U.S. SECURITIES AND EXCHANGE COMMISSION

SMALL BUSINESS CAPITAL FORMATION ADVISORY COMMITTEE MEETING

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U.S. Securities and Exchange Commission

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

PARTICIPANTS:

SEC Staff from the Office of the Advocate for Small Business Capital Formation

Stacey Bowers
Julie Davis
Courtney Haseley

Committee Members
Wemimo Abbey
Donnel Baird
George Cook
Vincent Cordero
Marcia Dawood
Greg Dean
Bailey Devries
Bart Dillashaw
Herbert Drayton III
Erica Duignan
Diego Mariscal
Davyeon Ross
Jasmin Sethi
Aren Sharifi
Marc Oorloff Sharma
Dennis R. Sugino
Sue Washer

PARTICIPANTS (Cont.):

Presenters

Valerie Szczepanik, Director of the SEC's Office of Strategic Hub for Innovation and Financial Technology (FinHub)

P R O C E E D I N G S

MS. DUIGNAN: Okay, it's 1:16 p.m. and I think we're ready to reconvene the meeting. All right, good afternoon and welcome back to everyone who is joining virtually and on the SEC webcast. This afternoon's agenda continues to focus on avenues for small business capital raising with a focus on the private markets. Angel investors, generally high net worth individuals who invest their own money directly into a business typically in the early stages, remain a significant source of early stage capital but deal volume and deal size have both dropped.

This topic certainly links to topics raised in prior committee meetings where we've recently focused on the accredited investor definition because most angel investors are accredited investors. The good news is that many of our committee members have raised money from angels, are angel investors or lead angel groups, so I think it's important that we're having this conversation and I hope it will include discussion of ways the SEC and our regulatory framework can further support angel groups and encourage angel funding in early-stage companies.

Another thing that we'd like to continue to discuss this afternoon is formalizing potentially a recommendation from our conversation this afternoon on Reg CF. So we will take a few minutes before we dive into angel investing after we hear from Valerie to see if we can come up with a formal recommendation and then thoughts for further recommendations after our next meeting.

So before we dive into those discussions we thought it would be helpful for the committee to continue hearing from SEC staff from across different divisions and offices of the agency to broaden the committee’s collective understanding of how the SEC goes about executing its mission.

Today we’re pleased to be joined by Valerie Szczepanik, director of the SEC’s Office of Strategic Hub for Innovation and Financial Technology, FinHub. We’re excited to learn about the role of FinHub and how it supports the SEC’s mission. In particular, I think many of us are looking forward to hearing Valerie’s synopsis of the regulatory landscape for crypto and token offerings, an area we hear a lot about both in the news and professionally.

It’s a fast-changing and ever-evolving landscape and we’d love to hear your experience. So, Valerie, we appreciate your willingness to join us today. Thank you.

MS. SZCZEPANIK: Thank you. And it’s a real privilege to be able to speak with you and address the group today. I apologize I’m not there in person and appreciate the opportunity to appear virtually with you. So I am the director of the Strategic Hub for Innovation and Financial Technology here at the SEC.

We are an office that really got started in 2018, in response to a number of areas of emerging technology and we saw you know pockets of communication across the commission and at that time felt -- you know the commission felt that these should be consolidated and we should have a centralized kind of hub to address emerging technology issues as they were coming up across the commission.

And so we were set up in 2018 originally as part of the Division of Corporation Finance but we spun off into our own office in 2020, late 2020.

So since then we are a hub and spoke model. We have eight member of the core hub, I would say, in FinHub and that includes me, a deputy, a senior strategic advisor. We have a couple of attorneys but we have some technologists as well on the team, computer scientists, financial analysts and researchers. So we have eight people and then we have our spokes, which are the divisions and offices around the commission that each delegate someone to communicate with the FinHub and through the FinHub, and so therefore we can kind of cultivate knowledge and learning and what we need to onboard and then we can kind of send it into the divisions and offices as necessary and deal with the subject matter experts there as well.

We cover a number of technologies mainly crypto assets, digital assets and blockchain technology or DLT, distributed ledger. Also our official intelligence machine learning, robo-advising, online marketplace lending and then a number of other kind of ancillary technologies that are coming down the pipe like quantum computing and privacy-enhancing technologies, things that we want to keep our eye on. So I think I would best describe our office as we have an internal-facing function and we have an external-facing function and internally we are meant to be kind of an earpiece to what's happening outside. We want to do some horizon scanning to make sure that we know what emerging technologies are coming across the horizon and may impact the work of the commission. And so we want the commission to be prepared across the board for these emerging technologies and how they might touch upon the various divisions and offices and activities that happen at the commission.

And so we are onboarding tools, technology, data and sometimes building special skills whether that’s in-house or whether we seek to get some specialized skills from outside. So we want to get the commission prepared on all these technologies and then internally we serve as subject matter experts to various things that are happening across the commission whether it’s an examination or rulemaking or an enforcement action or something kind of bespoke that somebody is working on they may come to our team and say, tell us how this blockchain works or how this smart contract works, what is the technology here and how do we understand it in a way that we can do our work.

And then we have an outward-facing function. So we liaise with a number of market participants. We are meant to be kind of an earpiece and a mouthpiece at the same time, so we want to hear from people about regulatory challenges that they have or any pain points that they’re experiencing as they are innovating and we want to encourage responsible innovation. So we want people out there in the industry that are innovating to understand that there are guardrails, that there are laws and rules that apply. And, you know, as you probably know when you're in the financial industry and you're handling people's assets there are pretty stringent frameworks in place for good reason and so we want people to have a place where they can come to the commission, get the right staff in the room very quickly to talk about you know kind of their projects and how we see the federal securities laws and how they you know may want to -- you know we may want to flag issues for them. We can't act as their counsel of course. We can't give legal advice but we can always tell people -- issue spotting or we would recommend that you talk to securities counsel or recommend that you would talk to a different agency, another agency like FinCEN or CFTC or some of our sibling agencies that might be dealing with the same kinds of topics.

And we also get engaged a lot in the domestic work, so if there is sometimes projects going on inter-government like the executive order involving crypto assets or digital assets we got involved with helping the staff respond to a bunch of requirements under that. And then we do get involved in representing the staff on various international work streams, so we do a lot of work with the Financial Stability Board, which has a crypto asset working group. It also looks at policy issues around global stable coins. It’s looking at you know tokenization, those kinds of issues from the financial stability standpoint and then we get involved quite a bit with IOSCO, the International Organization of Securities Commissions, as they do work.

So there was a FinTech task force set up in 2022, I believe, and that task force initially was set up to look at crypto asset issues and we put out two sets of recommendations last year. We delivered upon our promise to deliver high-level recommendations that cover market regulation, standards and principles over crypto asset markets and also over DeFi. So my staff led the work on the DeFi report which we put out in final form last December. And there is ongoing work through IOSCO. This year we’re going to be taking on the lead for work around artificial intelligence in the financial products and services and looking at some of the issues around emerging innovations and technologies in artificial intelligence.

So just in a nutshell they asked me kind of to cover crypto and AI real quickly and I’m looking at the time because I want to leave it open for questions. In the crypto asset space the commission has pretty much steadfastly taken the position that any particular crypto asset you have to analyze the facts and the circumstances around the transaction involving the crypto asset to determine whether or not it involves -- a security and if it does the entire panoply of the securities laws will apply to that transaction and to participants around that transaction and activities happening with that crypto asset. So there could be implications for the federal securities laws involving an offering of a crypto asset that you know an offering, as you probably know, has to either be registered, exempt from registration or otherwise it’s illegal and that guarantees investors very, very important disclosures around their investment.

And then you’ve got the intermediaries so if there are intermediaries that are carrying on certain activities like broker-dealer activities, exchange activities, investment advisor activities they may be doing things with crypto assets that are securities that would require them to register appropriately and become subject to our examination, inspection and oversight authority. And then I would say you know we have brought a lot of enforcement actions in this area and they kind of run the gamut around any kind of misconduct that you would see in the securities area, the same kind of thing applies to crypto asset securities. So we’ve brought cases involving unregistered offerings, fraud in connection with an offering, unregistered entities like broker-dealers or investment advisors and those kinds of things. We also brought a number of anti-touting violations. So this is when someone is touting you know about a security but they’re getting paid to do so but they’re not disclosing that they’re getting paid. So we have brought a number of actions against some pretty high-level celebrities in this regard.

We’ve also done a lot to put out information from an educational standpoint to try to educate the public about kind of the risks of crypto asset markets and we continue to press forward. We are keeping our eye on there is a lot of talk around tokenization, so you know it's good to remind people that you know even if you put a security on a blockchain it’s still a security and securities laws apply. So there are lots of issues that we’re debating internally and with the international community over you know tokenization and issues that come up around that.

And then in the artificial intelligence area again just like crypto assets we are a technology-neutral regulator. So we really look at the substance and the economics of the activity that’s being done and if it involves a security we regulate it. If somebody uses blockchain to transfer something you know it doesn’t remove it from the federal securities laws and if someone uses artificial intelligence as a tool involving some you know securities markets we still have our laws. So we’re going to try to be technology neutral. There is a number of work streams as I mentioned internationally going on to kind of take a stock-take about what’s going on in AI, especially with the innovations in the past few years and then to you know determine whether and how we should look at emerging technologies there. So let me pause. I think I’ve been going for about 10 minutes. I want to see if there’s any questions or if folks have another topic that they want me to cover.

MS. DUIGNAN: Thank you. Yeah, I have a couple of questions. For one you know I would love to get a sense of what is going on kind of within the you know ICO tokenization market if that’s something that people have kind of lost interest in and then or if it’s still happening. And then, number two, FinHub’s perspective on DAOs, decentralized autonomous organizations, and sort of the fact that people are putting companies out there and raising capital and sort of saying no one is in charge so how do we regulate that.

MS. SZCZEPANIK: Both good questions. You know I think the ICO craze really occurred you know in the 2016/2017/2018 era. We put out -- the commission put out the DAO report back then and this was a report looking at one particular ICO called the DAO and explaining how the federal securities laws apply to such an offering and how we would analyze it. After that the commission staff put out a framework for analyzing ICOs and different questions you would ask under the Howey test. I think since then it’s hard to say you know I hope that there’s education out there that people know that just because you’re offering something using blockchain technology does not mean that you don’t have to comply with the federal securities laws. As I mentioned if it’s an offering to the public in the U.S. or into the U.S., you know it needs to either be registered or exempt or it’s illegal. So hopefully, people have gotten that message on the IPO front.

I think on the DAO situation there are people -- we talk a lot about this in the DeFi report that we put out last year. We put out a consultation report where we had a number of folks commenting from the public and then that turned into a final report of recommendations. You know from my personal perspective and I guess I could have started this whole thing by saying this is really my personal views and not -- as the director of FinHub and not necessarily reflective of the commission or any commissioner or other staff member but what I see is that claims of decentralization are largely overblown. Most, if not all, of the projects that I've examined in the so-called DeFi space are actually run by a person or small group of persons or persons acting kind of together.

I think what you see is -- you know I like to analogize to think about what we all were in the days of COVID and we were you know logged in from all over different parts of the country or world but we were still an organization. We were still working together. There was still a structured decision-making coming down from kind of the top. And I think what you see in the so-called DeFi space is that people are using different technology to communicate. Instead of meeting in a boardroom or a building they may be meeting on Zoom calls or coordinating through you know Discord or Slack channels. They may be issuing crypto assets instead of issuing stock to raise money. They may be you know voting through a DAO as opposed to voting shares but many of the activities that you're seeing have analogies to what we see in traditional markets and I say you know just because people have found different ways to organize and communicate doesn't mean that they're you know decentralized. They could be distributed across geographies but they're still pretty much from what I've seen centralized in making decisions.

If people choose to organize as a DAO you know as opposed to you know incorporating as a legal corporation somewhere or an LLC, you know, that's their choice. There have been some enforcement cases brought charging DAOs both by the CFTC and the SEC. So again I think it could be a new form of organization but it's still people and we're going to look at if humans are providing financial products and services we're going to look at the facts of each situation and figure out is there a financial product or service being offered and do we regulate it. We apply the same regulation to the same activity and you know finding who is regulatory responsible may be a challenge in some cases but you know there is always a human behind what's happening.

MS. DUIGNAN: Thank you.

MS. SZCZEPANIK: That's my own perspective but I can't speak for others here at the commission.

MS. DUIGNAN: Thanks. Bart, did you have a question?

MR. DILLASHAW: Yeah. I have just a -- maybe just a general one. Of the either crypto or token projects that you're seeing do you have a rough sort of idea of how many of them are being classified as securities versus something else? I'm just sort of curious if there is sort of a consensus in the market you know forming on how to address this stuff or not.

MS. SZCZEPANIK: Yeah. I think, I would say that for people who are claiming to be engaging in tokenization projects the ones I've seen have been -- you know these are more -- they tend to be more traditional players who are seeking to experiment around putting things on blockchains to see if there are efficiencies to be gained through a different plumbing, a different set of pipes that you're using for you know issuance and transfers. I think that those projects tend to -- they don't back away from being a security, necessarily. So we've seen bond issuances. We've seen people want to tokenize money market shares, money market fund shares. That's happening and you can you know read about in the press which ones are out there and public.

And I think institutions are experimenting with that to see can they bring on market efficiencies and reduce cost and you know get other benefits from that. So those market participants don't seem to be claiming you know that these aren't securities and many you know work with the regulators to make sure that you know they're informing the regulators at every step of the way what they're doing and they may you know seek to get some engagement with the regulators. I think on the other end of the spectrum you've got folks who are market participants who want to twist themselves all in which way to avoid being called a security. So even though you know the duck test, you know if it smells like a duck and quacks like a duck it's a duck they want to put a hat on it and say you know it's not a duck, it's something else you know a dog or something like that.

So I think there are a number of players who want to avoid having to comply with the securities laws. They want things to issue and trade in kind of unmarked, unregulated spaces or spaces that evade regulation I should say. And so there's a number that try to say that they're not engaging in capital raising or financial transactions.

MS. DUIGNAN: Thank you.

MS. SZCZEPANIK: But I would say that the tokenization you know as that term is generally used I see a lot of kind of known financial institutions experimenting with it, rolling out proofs of concept or actually commercializing new products to see if there are efficiencies there.

MS. DUIGNAN: Bailey?

MS. DEVRIES: Yes. Thank you. It’s wonderful to learn about your office. I actually wanted to pivot and talk a little bit about -- I had a few questions for you. So I think back to the introduction of robo-advisors and many of the considerations there from a fiduciary perspective but would love to hear more about how you’re thinking about AI in the context of financial advice.

MS. SZCZEPANIK: So I’m somewhat constrained because we have a rulemaking out there. It’s the predictive analytics rule. It doesn’t specifically only apply to AI but it applies to technology that would encompass AI and so there’s a proposed rulemaking out there from the commission that essentially says that if an investment advisor or a broker-dealer are using this predictive data analytics technology, it’s called covered technology, it’s defined in the proposed rule then they have to take steps to eliminate or neutralize any conflicts of interest created through the use of that technology. And I think that’s a really interesting you know rule that talks about -- really it’s focusing not on the technology itself per se but on the conflicts of interest that can arise both in terms of the fiduciary obligations of an investment advisor and then the broker-dealer you know suitability issue.

So I think that because that rule is out there I can’t really comment on it except to say that it’s out there and that we’ve received comments and they’re being considered by the staff and the commission. And so just from my own work that we’re doing at IOSCO we’re trying to look at how these technologies are being used and are contemplated being used and we’re going to look at a spectrum of risk. So there’s some micro risks which is you know how could this impact the individual investor that’s being given services using AI or how can this impact the individual firm that’s using the AI, what kind of you know micro risks I would call it could be there from for example vices that are inherent in the data or mismatch of the models fitting what you’re trying to do with it or a disclosure problem about what the model actually does and what it’s capable of and what the investor thinks it does.

So those are kind of micro risks and then on the other end of the spectrum are these macro risks and this is something that the chair has talked about as well is that as these technologies become more broadly used and we have concentrations among product service providers or data sets or models, do those concentrations create any kind of ill effects to the market? So would it create a hurting effect for example if a lot of people are using the same model to do something or would it create a cascading effect if inputs from these models are all interconnected in ways that we don’t see yet. So I think these are the kinds of risks that we’re going to explore along the whole spectrum through our work there.

MS. DUIGNAN: Diego?

MS. SZCZEPANIK: I don’t know if I answered your question but I hope I did.

MS. DUIGNAN: No, that was great. Thank you so much.

MR. MARISCAL: Well, yeah, thank you for your presentation. It was really informative to learn more about your office. My question is around a lot of our discussion this morning but more broadly as a committee has been focused around supporting underrepresented founders and thinking about systematic approaches that we can take to be more supportive towards various communities. And so I'm wondering from where you sit both in artificial intelligence but also tokenization technology do you see those advancements playing a significant role in excluding -- in including or excluding minority communities and can you talk about sort of the challenges or opportunities in both of those scenarios? Thank you.

MS. SZCZEPANIK: Yeah. I think it's a great question and I think people who are true believers in technology you know I think they do say well this can increase financial inclusion because it can kind of level the playing field and create new ways for investors to interact with the market and to get information and to trade. I think as long as technology is developed in a responsible way it can achieve these benefits. I think unfortunately in what we've seen in the crypto space is there is a lot of bad actors and unfortunately they can drown out the good actors but we have seen you know instances of affinity frauds, frauds where they're targeting specifically communities that feel underserved as a way of bringing them into a fraudulent scheme. So that's you know I think unfortunately we do see that and I think with AI you'll see the same thing.

You know whenever you have a new technology you're going to have a lot of hype. You're going to have bad actors who are going to play upon that and then target vulnerable communities. There is a huge problem in the crypto space dealing with romance confidence scams. They have a terrible name for it called pig butchering which I don't like to use but that is how the scammers refer to it but you know they're preying upon vulnerable communities.

MR. MARISCAL: Right.

MS. SZCZEPANIK: And I think that you know we have to be vigilant and look out for that but at the same time if we can encourage responsible innovation with appropriate guardrails then we can create those pathways for inclusion.

MR. MARISCAL: Just as a quick follow up to that I'm wondering is there anything that you see as we continue to discuss possible recommendations as a committee is there any sort of recommendation or action that you would see that this committee could put forward that could address some of the challenges you mentioned?

MS. SZCZEPANIK: Wow. You know just off the top of my head I think education is a big thing. I think getting the message out there providing education for investors so that they understand the risks involved and they can separate myth from reality and they can kind of learn how to do their own homework and empower them to you know really understand a market before they delve into it. If you can help that happen and increase kind of -- that kind of financial literacy and understanding I think that would be -- go a long way.

MR. MARISCAL: Thank you.

UNKNOWN SPEAKER: One sort of follow up question to that now that we're a little bit longer into the hype cycle for crypto have you seen anything in the market that you think is sort of particularly innovative in terms of doing things to limit the propensity for fraud or you know bad actors generally, you know if there is anything out there that you sort of have seen that seems to be effective in mitigating that I'd be curious.

MS. SZCZEPANIK: Yeah. I think that -- I have always said that the technology has a lot of potential to actually embed compliance and features that would protect people right into the technology.

I mean one of the cool things about a crypto asset is it's a programmable, so you know you can create rules and features wrapped around the asset itself that would help improve compliance and reduce you know fraud. So I'd like to encourage folks to use the technology itself. There's a lot of work being done around you know digital identity or technologies that promote AML/CFT that I think could be you know focused on a little bit more. People want to move fast. They want to make money but you know I think the projects that will have the longevity and the real breakthroughs will happen when people figure out how to build these things you know to be compliant from the get-go.

MS. DUIGNAN: Herbert.

MR. DRAYTON: Hi, Valerie. I looked at the website and I couldn't find anything but you mentioned Quantum as a part of your presentation. Can you tell me what body of work is being done around Quantum?

MS. SZCZEPANIK: Yeah. I mean, I think you known we're always kind of keeping our eye on it and seeing right now I think you know cybersecurity folks are focusing on it quite a bit and there are other folks at the commission outside the FinHub. We are looking at it kind of scanning the horizon and seeing how it might impact things and raising things but I think it's very preliminary. Quantum always seems -- every time I've heard about it people say it's 10 years away and I've been hearing that for a long time and I know that you know pretty big breakthroughs are being done but you know right now it's surely in a theoretical phase in certain ways but it's also thinking about how to prepare and prepare data privacy and protections.

MS. DUIGNAN: Great. Any other questions? All right. Well thank you so much, Valerie. This was incredibly helpful and we appreciate your time and the opportunity to get to know you and your office a little bit better. We are certainly hoping to be inspired to potentially come up with some recommendations on crypto or token offerings in the near term, so thank you for that.

MS. SZCZEPANIK: My pleasure. Thanks for having me. Enjoy the rest of the day.

MS. DUIGNAN: Thank you. All right, so before we jump into our discussion on the angel investor market and potential ideas for recommendations there we did feel like we made sufficient progress earlier today to potentially make a bit of a recommendation on at least one area of the

Reg CF rules that we thought we had consensus on. So I would love to maybe by show of hands to see who here would potentially be interested in recommending that the commission increase the offering threshold under Reg CF from $125,000 to some other larger level if you’re in favor. Okay, it looks like -- oh, sorry. I think that was everybody, maybe not Greg. Okay, sorry, nearly everybody. Okay. All right, great.

And so you know I think in order for us to come to a number that makes sense we have a few different options. So you know one is that I believe that what we learned in the earlier meeting was that perhaps during the pandemic it was increased to $250,000 so we have precedent that we could just go to $250,000. You know another kind of interesting way to look at it is to you know since the additional requirement is for reviewed financials to make sure that the cost of the reviewed financials is some reasonable percentage of the limit. So does anyone here, probably George, have a good sense of what the annual cost of reviewed financials is for a start up?

MR. COOK: Yeah. For an operating business even a startup you know if you think about a startup as less than three years old it can be -- we’ve seen an average of about $5,000 up to $10,000 for reviewed financials. For a pure startup entity with no operating history it still typically costs about $2,500.

MS. DUIGNAN: Okay. All right, so go ahead.

MS. WASHER: I would say I would prefer if we're going to do this kind of methodology, which is I think is great, that we look at what are the all-in costs to raising that chunk of money, not just the financials because I think we learned earlier today that there were other costs associated.

MS. DUIGNAN: Yeah. So, I mean, I definitely agree with that but you know our recommendation wouldn't necessarily be affecting any of those costs. So you know we can definitely look at both but you know the recommendation is specifically on whether or not we require the reviewed financial statements. So I think just getting a sense of like incrementally how much that's adding out of the total raise. So using George's number, a median of $5,000 depending on the size of the company, at the current level that would be sort of an annual additional cost of four percent of your total money raised, which seems like a pretty heavy tax to have an additional four percent of the total just go out the window. At $250,000 it would be a marginal two percent per year.

So given that okay you know you’ll basically have to spend two percent of that minimum level per year on the increased expense does that number still make sense. Would you want to go lower or would you want to go higher? How do people feel?

MR. MARISCAL: So I would recommend and I mean this is something for us to potentially continue to talk about but last time we -- the last recommendation if I recall we opted for trying to be more generic and less specific so that the recommendation could go through and we didn’t get too much into the weeds. And so I think potentially the way that this recommendation could be structured is we could say whereas there has been a precedent of raising the minimum to 250, COVID, whereas we saw an increase of participation in such and such way we recommend that the minimum is raised to -- and we perhaps don’t even have to mention an amount, right. I think that we could point to those things to consider, right. An important point of consideration would be the percentage amount that companies are spending in such and such accounting you know financials but I think if we are able to potentially keep it broad it would have more chances of being considered. I’m just pointing to the fact that that was a point of discussion we had last -- when we last made a recommendation.

MS. DUIGNAN: Okay, thank you. Vincent?

MR. CORDERO: I would actually recommend we come up with a number just to keep it clean and simple. I think it’s -- but two questions. One is one to George if -- you know I would love to hear you know with a blank slate what would be his recommendation and then separately a question to how did they get to the 250 during COVID? Like what was the rationale? So one is you know how did they -- what was the rationale behind 250 during COVID and then separately put that aside if -- I would love to hear what George’s recommendation would be just with a blank slate.

MS. DUIGNAN: Stacey, do you know why it was 250?

MS. BOWERS: No.

MS. DUIGNAN: No? Okay, all right.

MR. COOK: I think as we’ve just discussed there is a strong precedent for 250. I think 250 makes a lot of sense. There is conversation around 500. I don’t have a strong opinion there. I think the data that Dr. Chang shared earlier I think the median is about 300 right now being raised on Reg CF.

So there's quite a few that are raising above that 250 threshold that would be impacted. So you know it is -- I think a case could be made for 500. I think a stronger case could be made for 250.

MS. DUIGNAN: Okay, I love that. You know maybe we should look at Dr. Chang's data and then you know I personally think using something that's an approximation of the median might actually be kind of a fair number. Let's see, I think I have her deck open here somewhere actually.

MS. WASHER: Yeah. Erica, I think that's a really good idea because then we have some data, a presentation made by an expert that has told us this is a number.

MS. DUIGNAN: Yeah.

MS. WASHER: It's not just -- I mean, I hesitate to guess but they probably just doubled -- to get 50.

MS. DUIGNAN: I think you're right. That calculus comes in handy.

MS. WASHER: But having a presentation that says the median is 300, I think that would be very supportive of our recommendations.

MS. DUIGNAN: Yeah, absolutely. Okay, so actually the -- in 2022, the average raised was 364 about and the median was 115. So you know that means that, yeah, there's a lot of people who are on the smaller side who probably don't want to have to deal --

MR. CORDERO: But it could be a result of something you said, George, which is they don't want to raise over a given amount. So in a sense it becomes --

MS. DUIGNAN: So maybe we -- you know maybe we recommend like 350, you know a little bit closer to the median.

MS. WASHER: Yeah. And the average overall was -- yeah, the average over all years was 336. So 350 seems like a number that's supported by the data meaning that a lot of the people that will benefit and then the people that really want to push above they'll have to comply with some reviewed financials.

MS. DUIGNAN: Yeah.

MS. WASHER: I like that.

MS. DUIGNAN: Okay. And I think it also -- you know it feels like a number that is enough to kind of justify the additional cost of their reviewed financials. So, okay, yes.

MR. DILLASHAW: Just one other data point you know is some of the alternatives to some of the other exemptions when you look to the in-state exemptions and 504, which are in the overall offering landscape or sort of the other ones out there that practitioners look at. Those are all dictated at the state level but the states often have financial requirements that kick in at higher numbers at you know I've seen everything from $500,000 to a million. So there is some precedent out there in terms of the other offering exemptions that are at higher levels for whatever that data point is worth and again a lot of variability state to state but that's out there.

MR. COOK: Well what's your perspective, Bart, I mean if we're talking about it?

MR. DILLASHAW: You know, 500 sounds right to me but that's --

MS. DUIGNAN: I feel like that's a big jump from where we are is the only issue.

MR. DILLASHAW: Yeah. So I agree. I mean, I'm going to defer to George way more than me but kind of like 500 seems good because that's going to be the -- you know that's going to allow the vast majority of folks to raise at that round without putting an additional burden on them but like do what George says, not me.

MS. DUIGNAN: All right. Any other thoughts or sort of dissenting opinions and we can see if we can get to a number that people feel comfortable with. Sue?

MS. WASHER: Yeah. I feel really comfortable with 330 or 350, because we have that presentation that we all listened to and it's on the record and it feels like it's a reasonable jump.

MS. DUIGNAN: Yeah.

MS. WASHER: I think to be able to -- I also knee-jerk would pick 500, to be honest, but I think we would need to have more data. It would be great to have data for the time period where it was raised, what happened and then if we had more data we should come back and say, hey, well based on the data of the people that raised more money maybe we could raise it again but I think for right now going to the 350 with this you know the guardrails we have makes sense.

MS. DUIGNAN: Yeah. And I think the point here isn't to eliminate the requirement. The point is to eliminate the requirement in cases where it's financially onerous and I think if you've raised over $350,000 you can definitely afford to pay -- you should absolutely be affording a CPA to pay $5,000 a year to review your financials. I mean that's you know a substantial amount of investor money which is the only reason why I would you know not recommend going so high because then it's sort of making it seem like well this isn't even like an important thing to do.

MS. WASHER: I agree.

MR. DEAN: You could start with the 350 and then require a review process by the commission staff after a two-year period of time as to whether or not they should raise it or not. That way you get an automatic review and they can determine based upon the higher threshold.

MS. DUIGNAN: Okay, wonderful. So let's I guess put this to a vote. I'm going to sort of read the recommendation without trying to sort of include what Greg said but maybe you can email that after or re-state it and we'll make sure Jasmin writes down the specific language that you want to use on the caveat for the next two years.

MR. DEAN: Yeah. I'm happy to work on language after that.

MS. DUIGNAN: Okay, great.

MR. DEAN: It's just a ballpark of requiring a commission review after a two-year period of time after effectiveness.

MS. DUIGNAN: Okay, wonderful. All right, so we'd like to vote.

SPEAKER UNKNOWN: But that review is not the review of the escalation to the proposed 350, but a review of further escalation should be put in place at that time.

MR. DEAN: Correct.

MS. WASHER: Two years from now further escalation.

MR. DEAN: Yeah, after.

MS. DUIGNAN: Okay. So we'd like to vote to recommend that the commission increase the offering threshold under Regulation Crowdfunding from $124,000 to $350,000 the level at which reviewed financial statements are required so that companies offering less than $350,000 of securities and reliance on Regulation Crowdfunding within a 12-month period are permitted to use certified financial statements and certain tax return information for the fundraise. All in favor? All opposed? Okay. Any abstentions? Okay, all right. It looks like we have approved a recommendation. Aren, yes, provide your dissenting opinion.

MR. SHARIFI: Yeah. So I just haven't seen any data on the 350. I mean, I understand we picked that number because it was the average but it wasn't the median. So that's where I'm dissenting is the number I'm not sure if I agree with it and I just don't have any data on what happened when we raised 250 if it was -- did it actually help companies? Did it help it or did it hurt us? I don't know. So without knowing and having more details there I would like to withhold my vote.

MS. DUIGNAN: Well one thing you can see is you know if you do look at table one, which is page three I think of the report that she gave us, you can see that it appears that the median amount raised increased when the threshold was lifted and it looks like it went back down after the threshold was then decreased.

MR. SHARIFI: Yeah. I have no doubt that the amount raised would increase. I'm talking about the success of the businesses like were more businesses successful by raising that amount, by having more access to capital? Is there a direct correlation to raising more capital and not having reviewed financials.

MR. ROSS: I don't think that that's in here.

MS. DUIGNAN: We're not going to have that.

MR. SHARIFI: Yeah, we're not going to have that data.

MS. DUIGNAN: We’re not going to have data on that.

MR. SHARIFI: Yeah.

MR. ROSS: But there is some interesting stuff here too, right, like during that time period where it was around the 425K, 78 percent of it was funded which says a lot and then you know if you think through historical years it was 70, 65, 61 and 62. So I do think that there is some direction that would you know lean to the number that we’re suggesting. However, I’m trying to think through the 2021 timeframe in regards to where you know the amount raised in total was its highest and I’m wondering if they had something to do with you know 2020 and George Floyd and everything happening there, so but there is some inclination here, definitely not what you were asking about specifically but there is some data.

MR. SHARIFI: Yeah. And that’s it I just don’t have the data available to say 350 makes sense or you know 250 and that’s why I’m -- I guess mine is more of an abstention than a dissent.

MS. DUIGNAN: Okay, all right. Wonderful. Thank you, Aren. Okay, great. So we are running pretty well on time or actually not. We were supposed to start this at 1:30 p.m. Okay, so but we do have a little bit less than an hour for our afternoon topic. I'm really pleased to now turn to the discussion of the state of angel investing. Angel investors play a critical role for early stage founders particularly supporting those who may not have access to capital from friends and family. Within this committee we have a wealth of knowledge and experience regarding angel investing. Many of us have received angel investments to kick start our small businesses. Others of us are or have been angel investors, members of angel groups and/or advisers to angel investors or leaders of angel groups. I'd like for us to explore how angel investors make their decisions, their views on investment risk and consider whether there are ways to encourage more angel investment activity as well as to get a sense for the state of the market, changes and trends in angel investment.

So to help ground our discussion in data, we are going to take a few minutes for Julie Davis from the SEC's Office of the Advocate for Small Business Capital Formation to provide a brief overview of angel investor activity as reflected in the office's 2003 (sic) fiscal year annual report which includes in-depth data on the state of capital-raising activity.

Thank you, Julie.

MS. DAVIS: Of course. So seeing how much you all love data we thought we would just quickly show some of the data from our office's annual report on angel investing. I don't know if you can see this or if the numbers are big enough but we have a whole page on page eight with just stats on angel investing and a lot of this data comes from the Center for Venture Research at the center of -- University of New Hampshire there is a professor there, Jeff Sohl, who is the expert on you know angel data. He does a report every year. So the numbers that we have are from 2022. That's the most recent. That was what was in our report and we haven't seen those 2023 numbers yet but in 2022, there were about 368,000 active angel investors and those investors invested in about 62,000 entrepreneurial ventures for a total of $22.3 billion in total angel investment, which compared to the dollars we've been talking about is quite large but also that $22 billion was a decrease of almost 24 percent from the prior year, which 2021 was a boom year for a lot of types of investments.

So both the dollar numbers had gone down from 2021 as well as the number of companies funded but I think interestingly that the number of active angels actually went up a little bit between 2021 and 2022. So you do see more people -- you know it was a slight increase, a 1.2 percent increase but it did go up. Another interesting stat just to through into the mix for your discussion is that first-time CEOs constituted 73 percent of the entrepreneurs funded by angel deals. So these are very -- these are risky investments that folks you know recognize that. I mean you see 17.7 deals on average per angel group. So folks are recognizing the need to diversify and they are investing in those early-stage founders.

So just quickly moving through because I know you don’t have a ton of time here left but I wanted to just show the map here of where angel investor -- they’re investing in their regions and this has been the case for a long time you know but we do see a shift where like for example you can see in the northwest even where there was the highest percentage in 2022 of folks -- of angels investing in their region, it was 80 percent, that was down from 95 percent the prior year. So you are seeing I think we’ve talked about this a little bit and a few other folks have mentioned this today that trend where more are invested -- they’re still predominantly investing in their own regions but more are taking a look outside their region for investments.

Real quick since this is always an area you all are interested in, in our women's section in our annual report, 2022, the data shows was a strong year for women, women entrepreneurs seeking angel capital and that was up from 28.6 percent the year before. So that's a pretty significant jump and the yield was pretty good for those entrepreneurs. Angel investors invested in 25.6 percent of the investment opportunities brought to their attention and that was up from 19 percent in 2021. Also when you look at the investors themselves, we've been talking about the entrepreneurs getting the angel funding and now we're just going to look quickly at the angels, 2022 was a record high for the number of women angel investors, 39.5 percent of angels were women and that was up from 33.6 percent in 2021.

Similarly, for diverse founders and investors we had -- women were underrepresented and entrepreneurs even more so but the numbers are slowly increasing, a upward trend. So founders of color constituted 15 percent of entrepreneurs seeking angel investment, which was an increase from 2021 and a significant increase from five percent in 2020. And angel investors again with that yield, angel investors invested in about 33 percent of those investment opportunities brought to their attention, which was also a slight increase. And last not least the percentage of angels that were of color, 8.6 percent in 2022 that were racially or ethnically diverse which was up from four percent in 2021. So that's just a quick overview of some of the stats in our annual report and hopefully that will help frame your discussion. I know a lot of you may have even more recent data and anecdotes to share.

MS. WASHER: Thank you, Julie. So Erica asked me to lead this section of the discussion and I'd just like to kind of preface it is one of the reasons we brought this to the table to discuss is because we had heard that there was a decrease overall in angel investing. I'm not sure that all those numbers say that -- support that statement but also because I think we all know that angel investing somewhat like crowdfunding kind of provides the onramp to the public markets and to the larger investments. If you never get that first little bit of money you're not going to get the next bigger part of money and you're certainly not going to go public, I thought what was very interesting about the data Julie just presented is that 73 percent of the companies that angels are investing in are first-time CEOs and to be the more experienced CEO, to raise the money from the VC to take the company public you have to be the first-time CEO first.

And so that's why I think even for us as an advisory committee to the SEC this is an important topic for us to discuss and so I'd like to throw it to the group to you know as Erica said we all have experience of some variety or another in this space and to be able to really dig into is there something here that we can do to be effective and I'd like to go ahead and start with Marcia based on the experience that you have and your recent research into the area.

MS. DAWOOD: Sure, thanks. Well I could talk about this all day considering --

MS. DUIGNAN: Well you have like 45 minutes.

MS. DAWOOD: Yeah, right. I really think like we talked about with Regulation Crowdfunding our biggest problem in angel investing is awareness. People just don't really know about the topic. They don't know it's available to them and the biggest myths out there are that it's only for rich people and it's only for the well-connected. And that's just simply not true anymore and the geography that Julie just showed is so interesting because we -- I have seen again these are all just my opinions but that during COVID we really saw people start to go online to find angel groups to do their investing.

I had a personal situation where a friend of mine, lives in the northeast, ended up becoming a member of an angel group several states away because they felt like that was a better fit for them and because now so many angel groups are online and they are investing nationally. In many cases it was you know something that they felt you know was a better fit for them and so I think we're seeing that across the board. I think when I go back to this awareness piece we're just not -- there's not enough education necessarily out there so that people understand it. They might think, oh, I really -- they might find a company or see a company or find or meet an entrepreneur or even go to a pitch event and they'll think, oh, this is so great. I love you know what these entrepreneurs are doing. They're making huge change in the world. They could be working on some kind of a health care advancement or something like that but when it comes down to it the idea of actually taking a step forward and saying, oh, I'm actually going to make an investment seems extremely daunting. They're not sure how to decide or who would they you know work with.

So in a lot of cases that comes down to the angel group but the angel group business model is not the best and we can go into a whole other thing about that but since we're just sticking with the how do we get more capital to our founders I think it really comes down to letting people know about the fact that this asset class exists and then we have to educate them more on how it works and how to actually make a decision and become a part of the investment process not just through dollars but through mentorship as well.

MS. WASHER: Thank you, Marcia. Any other comments from the group? Bart, in your experience when you're working with companies what have you seen over time? What are you seeing currently about how they access that first -- angel money is usually kind of the first money.

MR. DILLASHAW: Yeah. So echoing everything that Marcia said times two but angel capital tends to be smaller and tends to be more local you know for sure versus going out to a venture capitalist. So if you are an especially first-time entrepreneur that doesn't have -- hasn't raised venture capital before and doesn't have access to those networks you are very likely going to your friends and family but the broader community that is connected to your friends and family which is going to tend to be your local backyard and you're probably looking to raise somewhere between $250,000 to you know maybe a million up at the sort of top-end and that is angel groups. That tends to be too small for most venture capital companies. Even a sort of a small venture capital fund is probably looking to write checks into $1 million or $2 million rounds and so that's the realm of the angel.

Now the good news about angels is they tend to be -- you know they are more willing to look at factors other than pure financial return, so they are more willing to support local entrepreneurs, entrepreneurs that are hitting on another impact point. And so when I'm talking with you know companies that are seeking that class of investment you know I'm generally saying you're not ready for venture capital. You should go find the local angel group and the great thing about angel groups is they have really proliferated in the last 10 or 15 years. You know they are much more sophisticated than they were a decade ago largely thanks to groups like the ACA if they are more syndicated so that if there is a good deal, quote/unquote, that one angel group likes it is much easier for them to then package that deal and give it to others.

So and the other one is I'd say in terms of myths there at one point was a myth that you could only start a startup in Silicon Valley and that I think is -- at one point that may have been true. I think that it's far less true today. So in terms of the opportunity for investors it is much more geographically dispersed than it once was.

MS. WASHER: So let's get back to -- Marcia, you talked about awareness and you know there's two sides to the awareness. There's the small, little first-time CEO company being aware of angels and finding connection to angels and then there's investors understanding they can be an angel. So what's the push and pull between those two and where is the real pain point to be able to get the capital flowing. You want to take a stab at that one of you? Anybody else is welcome to join the discussion.

MR. DILLASHAW: I'll take sort of an initial crack at that. So the tension is often if you're an investor and you're looking to raise between $500,000 and a million, somewhere in that range, like it's difficult to find a single investor that can write that kind of check especially if a single investor that is sophisticated to know that they should be trying to get into many, many, many deals. And so that tends to be the nexus point that gets attracted to an angel group where you have an investor that may say, oh, I've got a friend/family mentor that's interested in investing but they don't want to put $500,000 in and that mentor has probably said, oh, I've heard of the angel group or there is sort of the envoy there.

And then when the angel group comes in they tend to be more sophisticated and start to structure the deal and then they'll probably pick up some of those friends/family investors that are like, oh, I wanted to invest in this deal and you guys are helping to sort of you know pave the way and now that I know it exists I'm going to go invest in others. So at least that's the nexus point and the envoy that I normally see.

MS. DAWOOD: And in fact what we were talking about earlier today with the marketing and how you're allowed to talk about this I mean entrepreneurs are not allowed to go out on social media and say, hey, I'm raising a round let me find all the investors I can. So I think it's very challenging for them to even be matched up. I talk to entrepreneurs all the time and they're like, okay, well this is the type of company I have and this is the type of funding I'm looking for and then you know a lot of it comes down to they just have to network and network and network just trying to find the people that match up to them. And I mean I know a lot of people in the angel world but I have struggles even to talk to an entrepreneur and they're like this is exactly what I'm looking for and then I'm like thinking through like who do I know. This angel group invests in this and you know so this it's very kind of dispersed across the country about who invests in what and there isn't necessarily a place that you can go to find out. I mean the Angel Capital Association's website we try to put a list of the angel groups that are out there and kind of of what their focus is but it's like the matchmaking is very challenging and they're not allowed to talk about it so that becomes very challenging too.

MS. DUIGNAN: What about Angel List? Isn't that kind of like what AngelList was supposed to do in the first place?

MS. DAWOOD: Yeah, but I don't really know enough to speak to that.

MS. WASHER: Well some of it I think is

though that some of the angel groups don’t want their name and their existence to be publicized because they don’t want to just be you know attacked by or flooded by whatever word you want to use flooded by 500 different things. They want to be picky, so I think there’s a little bit of investor education and, hey, you can have some kind of presence without being personally assaulted in the grocery store by an investor so I think -- by a company. So I think that’s part of it too, but I do think that these lists have not served their purpose.

MR. MARISCAL: Marcia, can you explain a bit about what’s the reasoning behind a startup not being able to publicly say that they’re raising? That point was mentioned last session and I just don’t know enough about that.

MS. DAWOOD: Well we’ll refer to Bart, the lawyer on here, but the 506(b) rule and the 506(c) rule around general solicitation is kind of where that comes down to. If they are registering under Reg D, under 506(b), they have to be able to only present their offering to people who are close to them or who have been invited and if they do a 506(c), then they could very well go out to social media and talk about the raise but now that’s a completely -- you know it’s a different offering.

MS. DUIGNAN: Yeah. You know, Diego, I would just say if you've ever seen the movie Glengarry Glen Ross like that's a great example of why they're not allowed to just call whoever with the info on the deal.

MS. DEVRIES: You know, Marcia, one of the things I've been thinking a lot about lately, so I'd appreciate your comments here, is just are there opportunities for lift in terms of how we organize many of our federally-supported tech accelerator programs? Are there ways for us to be a little bit more intentional and organized around sharing with the permission of the entrepreneurs information about the businesses that are going through these accelerator programs in a more targeted fashion with angel groups that are either focused on a particular technology vertical industry or geography and some sort of matrix of taking that information. So that way you know there is that release of capital that is there for the companies that are going through that tech accelerator process. You know a tremendous amount of federal and state funding have gone out in the past couple of years to start to seed accelerators and incubators, so I think there might be something there.

MS. DAWOOD: I totally agree and Diego probably has more statistics around what you know how much more successful businesses are going through an accelerator but I would love to see federal and state money getting behind angel groups and in some states I’ve seen that happen before. Ohio used to be extremely generous. I don’t know recently. I haven’t been paying as much attention lately but you know there are some states that are just you know very generous about helping these angel groups get started but there is also perception out there, well, angels are a whole bunch of rich people who don’t need any help and that’s not really the case.

You know the angels are taking the most-risky step you know by investing at the very earliest of stages and yet they have to use their after-tax dollars. You know sometimes there is tax breaks with 1202 and all that. We won’t get into all that but you know if they hold the stock long enough but it’s not liquid you know and I think that there are things that we could do to help incentivize more people to want to participate. I think one of the things we could do is help angel groups with the organization and sophistication to Bart’s point. I’ve seen a lot more angel groups put funds next to their angel group, so almost like a micro VC fund so that the investors do start to diversify and start to reduce their risk. They become more educated by watching what happens you know within the group with only having to put -- you know write one check as opposed to writing 10 or 20 checks just trying to get diversification.

MS. DEVRIES: Just to take it full circle before we wrap it up, you know, if you think about it and then we bridge the gap between the conversation around Reg CF and having the technology platforms and the opportunities you have where you’ve got focus and expertise I mean you could imagine a world where say we had dedicated Reg CF technology platforms that were focused on providing the infrastructure to get the capital to businesses that were coming out of these federally and state-supported tech accelerators to help with the valley of death and then having angels at the ready to be able to invest in them off those platforms either directly or to your point if there is any innovation and regulations to allow pooling of the risk there might be an opportunity set there.

MS. DUIGNAN: Davyeon?

MR. ROSS: I’ve got a few thoughts. One you know I think the tech accelerator approach is a good one. However, I don’t want to just limit it to the tech accelerators, right, because if you look at some locations or as it relates to geography most of the tech accelerators tend to be on the coast and you know someone like myself or someone in the Midwest really don't get the benefit of some of those major tech accelerators. So I want to make sure I think it's a great avenue but I think it's not a single bullet by any means. That's my first point.

Secondly, and I think I talked about this in the past but Kansas has done a really good job in regards to how they can leverage their tax credits to drive angel investment where you know for every hundred thousand that you invest you get $50,000 off your Kansas income tax and if you're a husband and wife and you're going to invest 200 then you get a hundred thousand off your Kansas income tax that can roll multiple years. So I think that there are strategies like that because when they actually instated that you know I know many of the angel groups when the person presented they said have you ever -- do you have tax credits is one of the big questions because if you think about the math associated with it you know 50 percent is somewhat mitigated based on the tax credit and then if the deal goes south you know you're looking at I think it's approximately 40 percent you know off your cost basis, right. So you’re really risking 10 percent of your capital which makes it a lot easier for angel investors to participate.

So I think programs like that are -- I mean it increased substantially the amount of angel investment that actually came out of the state of Kansas to the point where you know it actually drove people moving from Missouri to Kansas to participate because you had to be a Kansas company to benefit from it. And then the last thing I would say is that one of the big challenges especially with increasing the investors, angel investors, is that you know the game of the angel investor is not just pick one company and invest in it, right. This is early, early, early stage so you need a portfolio of companies, right. And I think what happens is that we bring in individuals into angel investing and they say, okay, I’m just going to put 25K this year but then they put it in one company because the angel groups are not necessarily set up to hold capital and to somewhat divide that capital across multiple companies and I think that’s a big challenge and something that if we can address it, it’s probably better for that person to you know take 5K and put it in five companies versus 25 in one just from a diversification perspective.

So that’s something that I don’t know how we handle it. I don’t know if there is something that could be done with the angel groups that -- somebody give me a timer, the angel groups to allow and to mitigate that risk but I think that that’s a big deal because that one person invests 25K in one deal and that’s the deal that doesn’t do well I mean they’re not wanting to actually participate in angel investing ever again.

MS. DAWOOD: Right.

MR. ROSS: And now they’re like, okay, no I tried that once before. I’m going back to real estate or something else and I’ve seen it. I’ve seen it.

MS. WASHER: What about could we leverage the existence of the portals for crowdfunding? I mean so there -- you know, George, if you could speak to this you know you’re there to address non-accredited investors and they can make $250 bets but you have lots of companies on your system that they can pick and choose from, is there a way to leverage the existence of that portal to service the angel investors, the accredited investors who can invest more and have a whole different set of companies that they could -- I mean the systems are there, correct me if I’m wrong.

UNKNOWN SPEAKER: Republic already does that.

MS. WASHER: Okay.

UNKNOWN SPEAKER: Yeah.

MS. WASHER: I mean so is there a way to incentivize that? I mean we’re an SEC advisory committee, so what kinds of things could be done to incentivize something like that?

UNKNOWN SPEAKER: Go ahead.

MS. DUIGNAN: So I just want to just say something from my own personal experience a little bit you know not an exact response to what you said but just to give a little bit of my story. So you know I get the sense that folks think that you know diversification is like the whole challenge and if we just solve that you know everyone is going to make money. You know I’ll give you an example. I was a managing director for several years for you know one of sort of the top three national accelerators and you know worked on their second fund and you know personally made a very large LP commitment to it. I think this was a 2012, maybe 2013 vintage fund and had 180-portfolio companies in it for which you know we got six percent of the common for like 25 grand, extremely cheap, up-front investment. You know we’re now many, many years later basically 14 years into it and you know still have not recouped the initial investment and you know that’s not very good when you think about time value of money and you know even coming out slightly ahead. And we’re talking about 180 companies and you know one of the top three accelerators in the nation.

So the diversification was there, the cheap buy-in was there, everything is there and you still you know can have incredibly extended holding periods and the returns you know are not even guaranteed to be middling. So you know I think we just need to be a little bit more realistic that you know it’s not necessarily just about you know a pooling problem. It’s you know a few other factors too that make it a difficult asset class to work with. And then I would say having you know been sort of a former executive director at Golden Seeds one of the main things I thought that we ran into which is completely reasonable is just what we call like angel investor exhaustion, right. Like if you are going through deal by deal and it’s 10 years later and you still haven’t had an exit like it doesn’t matter how much rich you are at a certain point you’re like I am tired of this, like I’m out.

So I think that’s another thing that we kind of need to deal with but you know to Davyeon’s comment on the accelerators you know it is I think relatively easy for an accelerator to set up you know a fund to essentially like back the companies you know that are coming through their program either you know through a co-investment model at the end or you know to actually provide some of the upfront capital when they come in but you know typically like that is how -- what most of the accelerators have been doing and you know have I think the tools to do pretty effectively.

MS. DEVRIES: Sorry, Erica. I was just going to say you know I’m glad that you brought up the many dimensions of diversification. You know I spent a great deal of time extensively in the private sector when on the private side at a large platform that was investing in seed stage/early stage through growth and primary, secondary funds co-investments across all of it you know and I’d encourage us to think about not just diversification in terms of the number of companies in that basket but the portfolio construction is incredibly important and being able to invest across stage and across vintage year. I will say if you look at it the risk-adjusted returns when you are able to diversify across the vintage year or across the stage of investment as well as having broad exposure with good portfolio construction it significantly de-risks private market portfolios but there’s a number of elements.

And so I’d encourage conversations about this to think also about the needs for follow-on capital because that can further de-risk to think about having these vehicles happen over multiyear timeframes and how those might be tools to create an investment opportunity that has a lower risk of loss which might encourage more people to make these investments.

MR. ROSS: And then from -- just one other thing you know and when I talk about the diversification also, I’m also looking at it from the perspective of just the angel investor, right. I know many people who have tried out angel investing and invested in one deal and decided that they will not angel invest again. I mean and that’s just the reality of it, right, and maybe they didn’t get the deal via an accelerator who, yes, they do a really good job of demo days and invite everybody in, right, and try to invest -- and I think that comes back to education you know as Marcia was saying, but I know many people who they tried it one time and not that they had a bad -- but it was just one deal that they put in and they got a negative experience.

Now I don’t know if -- we’re probably not going to mitigate that. We probably can’t change that but I think anytime you can help educate people and help them go through a process of understanding because angel investing is risky. I mean you bring up the point about follow-on capital. Most times the angels are the ones who get squeezed if you don’t have the following capital because something happens. Someone comes in, they don’t care how much success. They don’t care that you don’t want as an angel investor that helped get the company to this certain point but that gets squeezed either via liquidation preference or you know, hey, we want to re-cap the company. Those are all risks that come with the early stages of angel investing and anything that we can do to help, one, educate people and mitigate some of that it’s you know at least worth exploring.

MS. WASHER: So I think the two things that have come out most are education because, Marcia, you started with awareness which is education and Bart was talking about connecting the groups and you were talking about the companies and even you who are knowledgeable can't tip through all the investors and, Davyeon, you just talked about you know making that connection and having somebody who has an experience even want to do it again after you've already made a connection. So what is it that we -- you know are those the things that we need to think about, connectivity, awareness, education and diversification? It seems like all three things are part of the issue of making the engine go but what are people's ideas as to solutions for those three issues that have been brought up? Bart?

MR. DILLASHAW: Well I think you hit the nail on the head and I think it is part of a robust ecosystem because I think it's not one answer and it depends on each one and there's a different aspect of it. What I will say is there is a tension or a spectrum where angels tend to want a more hands-on experience. They want more of a direct contact with the founders with that so to your point about like AngelList like, AngelList exists and it's a great platform and you can go access thousands of companies but it doesn't tend to dominate the angel world. And I think it's because it's just, you know, you just log on and it's this un-curated mass of whatever and so you're missing that personal connection, the trust network or whatever you want to call it that I think angel groups provide a little bit more of a direct contact with.

Now within that spectrum is, Bailey and Erica, as you were talking about like you can quickly go up the sophistication curve, right, where you know if you really want to do it right you're doing full portfolio analysis and you're doing all this stuff and that quickly can get beyond what an individual angel wants to do. You know so there is just this spectrum where you know the more serious you get about the financial components of it, the more inside baseball you want to get, the more you're going to go to a fund. As you go to the fund that's when the fund regulation is going to kick in. You've got your investment advisor regulations and everything else so I don't know that there is any one answer. It's just this spectrum where I would probably look to some of the regulation around the cost associated with being an investment advisor and some of the limitations that investment advisors have. It is a fairly heavy admin burden that puts a lot of cost on it that makes it very difficult to have a small fund. Erica, I'm sure, can talk to more about that but in terms of areas for regulation that might be a place to look.

MR. DRAYTON: I’ve got a quick -- I think awareness and education are two different things, so as we’re moving forward please keep that in mind. And I think I shared with this group at an earlier meeting that I thought I had an angel who committed $15,000 and then when the deal went bad, he said he wanted his money back and then I found a way to get him his money back because I had to see him in church every Sunday, right, but I also think that someone mentioned that having angel groups set up alongside fund managers that actually creates a funding path for these companies that angels are investing in.

So we should encourage angel groups to partner with fund managers in their regions so that at least these companies have a path for additional capital. And some of these other resources that I just have never -- Angel Capital Association, Center for Venture Research I heard earlier this is the first time I’m hearing about those. I think getting those resources out would be helpful as well. And, finally, what I would say you know we’ve got a number of accelerator programs in our region and when I attend these things, I rarely see the folks who are part of the angel groups attending some of these pitch events. It’s like they'll get the person from the CDFI and then the banker to come in to listen to these pitch events but they're not getting those angel investors to sit in as well. So maybe we recommend that those folks stay involved in the pitch events as well.

MS. DUIGNAN: Yeah. I mean, I'm not sure you know what the current level of organization is but it does seem like it would be interesting to provide some support for vehicles you know that are specifically set up to co-invest with local angel groups, right, maybe matching -- bye, guys, matching you know dollars one to one or whatever it is and then to provide a little bit more of sort of a national format, right. Like let's say I'm interested in becoming an angel investor but you know I don't really know how to get started.

I could you know go to a website and sort of look at a whole list of different angel groups across the country. Maybe they're near me. Maybe they're not. Maybe they're themed and then have the opportunity to say, okay, you know I'd like to put 25 grand in sort of a side car fund with this group, like they look like they know what they're doing. Like they look like they're funding companies I'm aligned with and you know maybe it doesn't make me a member but I can you know join the meetings by Zoom and learn -- until I kind of get my sea legs about you know the whole thing but I think it would be interesting to you know figure out how to use technology to kind of leverage the efforts that you know local groups that really care about their communities are making.

MS. WASHER: You know I think that kind of closes the loop on the theme we've been talking that helps the awareness, helps the education, helps the connectivity, et cetera and can we work with existing accelerators, existing angel groups where they do exist and the crowdfunding platforms to kind of pull that all together. And then what is it that you know I think this is going to require us to go back and do some homework and come back and talk about it again. What would a recommendation around those aspects look like? And I think we need to do some more homework about how to pull that together, how to incentivize the side car investing.

MS. DUIGNAN: The other thing too is that you know I think a lot of us we've been part of angel groups that are very kind of egalitarian and open and wanting to help people but the truth is that the vast majority of the angel groups that make a lot of money are purposefully incredibly exclusive and they're not trying to you know put what they're doing out there and share with people. So you know we also kind of have to remember that as well that you know a lot of angel money is coming from places that you know maybe they are getting you know unique access to deals through relationships. Maybe they have more leverage on sort of exit outcomes. I think that's important to remember.

MS. WASHER: I think Marcia and I were talking about that at lunch that there are some very successful angel groups. They unfortunately tend to be in the -- you know we could list the geographies where they are and they would have the makeup of you know what VC -- they operate much more like a VC firm than an angel firm.

MR. ROSS: In Kansas they call it rich and anonymous.

MS. WASHER: Yeah.

MR. ROSS: I mean that's the approach they don't like to share deals and I think it's something that I've seen also on AngelList, because AngelList has become more of a you know SBV-type of management platform for inviting folks. I mean, I got lucky to get invited to the former Lyft employees angel group and the types of deals that they see I don’t even know how I got in but the types of deals that they see I wouldn’t have heard about them anywhere else. I would hear about them three years later than when they actually came out, so AngelList there is a lot of that going on and it’s very, very exclusive, which is on the opposite side of the spectrum of Bart talking about when you go into AngelList and you just see everything.

MR. CORDERO: And if I could -- I’m glad you guys are bringing this up because I was going to say what’s the goal? What are we trying to accomplish? And I say that for this reason, whether it’s a crowdfunding conversation that we had or this conversation there’s a private marketplace that we all appreciate out there but it's the Plum private marketplace that we’re actually all really talking about. And then we’re trying to create these kind of bridges into it but in fact there is these almost like side private marketplaces that we’re talking about.

And right now I think what I’m hearing in the conversation is exactly right which is, is the goal for us to try and create a very robust alternative almost private marketplace or is the goal to have alternative avenues or is the goal to try and gain access into kind of this -- you know and I say gain access because I think from our last conversation everybody was very oriented towards kind of creating more access for everyone, more access for investors, emerging fund managers and for founders to gain capital, you know access to capital because again if you're in network you're great. If you're not in network, you're not great. So kind of as I hear this conversation I almost feel like there is -- you know there is like a tug of war a little bit in terms of -- are we trying to create an alternative or are we trying to get access into. And I just -- I know it's a little bit nebulous but I hope you guys kind of understand what I'm -- yeah.

MS. DUIGNAN: You know, I do understand what you're saying, you know, and I think it's interesting, right, because people you know do some research and buy a public stock and then the stock goes up regardless of their involvement, right. Like they don't have to do anything. All they have to do is own it whereas at the angel stage it's very different. Generally, angel investors are not just contributing capital. They're actually usually working -- and VCs as well they're like contributing a lot more than just the capital. It's relationships. It's advising the company.

What we're sort of dealing with is a scenario I think where you know sort of an average person is going to hear, oh, somebody made a lot of money doing an angel investment and they think about it in the same way as a public stock investment and they don't realize, yeah, that guy maybe put a hundred grand in but he also introduced them to their first big customers and advised them for a year and introduced them to their next investors. And we're kind of missing all of those components that actually go into creating the power law of successful companies. And I think that's also something to be aware of, so you know I'm glad we were able to make a little bit of a recommendation on the Reg CF stuff this morning because I really do think like this is going to be something that you know we probably need to dig in a little bit longer similar to an accredited investor to come up with something useful.

MS. DAWOOD: And just to add to all of the things that we're thinking about I believe that the younger generation they're not going to function the way that we have or even our -- you know the people who are running angel groups right now. At the Angel Capital Association we've actually seen several groups, successful groups that were -- you know had put a lot of capital into their markets actually not be sustainable because they didn't have a succession plan. And they're so many people that I've talked to in the younger generation that have just said, well, we want to do everything on our phone. We just want to be able to go to an app and you know push invest and I'm like what. Yeah, I mean but that's kind of how they're thinking about it.

So I think we have to be aware of that so that we can try to see what can we do because I'm worried that you've got the group that are you know making angel investments now who are running angel groups. You've got the younger generation that's kind of up and coming and they haven't gotten to that accredited investor definition yet and then what's going to happen when there aren't enough people in the succession planning who are going to continue these groups and then we're going to see this like dip in funding to entrepreneurs.

MR. ROSS: I think we're seeing some of that already. I think we're seeing some of that already from the perspective that I mean I know of several angel groups that when they have a pitch night you know they have 20 percent of their folks showing up, right, for multiple reasons, right. Either you know folks don’t care about it anymore or folks are getting their own deal flow directly so they’re not necessarily depending on the angel groups. So I think we’re seeing a little bit of that already and it’s a little bit scary.

I also think that someone made a point earlier that there’s got to be this joined at the hip-type of relationship between whether it’s you know early-stage capital, it’s not angel capital. I think that that’s a very unique dynamic. I mean you see large venture firms who have not an angel capital but an early stage, right, because it's lead gen for them and I think that there’s an opportunity for these angel groups to be lead gen for you know early-stage capital. And then I will tell you it’s pretty powerful to know that there is some follow-on capital that’s sitting there if the companies are doing well. So I do think that we’re seeing it and we should be looking at more ways where early-stage capital should be teeming up and sharing deals and I know it’s happening in some places but not in a very -- probably not in a very sophisticated manner across nationally.

MS. WASHER: So we’ve talked before about how there is the kind of sister group advisory committee of investors to the SEC. Would this be a topic -- and we've talked about maybe having some interaction with them, would this be a specific topic that both those advisory committees would have an interest in, we should have some kind of joint conversation?

MS. DAVIS: Marc Sharma can correct me if what I'm about to say is wrong but I don't -- I'm not a -- they may have a few angels on there. My sense is that they focused more on public investing.

MS. WASHER: Right, but they need the lead gen.

MS. DAVIS: Yeah. And more retail investors you know in the public markets.

MS. WASHER: Yeah. Oh, okay. The more retail -- okay.

MS. DAVIS: Now that doesn't mean they wouldn't be interested because I know there are -- I know there's at least one angel investor I'm thinking of that has been on that committee but as a general matter I think it's been more retail. I don't -- that isn't --

MS. WASHER: Okay. If it's retail it's not going to -- yeah, doesn't know. Okay.

MR. ROSS: I like the way you're thinking though. I like where you’re at.

MS. WASHER: Well I think this has been a really productive conversation. I’ve made lots of notes about things that we maybe should follow up with as far as with information gathering. And I think all of us need to think hard about -- I think we’ve identified a lot of issues and a lot of pain points but what is it we could productively do that would help move things forward is I think something we need a lot more thought.

MS. DUIGNAN: Yeah. I think this is you know one of those times where we say let’s kind of noodle on things a little bit and look for inspiration between now and the next meeting. And, Marcia, I know you’re going to an angel investor conference you know over the next couple of days so you can go and solicit from the crowd and you know find out how we can help people or you know do things better. I mean, I do think there are opportunities for improvement. You know, I think we just need to be a little bit creative around how we suggest them and this is the perfect group to do that. All right, any final comments on angel investing? All right, wonderful. Well thank you, everyone, for a great discussion on two very important topics today as well as coming away with what I think is a very helpful recommendation that we can probably get drafted up really quickly. I want to remind everyone that our next meeting is scheduled for July 30th and it will be fully remote and I hereby move to adjourn the meeting. Thank you, all. Do we need to vote on adjourning? No? Okay, great.

(Whereupon, at 2:54 p.m., the meeting was adjourned.)

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PROOFREADER'S CERTIFICATE

In The Matter of: SMALL BUSINESS ADVISORY COMMITTEE
File Number: OS-0001
Date: Monday, May 6, 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.

_______________________ 5/13/2024
Kyleigh McGinnis (Date)

CERTIFICATE OF REPORTER

I, Kevin E. Carr, reporter, hereby certify that the foregoing transcript is a complete, true, and accurate transcript of the testimony indicated, held on May 6, 2024 in the matter of:

SMALL BUSINESS ADVISORY COMMITTEE

I further certify that this proceeding was recorded by me, and that the foregoing transcript has been prepared under my direction.

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