasonable steps to verify accreditation or are we kind of going in a different direction?

MS. STANDIFER: I guess I challenge the notion that the cost of -- like the true cost of the verification is a burden.

MS. MINNIHAN: Yeah. I don't think so either.

MS. STANDIFER: Right. I think it's the perceived negative signaling of having to do the verification that is a burden. I think the tools already exist as Jasmine pointed out. I think they're even getting better as, you know, a lot of those processes can be, you know, automated, the fund manager never has to touch, you know, an accredited investor's financials to do that verification process, right. There's third parties and services that they could use.

And I also think, you know, a lot of folks that are -- if you remove the barrier that I only have to talk to people within my network and I have a cache and that's no longer a thing, I think you're going to get uptake. I think you are going to see experienced managers even talking more broadly, right, because they want to expand their networks. They want to get more LPs. They want fund 4 to be 5 times this big as fund 3, right. And I think that could remove negative signaling and actually help the emerging managers along the way.

MS. MINNIHAN: So I did the question because, you know, would love to get a better sense of it. I'm not sure that the majority of the negative signaling is around cache necessarily. I -- from my perspective I would think that the majority of the negative signaling is around counterparty risk in a partnership, right. Because we have to remember that venture capital funds are partnerships, right. They're not structured like other companies. So just -- you know, if -- you know, in my mind whatever negative signaling is there really revolves around I'm concerned if the general partner does not know the other LPs well enough and hasn't, you know, necessarily verified their accredited status, that this presents a risk to the entire partnership. I think to me that's where most of the negative signaling comes from and to me that risk seems valid, right. It's not just sort of like invalid negative signaling that, oh, you're not cool and you didn't know, you know, other wealthy people. So, you know, I'm wondering, you know, is there a component of the negative signaling that we think is material and not presenting a valid risk to the other investors that, you know, the other LPs haven't necessarily been validated with reasonable efforts as accredited? And, Bart, I think you had some thoughts.

MR. DILLASHAW: Oh. I -- so I agree with that and I think a lot of that also kind of goes back into sort of fund size limitations, right. You know, so there's also a -- even the folk that you don't know as well, but are, you know, sort of in your direct network are probably going to be smaller investors, are probably not going to be writing a $500,000 check, a million dollar check. And if we sort of have a minimum fund size limit -- we sort of talk about a 25 million, we're sort of limited to a hundred investors and so now -- I mean, I think that does sort of put overall pressure and you're going to people and you're asking to write really big checks and so sort of you're not going to get a million check on a general solicitation very often. So I think that's also some of the pressure going in that direction which ease of lot of these things that you're sort of highlighting.

The other thing I kind of want to go back to -- and this is diving too far into the details on 506(c), but we keep talking about the additional and terminal burden of the validation. And, you know, I think even from a practitioner perspective, like it's not that big of a deal, but it is another step in the process especially if I have to involve a third-party into the process.

And keying off of one of the things that Emily said, the wild aspect of really deep into, but I don't think the SEC has ever formally said that you can rely on an accredited investor questionnaire or self-certification. That's been very prominent throughout sort of the 506(b) realm and so at least from the practitioner side, I've always sort of interpreted the guidance from a C that it needs to be something more than just self-certification. If a self-certifications or an accredited investor questionnaire were sufficient, then I do think that would further reduce the friction on it because you're not having to get a third person involved. You're not having to ask an investor to give you you're -- their W-2s or a net worth statement, which is sort of like a deeply personal question and so that has a lot of social friction in it. Again, I think that maybe a little bit of side issue, but at least got to get into the direct, you know, topic and talk about the additional transaction costs. It's a little bit higher than it would otherwise perceive just because sort of the -- either the transaction time or the social cost to it at least in my experience.

MS. MINNIHAN: Yeah. Bart, I mean, I think that's a really great point, you know, possibly bringing up the social cost. So interesting idea. You know, I kind of -- I feel like there's two sides to this coin, right, which is, okay, you know, it sounds like the reasonable steps are not exactly onerous, right. They said it could be an e-mail from another person or, you know, as you said, they could submit a tax return. Maybe we could sort of dig into the details. So on the one hand I do agree with you that it's reducing the social costs and so there are some upside there, but then, you know, also on the other hand, you know, does it make sense for their potentially be, you know, some social cost and not make it just too easy for people, you know, to jump right in on the investor protection side, right. Because I would think, okay, if I'm literally going into partnership with somebody on a 10-year business, you know, I should probably be willing to, you know, provide them some evidence that I'm actually accredited, you know. So that's just the thought that I would have, which is that we sort of do want to minimize friction, but at the same time, like, you know, these are relatively long-term, you know, commitments that you just really can't get out of, so, you know, does it make since to provide some reasonable barrier to people entering too quickly.

MR. DILLASHAW: Well, I hundred percent agree. I think that exist in B or C and I think that's the reason that even in B offerings we often do have these investor questionnaires were asking those. I guess one area that -- and maybe some folks from the SEC or some of the other practitioners can weigh in on. You know, one of the statements about it is okay to just to rely on an e-mail from another accredited investor, like, I don't know that that is definitively okay. So part of it is, like, there is the fuzziness of let's say that we are in reasonable steps to verify territory, you know, there's a little bit of thought that the lawyers have to kind of go through and look another each individual one and I don't think there's been clear guidance to sort of say, yeah, self-certification alone is totally okay or referral from other accredited investor is totally okay. So some of those statements I don't know that -- somebody correct me who is deeper in this as well, but we can -- that are -- you can for -- for face value as oh, yeah, definitely over time that's all you got to do.

MS. MINNIHAN: Yeah. I mean it feels like -- on the surface of it to me it feels like self-certification for 506(c) seems like actually a really good idea because, you know, it does mitigate some of these things that you're saying. I'm just trying to kind of like imagine the scenario. Is there a scenario in which, you know, unaccredited, unsophisticated folks are just told, oh, yeah, just sign it. Like, you're going to be rich. You're going to have that much after. You know, just do it. Like, don't go read the fine print. You know, that's the only thing that I'm kind of, like, thinking, like, I can totally see that happening, but we'll gather peoples' thoughts.

MS. NEWTON: I just wanted to add to

your point Bart and Erica about the trepidation around, you know, having to walk through that process and go through that verification. I've seen especially with communities that rely heavily on foreign investments and so there's a lot of hesitancy to get them to fill out that form. Even though it's -- administratively it's not, you know, that significant of a burden to do. There is some trepidation there and I don't know if it's lack of distrust, you know, with -- I'm just dealing with the US, but I know that firms and issuers are often hesitant that, you know, it's going to cause a little bit of delay and in that, you know, they may potentially lose the investment if, you know, the foreign investor is not comfortable with, you know, the level of inquiry in that questionnaire. And so I've seen it come up with a lot of communities that rely a lot on foreign investments because it's -- you know, it's just more information that they have to disclose.

And to your question, Bart. What I've seen folks use in the industry is just a standard, you know, questionnaire, you know, that seems like a lot of law firms use the same sort of format and even some of the emerging platforms go through the same process. But I don't know if it's the administrative piece that is the deterrent or it's just the fact that it is just -- it's another step that folks have to go through. And particularly if they're out of country, if they're foreign, it's not something that they are often excited to do.

MS. MINNIHAN: And, I mean, can you give us a sense of -- I mean you said communities that rely on foreign investment, I mean which type of communities would these be?

MS. NEWTON: Sure. Yeah. So I'm in Miami. I'm in South Florida and so the demographics here are huge populations of Latin American companies, Latin American families that have ties to countries outside of the US and Latin American countries, and so oftentimes there are opportunities and -- coming out of those countries to invest in startups or in companies here. And so while there is opportunity and access to capital, I know that a lot of our firms here are very delicate with those relationships because although there is a lot of capital there in interest, there's not a lot of tolerance for lots of process. And so it's very -- sometimes very delicate with handling foreign investors because they don't like to disclose much and so that's oftentimes why you get some push-back. And it might be just easier for folks to get around it and that might be driving the preference for the 506(b) as opposed to having to go through another administrative process particularly for those kind of investors who are not that forth giving with information.

So mostly I would say in communities like South Florida where there's a huge variance in the demographics in terms of the kind of capital that comes, it's not just US capital that comes from foreign investors that are broad and, you know, there's lots opportunities for a lot of companies here in South Florida, but it does create some trepidation when you -- you know, you create that new administrative burden of coming to get more information on the investor.

MS. MINNIHAN: Okay. All right.

Great. So -- I mean I think we have an interesting sort of ground work for a potential recommendation, right, which is that we are sort of balancing between -- you know, can you reach out to investors that you don't know? And if you as an issuer are going to take money from somebody that you don't know, should you at least take reasonable steps to verify that they're suitable? You know, do we want to say yes to that or do we just leave the entire responsibility in the hand of the investor? So I think, you know, that's one thing we can definitely talk about.

I know that one of the issues -- and as we're -- you know, we have about 25 minutes left for discussion was around, you know, this rule on the exemptions under 3(c)(1) around ownership and AUM limits for these qualifying venture capital firms. And we talked a bit about, you know, the viability of the 250 beneficial owner and a $12 million AUM maximum. So do folks have thoughts there around a possible recommendation on improvements and why?

MS. STANDIFER: One of my thoughts

there kind of bridging the gap of these two discussions and thinking of investor protection, I think if you go bigger, so if was want to increase the uptake of 506(c) and if you do, you know, both for sort of economics and the check size that you're going to get, 250 -- under 12 million doesn't make sense. You're going to need to bring 250 up and you're going to bring the new 12 million up, but does that still retain, right, this friction point of then having to verify and ensuring that every is, in fact, an accredited investor, right. That is a friction point that you're building into the fundraising, but that's come at the benefit of having greater access. You can raise for more people. You can have a fund that's bigger and still be not registered. And if you want to stay small because you don't want the friction point, right, there's a pathway there to potentially use general solicitation with, you know, some -- something less than -- maybe it is just the self-certification in a rep now or maybe there's something in the middle, right. Is there a pathway that as a manager you can choose that you want this greater access, but it comes with potentially friction if you're going to have to verify.

MS. DAWOOD: If I can just add that what I've heard out in the field is there are angel groups that have fairly large membership and if they do annual fund or put some kind of a fund together and they have more than 250 members and all the members want to participate, that's one of the -- like, it's just one use case of how they're kind of bumping up against these limitations.

But to your point, Rose, you know, in past meetings we've talked about the accredited investor definition and we did actually make recommendations to the commissioners about adding an educational component, so I kind of wonder if we didn't have this all kind of marry each other and, you know, maybe there was a way that part of this be able to certify if people are accredited would have an educational component that could, you know, maybe be an out-of-the-box thinking of how we get around -- not get around, but like get -- make sure that the people who are getting into the fund to your point, Erica, about you don't necessarily want to take people who really aren't sophisticated or don't -- you know, haven't really done this before, they don't really know what they're getting into. That kind of thing. You don't want somebody couple years down the road saying I didn't really understand this, you know, give me my money back.

MS. MINNIHAN: Yeah. I mean, that's a really good point. And, you know, Marcia, I'm all for education. You know, we like to take classes. I know you and I are in that thing. You know, I don't know that that applies to the majority of people in this country, unfortunately. I think -- you know, when I think about a barrier, I mean certainly having it as an additive that, like, I don't know if you took this class, great, but, you know, putting it in between people and investing. I think, you know, if we look at, okay, show me your tax return versus take this class. Like, the take this class thing is probably going to be a lot more of a hurdle for folks, but, you know, I do agree with you, you know, as you point out -- I think the concept, you know, funds that are kind of run by angel networks operating, you know, sort of in their own geographies to really provide that very early risk capital to folks that, you know, might be overlooked by the, you know, multiple billion dollar fund managers. You know, we certainly would want to create some regulatory frameworks under which they could operate with, you know, the least amount of kind of regulatory burden and expense, you know.

So right now we're looking at, you know, they might be constrained. In fact, I think they would definitely be constrained with a fund that's 250 owners and maximum of 12 million. You know, do folks think something like, you know, a thousand potential and 25 is more of like a viable fund size? I mean -- I know I haven't kind of been in the angel world for a long time, but back when I was doing it, you know, $25,000 commitment was kind of like the general rule of thumb minimum commitment. You know, two things, whether they were individual investments or not. You know, to me that seems a little bit more of like a reasonable size to accommodate, you know, folks who are, you know, looking to put together small, simple vehicles that can, you know, take reasonable check size from a decent community without having a ton of regulatory burden on them.

MS. DAWOOD: Yeah. I mean, I agree. That's what we're hearing. It's almost like the -- they want to put a fund together because over time these angel networks ends up with investor fatigue.

MS. MINNIHAN: Yeah.

MS. DAWOOD: If an investor makes one or two -- I mean even if your overly accredited investor definition as far as your income or wealth, you know, a lot of people are kind of just hitting or there's a little bit over, they can't write, you know, big checks over and over, and over again. So, you know, to get a diversified portfolio, they almost have to do some kind of a fund model. And I've seen so many angel group over the last -- especially the last 5 years add this to their repertoire and that's, I think, where, you know, it starts to get a little murky. So is two -- like, that's why I was asking, like, John about, you know, what's the -- what was the difference between having a hundred or having 250? Were there any ramifications? Did anybody see any, like, real push back 'cause then what's the difference between 250 and 500? What's the difference between 500 and a thousand? I don't know the answer.

But, you know, if we're really hurting these angel groups to be able to allow their members to participate and get that diversified portfolio, which we're always talking about being the best way to minimize risk, well, then we're actually like doing them a disservice by not having these limits be higher.

MS. MINNIHAN: Yeah. Oh. Sorry. Go ahead.

MS. SETHI: I was going to add on, also higher limits would allow for some check sizes. So I think some angel groups actually allow for diversity on the investor to allow more women and minority investors are lowering it below the 25 that Marcia was saying to get a diversed investor base. So that has that benefit. And the other -- so I would support like a thousand -- 250 going up to a thousand.

And then the other thing I just wanted to circle back to. I think someone mentioned this briefly a little while ago. I think -- you know, I do see some benefit to collapsing the 506, the (b) and (c) such that, you know, having just kind of one pathway where you can choose whether you do a general solicitation or not and there isn't that signal. I understand Erica's point that maybe we want the signal in certain situations, but there might be other ways to gets that signal. I mean, these funds probably do talk about who all is investing. I'm sure that's part of the marketing. And how many investors and so forth.

So I do see some real benefits to like a simpler regulatory environment as well as kind of at least, you know, an experiment with what happens when you don't have this separation between the general solicitation and this kind of very narrow network path.

MS. MINNIHAN: Yeah. Yeah, I know. Totally agree, Jasmine. So, you know, here is kind of my -- a little bit of my thinking on, you know, why we would have want to move the number to where we want to move it and, you know, why not just sort or unlimited, right. So it feels like 250 and 12 is too small for a viable vehicle. You know, a thousand and 25 is sort of closer to where a viable vehicle is, but we're still keeping it kind of like under the amount where there is enough kind of profit margin in it to attract people that might be fraudulent, right. Like no one is going to, you know, get rich off of managing a $25 million venture fund. So there might be, you know, still keeping it, you know, within a reasonable limit. There'd be less motivation for people to kind of go out with funds of this size and, you know, potentially take advantage of larger numbers of people.

You know, on the collapsing of 506(b) and (c), I mean, I absolutely agree with, you know, that it might seem like a more efficient way to get there, but at the same time it would also, you know, include us kind of making a recommendation that, you know, kind of towards I think what Jennifer had mentioned, you know, that we're going to allow people to go out and solicit investment from folks who, you know, are allegedly on the one hand, you know, willing to join a partnership with you, but on the other hand, you know, not willing to provide sort of a reasonably low level of information that you don't know and you didn't know them previously. So I just think that, you know, we should not underestimate the risks that, you know, maybe we as, you know, law-abiding citizens, you know, might not be doing, but that could potentially be there, you know, and why, you know, those sort of edge cases that have required that reasonable steps of validation to exist, but I think it could be interesting.

MR. DRAYTON III: Erica, just a quick question. When we talked about the education piece, do we actually talk about requiring verification that they took these classes or we simply have to point them to where the classes were?

MS. SETHI: We were pretty general in our recommendation, I believe. And Marcia should correct me. I think angel capitalization has met with the SEC about more specific --

MS. DAWOOD: That's correct.

MS. SETHI: -- recommendations, right, certifications.

MS. DAWOOD: Yeah.

MS. SETHI: But we left it up to the idea as the SEC could approve whatever the program is so they could have certain approved programs.

MR. DRAYTON III: Okay. Thank you.

MS. MINNIHAN: Yeah. And I mean -- I think, you know, it's such an interesting opportunity because, yeah, technically it's like, okay, if you took this class, you know, now you could just share the fact that you took this class and you don't have to divulge any personal financial information, but, you know, the question remains, like, are people even going to take the class. But it's -- I think it's a wonderful idea to have that as an option that allows you to, like, maintain privacy, but show that you've committed to, you know, informing yourself about all the risks.

MR. DRAYTON III: Well -- and I do agree with marrying this body of work with the work that we've done previously around education. That just seems to make sense. 'Cause if you decide to go to -- what you say? -- 25 million and a thousand, so now you're dropping the minimum point of entry to 25,000 versus I think 48,000, so that's going broaden to the pool.

MS. MINNIHAN: And that's just average, right. So --

MR. DRAYTON III: Yeah. Yeah. Yeah. That's right. Yeah. I just did the simple math on that one. Okay. Thank you.

MS. STANDIFER: When you talked about education previously, was it for, you know, all accredited investors? Was there a certain threshold? 'Cause I think one of the tensions with this, you know, does accredited equal sophistication in terms of investor protection? Where do we draw the line? Do we think the actual final metrics for accredited are perhaps on the low side that they're not signaling that sophistication and were concerned, you know, just current economics that that doesn't protect them. Whereas if someone is going to come in as an institutional, right, as equipped or your qualified purchasers that you're going to have in a 3C(7), we don't have those concerns because they're sitting on such a pile of money.

I mean -- so did you guys distinguish between that when you talked about education before?

MS. SETHI: We definitely talked about all those issues and how education is essentially a better measure for durability to be investing in these investments than just your net worth. And so, you know, we've -- we keep the -- some kind of accredited investor test that is wealth based, but then we also -- we recommended that there be also -- again, I think Stacey has put the recommendation in the chat, so if I misremember this, please check the documentation. But we said that you should also be able to use education and I believe we had it as education plus income net worth. I don't think we said just education, but you should definitely check 'cause it's been a little bit since we discussed it. And we are kind of looking at the crowdfunding ranges as sort of a basis since they're, you know, more

flexible than the standard accredited investor.
MS. MINNIHAN: Yeah. I think we had said, you know, that you could use the education to meet the task, but then within that we sort of recommended a sliding scale on, you know, how much of your income you can actually invest. So opening it up, you know, to people who have educated themselves, but maybe don't miss -- meet the traditional accredited investor test with a limit around how much the can deploy in any 12 rolling months.
MS. STANDIFER: Right. Right. So that was sort of an alternative to the financial metrics.
MS. SETHI: Yes.
MS. STANDIFER: And I have this here similar to what was with crowdfunding. I guess what I'm saying -- and this doesn't necessarily create more simplified regulation. But in fund context, let's say you have a thousand people, it's 25,000, you know, per check, you're able to get that through general solicitation, is there a pathway for this type of issuer creating that fund partnership that it still --

you can't -- you know, you still have to have those financial, like, metrics, but perhaps if there's some signal verification around sophistication or higher financial metrics, there's less hoops you have to jump through for verification. What I'm trying to find is, is there a middle ground between your 3C (7), right, where you have all your qualified purchasers, you can raise -- you can have as many LPs as you want on the cap table, as big a fund, right. You can have your billion dollar fund, right, versus what we are trying to talk about access the crowd. Is there a middle ground that allows the emerging manager to get the fund size that they need that still has tight investor protection?

MS. MINNIHAN: Yes. I think that's the 3(c)(1) exemption -- qualified venture fund exemption that we're talking about --

MS. STANDIFER: Right.

MS. MINNIHAN: -- and increasing that.

MS. STANDIFER: But also -- but also looking at your accredited investor threshold as part of that, right. Like, if you're going

to say you can do that, you know, you're going
to get there with the 506(c), right, and we're
concerned that some of the existing friction
points that, you know, I think Jennifer
articulated well with the 506(c), is there some
other threshold in there? Is there a regulatory
middle ground?

MS. MINNIHAN: Is there one something
that you're proposing so we could get a better
sense?

MS. STANDIFER: Well, I mean, it
would be -- I'm looking at your prior -- the
prior recommendation on leaving the financial
metrics as is. I think in that situation,
would you actually increase the financial
metrics of accredited investor, right? Like if
we're going to allow -- so what we're hearing
is, okay, we're going to allow -- we want go
out and have general solicitation to increase
access to the crowd, okay. Do we want to level
up the quality of the crowd that can invest and
when we think about that in terms of, you know,
financials and education. And I'm more raising
this because I'm -- I can, you know, see the
recommendation, but I don't necessarily have

all the discussion that came behind that
recommendation on accredited investor and
whether or not it was discussed kind of in this
context.
MS. MINNIHAN: Yeah. So I don't know
if the point of it was -- no. We were not
thinking about making it harder to qualify as
accredited investor. You know, I think we were
actually thinking about giving people more
pathways to qualify as an accredited investor,
you know, but I think, you know, here the
friction is just have you verified that they
really qualified as one or not or are we just
sort of letting them, you know, say? So kind
of counterpoints, but I think in a way that we
think, you know, protect both sides. But I
don't know.
Jasmine, do you have more detail on
what our kind of intention was there?
MS. SETHI: Yeah. I think that was
out intention, just to broaden accredited
investor access. I mean, I see what you're
trying to do here with this middle ground with
the really large funds with, you know, a lot of
sophisticated investors and something that's

more suitable for angels. And, I mean, I guess I'm wondering how much we really need. Like, I mean, I would let some of the angel investors -- investor group members in the room -- like, I thought the groups do the verification. Like, how much do we really have to worry about verification? I guess to me it seems like if we just raised the number of investors so we can lower the average size, doesn't that kind of broaden access pretty well? 'Cause we already -- verification is already kind of taken care of in those groups, but what am I missing?

MS. MINNIHAN: Yeah, agreed. I did want to just mention that we have about 3 minutes left. And, Courtney, do we still have a corum if we would like to potentially vote on anything?

MS. HASELEY: You do just barely have a corum, but you need a simple majority for, you know, a recommendation to pass. So that would be kind of total consensus on what is proposed alternatively you could propose something, it could be discussed, you could paper it, and the committee could discuss it again in February on the --

MS. MINNIHAN: Okay.

MS. HASELEY: -- broader membership.

MS. MINNIHAN: Okay. Sounds wonderful. You know, is there interest from the group? So I guess we're maybe going to think about some sort of a middle ground between 506(b) and (c) and, you know, see if there are some opportunities to minimize negatives signaling and I think perhaps in the interim we could really sort of do a little research on, you know, what exactly those negative signals are. And then 2, on 3(c)(1) qualifying venture fund number of owners and AUM do folks feel sort of good about the thousand, 25 million? Or, you now, is there a reason for another number? It does feel like, you know, a four times increase and doubling of AUM is pretty material, but, you know, if there are ideas on why we would go in a smaller or larger direction, I would love to hear that from the committee.

MS. DAWOOD: Actually, Erica, I think that's a really good thing because in a lot of the angel groups, and funds, and people I've talked to that, that $25,000 number is very approachable for people who especially first time investors. So that to me would be like a really good, sweet spot of -- and how we would say that the thousand and the 25 million make sense because over and over again I've heard that number from people. It's most like 50K is too much. 10K isn't really enough to care enough to, you know, be invested for 10 years and really, you know, follow it, and be apart, and, you know, get involved. But that $25,000 number I think is a really good place and so I think all the numbers make sense.

MR. DILLASHAW: Yeah. I'll just -- one sort of other point of clarification just to, you know, sort of reiterate one of the things at this point. With regard to those numbers, the 25 million, those would be statutory changes, so our recommendation for that would be focused more towards the legislators rather than the SEC. So I think that also gives us a little bit more freedom just to sort of try to put out to the ether, hey, increase it and then you can go through the legislative process as well. And then to that end, I -- you know, I would say that what we heard was 25 million was probably the minimum viable fund size. So if we're going to set sort of the threshold, probably want to recommend that it be higher than 25 just case if 25 sort seems like the minimum just to get the ease and cost structure the same.

MS. MINNIHAN: Well -- I mean, no. I mean, I think -- you know, here is the issue. I think 25 is -- you know, it's clearly not the minimum. 'Cause like, you know, Karen said her fund is 11, right. 25 is kind of like, you know, a good viable fund size. I mean, I think part of the reason that there is a limit on size is, you know, once you're pass 25, like, you have enough to be able to sort of support whatever regulatory expenses that you have. And the issue with making it bigger is like you probably want to keep it a target size where it's not going to be attractive to people who actually want to scam. Like, a $25 million fund is just not going to provide enough --

MR. DILLASHAW: Yeah.

MS. MINNIHAN: -- management fee or whatever to make it worth scamming people, so, you know, that's why I would not recommend, you know, limiting. And for an angel network, you know, a $25 million fund that you maybe raise every couple of years, I mean, that can have an incredible impact on a startup community.

MR. DILLASHAW: Yeah. So I should have been more careful with my language. My -- and part of this is also sort of reiterating the struggle that I see with emerging fund managers in particular, so take it outside of the angel group context which inherently does have a little bit more admin structure 'cause you normally have probably multiple fees, dues, you know, the ways to sort of offset it. But at least sort of regionally and in the -- under certain markets that I see -- like the biggest struggle that I see is these folks go out and try to raise $10 million funds. Like they're just -- that's not enough to give them a real shot at being a fund manager and so that's why I was sort of saying 25 is the minimum, but you're right, that's a much more broader description of it. So --

MS. MINNIHAN: By the way, love your painting.

MR. DILLASHAW: Thank you.
MS. STANDIFER: Yeah. I'm supportive of the qualifying venture fund exemption recommending going up to 25 with a thousand sort of beneficial owners for the LP base. I would like -- I'm not sure that that -- that then still creates the problem for emerging fund managers and how do they find a thousand people that are going to write the 25K check. I think that, you know, there's one -- on one hand you have angel groups that kind have this, but if you're a true emerging fund manager, you have the -- sort of the weak LP network. I think there's still discussions to be had of if that is approved that it's a 25 million limit and you can have up to a thousand beneficial owners, how do we increase the ability. How do we encourage emerging fund managers to actually go out and get those checks and LP's if they don't have it in their existing network.
MS. MINNIHAN: Yeah. I mean, listen; I agree with you. You know, I'm an emerging fund manager and that is my job, so that's their job. That's what they spend every day doing and, you know, that's just the work,

right. It's not meant to be super easy and it certainly isn't, but, you know, I think what we're just hoping to do is not, you know, create I think excessive regulatory burden on those folks. So -- but, yes, it's still going to be really difficult. Like, I feel like that's not something that we can regulate away, but it's a really great point.

All right. Wonderful. So we're a few minutes over. Courtney, Stacey, anything else that we need to cover before our administrative session?

MR. SUGINO: I have a comment.

MS. MINNIHAN: Yes.

MR. SUGINO: It's Dennis.

MS. MINNIHAN: Hi, Dennis.

MR. SUGINO: Hi. And so are we talking about deferring the vote then until February?

MS. MINNIHAN: Unfortunately I think a lot of people have dropped off, so it feels like --

MR. SUGINO: Okay.

MS. MINNIHAN: -- we might not want to vote on anything until we have more people.

And I think it will also be easier to vote on something when we're all together in person.

MR. SUGINO: Yeah. So the reason I mention that is because we might want to have some actual users chime in on their feelings about the subject.

MS. MINNIHAN: Yeah.

MR. SUGINO: I mean, some underrepresented fund managers have them give their views.

MS. MINNIHAN: Okay. I think that's a wonderful idea.

MR. SUGINO: Okay.

MS. MINNIHAN: And you're talking about people who've actually used 506(c) general solicitation to raise funds?

MR. SUGINO: Yes. (c) or (b), or (c) and (b), or --

MS. MINNIHAN: Okay. All right. Interesting. I mean, I -- it sounds like most people are using (b) and, you know, maybe what we're trying to figure out is are there ways to improve (c). So it feels like we're probably maybe less familiar with people that have used (c). I don't know what other folks think if --

it would be interesting to hear from somebody who did it.

MR. DRAYTON III: Yeah. Erica, I think it's more, you know, the legal team that we use. They're very familiar with (b). I think it's just lack of awareness of (c).

MS. MINNIHAN: Yeah. So maybe we can find somebody who used 506(c) and, you know, get a firsthand account. Yes? Would that be interesting? Okay. Wonderful. If anyone, you know, personally knows somebody, you know, please let us know and we'll put them in the pipeline. Thank you for that. That's a great idea.

MR. SUGINO: I can use Nancy Sims to find that someone.

MS. MINNIHAN: Okay. Great. All right. Wonderful. Well, thank you all for a really amazing discussion.

I think these topics are vitally important and, you know, we're excited to hopefully come away with a vote on a recommendation at our next meeting. I also want to thank all of our new committee members. You guys added so much wonderful context and thought to the discussion today. We can already tell the committee is vastly improved by your presence, so thank you. I would love to announce to everybody, including those on WebEx, that our next meeting is scheduled for February 25th, so I certainly hope that you'll join us then as well and hear the continuing conversation. And I hereby move to adjourn the meeting.

MS. BOWERS: Thanks, Erica.

And then I'll just tack on and remind everyone there's a different link to come to the executive session.

MS. MINNIHAN: All right. See you at the executive session. And we're starting that at 12:45?

MS. BOWERS: Correct.

MS. MINNIHAN: Okay. See you soon. Thank you.

(Thereupon, the meeting was adjourned at 12:37 p.m.)

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PROOFREADER'S CERTIFICATE

In The Matter of: SMALL BUSINESS ADVISORY COMMITTEE MEETING

File Number: OS-0001

Date: Wednesday, November 13th, 2024

Location: Washington, D.C.

This is to certify that I, Kyleigh McGinnis, (the undersigned), do hereby swear and affirm that the attached proceedings before the U.S. Securities and Exchange Commission were held according to the record and that this is the original, complete, true and accurate transcript that has been compared to the reporting or recording accomplished at the hearing.

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Kyleigh McGinnis (Date)

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I, SHAUNNA H. MORAN, a Certified Shorthand Reporter and Registered Professional Reporter in the States of New Jersey, New York and The District of Columbia, and Notary Public of the State of New Jersey, do hereby certify that the foregoing is a true and accurate transcript of the testimony as taken stenographically by and before me at the time, place and on the date hereinbefore set forth.

I DO FURTHER CERTIFY that I am neither a relative nor employee nor attorney nor counsel of any of the parties to this action, and that I am neither a relative nor employee of such attorney or counsel, and that I am not financially interested in the action.

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I, Caretha Wisdom, Professional Court Reporter and Notary Public in and for the State of Florida at Large, do hereby certify that I was authorized to and did report said hearing in stenotype; and that the foregoing pages are a true and correct transcription to the best of my ability of my shorthand notes of said hearing.

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