A PROPOSAL TO INCREASE THE OFFERING LIMIT UNDER SEC REGULATION A

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

SECOND SESSION

DECEMBER 8, 2010

Printed for the use of the Committee on Financial Services

Serial No. 111–168

U.S. GOVERNMENT PRINTING OFFICE
63–126 PDF WASHINGTON : 2011

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

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A PROPOSAL TO INCREASE THE OFFERING LIMIT UNDER SEC REGULATION A

Wednesday, December 8, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:04 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Maloney, Watt, Moore of Kansas, Hinojosa, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Klein, Foster, Himes; and Castle.

The CHAIRMAN. The hearing will come to order. Our Republican colleagues are caucusing, and we will begin. I know our colleague from Delaware, Mr. Castle, is on the way, but unexpected traffic problems have caused a problem.

This hearing was called—we haven't been doing much in the lame duck session, but we thought that this was a topic that was, frankly, not a partisan or terribly controversial one in a lot of ways.

As I understand it, the Securities and Exchange Commission would have the power to do what we are talking about today, which was to raise the level on Regulation A. I know people keep talking about it as "Reg A," but that led some people to think that there would be Caribbean music and dancing. And I don't want to attract the wrong—not the wrong, but a different crowd to this particular hearing. My legislation on the legalization of marijuana will be heard in another committee. So I did want to keep the distinction clear, although both of these have a certain support in northern California.

The question is whether or not we should be urging—our colleague from Delaware has been able to join us, and we appreciate it—the SEC, as a practical matter, to increase this limit. The argument, clearly, is that it is helpful for capital formation for smaller companies and, in fact, is no detraction from a reasonable regulatory scheme.

We invited some witnesses, and we worked with the gentlewoman from California, Ms. Eshoo, who is here, who is a major proponent of this. We did not specifically invite people we knew to be opposed, but we haven't heard from people who are. But let me make clear that the record stays open, if there are groups. And I know that sometimes when we deal with questions—for instance, on the reach of Sarbanes-Oxley, there are various groups representing investors or pension funds who express concerns. We have heard of none in this case, but this hearing may elicit some.

And the hearing record will be open if there are any who would like to exercise different views.

I do have—where is that paper—two statements I wanted to mention now.

One, the National Venture Capital Association has offered a statement in support of this, arguing that it will enable more small companies to attract capital. And if there is no objection—and there does not appear to be any—that will be put into the record.

And, without objection, the record will stay open for any further comments that people might have on this proposal.

I should note also that it was Speaker Pelosi who first called this to my attention. Earlier in the year, we were a little busy with a couple of other matters people may remember. But it is something that the Speaker has taken a great interest in because of her interest in job creation. So we are glad, finally, to have this hearing. It may be in the next Congress that legislation could happen; it may also be that the SEC might be persuaded by some of what they hear today to do this.

I, finally, will apologize for the fact that at 10:25, I will be leaving and turning the hearing over to the gentleman from Kansas, Mr. Moore, because I will be required to attend the meeting of the Democratic Steering and Policy Committee to make the case as to why I should remain the ranking member—or not remain, but return to the position I once had of ranking member.

With that, I will recognize our colleague from Delaware.

Mr. CASTLE. Thank you very much, Mr. Chairman.

I really don't have an opening statement. I think we should get right to our witnesses, with the time limitations, except to welcome Anna Eshoo and the other witnesses who are to testify today.

I yield back, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

The gentleman from Georgia, Mr. Scott, wanted to make a 2-minute statement.

Mr. SCOTT. Thank you, Mr. Chairman.

Let me just say a couple of points about this issue. It is of some interest to me, and I just wanted to make for the record a couple of points that, certainly, I think should be made regarding the increase of the offering limit under SEC regulations.

I think it is very important that the proposed increase from $5 million to $30 million, though substantial, could indeed yield possible results if implemented appropriately. Because I think that this could help with job creation. And, as you know, on this committee I have been very, very much at the forefront of trying to appropriate our policy to place job creation at the forefront. And so I think that there is an advantage to this as job creation. And to facilitate the development of new technologies and products could also result from such an increase.

We have seen the dollar limit increase incrementally 5 times from its original level of $100,000 to the current level of $5 million, which was established in 1980. Since 30 years have now passed, the effects of inflation alone could be argued as a reason to increase the offering limit. And such an increase could enable smaller companies, small businesses, many of whom are backed by venture capital firms, more timely access to funding. And, again, these are the areas where jobs are created, our small businesses. And I think that this will be, certainly, helpful.

So I am certainly interested in hearing from my colleague, Ms. Eshoo—I know of her great interest in this issue—in terms of what her opinions are in terms of what increase should be made to the offering, if any.

Certainly, beyond any numerical increase in the limit, Congress should also consider the expected implementation by the SEC and whether such an increase would either be mandated or simply authorized.

Those are some important points I wanted to make. I look forward to Ms. Eshoo. I certainly respect her opinion on these areas.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentlewoman from New York, Mrs. Maloney, is recognized for 2 minutes.

Mrs. MALONEY. First of all, I want to welcome my good friend and colleague, Anna Eshoo. And I very much look forward to her testimony, so I will be very, very brief.

The issue of giving smaller companies the tools and resources they need to raise capital and become the driving force of our economy is really critical for economic recovery. So I think that this hearing is very timely and important, as it pertains to job creation.

And I look forward to her testimony about the benefits of raising the offering limit under Regulation A, as well as whether it will increase the use of the exemption for small issuers. So I welcome her, and I look forward to her testimony.

I yield back.

The CHAIRMAN. And our colleague from California is now recognized.

STATEMENT OF THE HONORABLE ANNA ESHOO, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Ms. ESHOO. Thank you, Mr. Chairman and members of the committee, for inviting me to testify today to talk about this proposal to increase the offering limit under SEC Regulation A, which was, as you know, enacted during the Great Depression to facilitate the flow of capital into small businesses.

As you know, I represent the innovation capital of our country, Silicon Valley. And we know there if we don't constantly innovate, we stagnate.

The larger policy context for raising the Regulation A limit from \$5 million to \$30 million is to create what we are so desperate for: good jobs. We need to promote capital formation, technological innovation, and job creation. And I think that we can achieve these goals by revitalizing what is essentially a nonworking section of the Securities Act.

So you may all ask, what is the problem and why should we consider increasing today's limits in Regulation A? The main problem is that hardly anybody uses it. Currently, there is little incentive to support the small initial public offerings under Regulation A. In fact, the current regulations are a disincentive, burdening a \$5 million offering with \$1 million to \$2 million in underwriting expenses. So that is a pretty good reason why people aren't using it.

At the same time, the threshold for traditional IPO funding has grown out of reach for most small companies, leaving them without the viable alternatives to raise money.

Two firms in my congressional district, Silicon Valley Bank and Wilson Sonsini, have more than 9,000 private company clients between them—companies that are or will need an infusion of public capital. Under a revised Regulation A, small companies would gain access to capital, and it is a way to test the market to see if there is additional support. Regulation A will allow companies to seek small infusions of funds as they go along, and then investors can demonstrate their confidence with their checkbooks.

But without this access to public capital markets, good ideas are really withering on the vine. And the impact of this recession on the venture capital market cannot be understated; it has been devastating.

Raising the Regulation A cap from $5 million to $30 million, I think, is a jobs program, and we should think about it that way—good jobs that are focused on the cutting edge of innovation, creating new products, new markets, additional growth for our economy. And these would be jobs created here in the United States.

In considering whether to raise the limits, it is useful to examine the history. In 1933, Congress set the dollar limit under Regulation A at $100,000. It has been raised several times since then: $300,000 in 1945; $500,000 in 1972; $1.5 million in 1978; $2 million in 1978; and $5 million in 1980. But, in 1980, the SEC waited until 1992 to actually adopt the same change in the rule. So it has been some time.

In Silicon Valley, companies are seeking capital for the next breakthrough of technologies and finding the available capital—and this is what really gets me—in other parts of the world. We are falling behind as the world's technology leader, and a few simple modifications could make Regulation A an engine for capital formation and economic growth.

Congress, of course, must weigh the potential risks to investor protection and the potential benefits—that is our job—all associated with Regulation A. It is a meaningful capital conduit, as it was originally intended. And the SEC can and should use its recently invigorated, thanks to your committee and your leadership here, reinvigorated enforcement program to prevent abuses.

But make no mistake: There is pent-up demand. The money is available, and investors are willing. And there are unnamed ventures today that have the potential to be the future: Googles; Genentechs; Facebooks; and eBays. And we can do something to help make this happen.

So I think overall this is a modest proposal, but I think it has high potential for capital formation, for technological innovation, and for job creation in our country. And, for all these reasons, I urge the committee to give all due consideration to the proposal to raise the cap on Regulation A offerings.

And I thank you for having me here today. It is an honor to appear before the committee.

The CHAIRMAN. Thank you.

I am going to ask just a brief question.

One of the things you mentioned in the bill—what I am hoping is that, in the funding resolution that is about to go through, both the Securities and Exchange Commission and the Commodities Futures Trading Commission get the significant increases they have asked for. We give a number of regulatory bodies increased authority, but the FDIC, the Fed, and the Comptroller, the new version, are largely self-funded through fees, and the new consumer agency will be. But the SEC and the CFTC, which both get significant increased responsibilities over derivatives and other issues, need the extra money.

In a small way, though, this would seem to me to contribute—if I am correct, doing this would considerably free up some SEC resources. That is, by increasing this level, you would theoretically allow people to—not theoretically—you would allow people to go forward, and the SEC would not have to divert resources. Not huge, but it would go in the right direction.

Would that be accurate?

Ms. ESHOO. It seems to me, on the face of it, that you have just stated the case; it would. It would free up resources. And—

The CHAIRMAN. And allow the SEC to concentrate on—

Ms. ESHOO. Exactly, on other things.

And I think, too, Mr. Chairman, that when you look at how many IPOs there were in 2005 and you take it to 2009, there is a drastic, drastic falloff.

So this is a wonderful tool. It is not government money; this is private-sector money that would go into the public capital markets. So it is an important tool. It is not being used. There is a pent-up demand.

So I think it is really an important proposal. And we are desperate to create jobs in this country. We know that. No matter where we go, people talk about it, "What are we going to do?" Here is a way of addressing at least part of it, a very important part of it.

The CHAIRMAN. I appreciate that.

And I do say, those who are fully familiar with the works of Jonathan Swift might want to refrain from calling this a "modest proposal," since his modest proposal was not a great idea, if people remember it. It was somewhat sarcastic. But that does not detract from the merits of this.

With that, I will recognize the gentleman from Delaware, and ask the gentleman from Kansas to assume the chair.

Mr. CASTLE. Thank you, Mr. Chairman.

I have no questions of the Congresswoman, except to thank her for, I thought, a clear statement of advocacy for this. I don't know what the other side is, but you did a good job on the pro side of it.

Ms. ESHOO. Thank you.

Mr. CASTLE. So we thank you.

And I yield back.

Ms. ESHOO. It is lovely to see you, and we are going to miss you here a great deal.

Mr. CASTLE. Thank you. Thank you, Anna.

Mr. MOORE OF KANSAS. [presiding] I understand Mr. Castle is finished.

Do you yield back?
Mr. CASTLE. I do.
Mr. MOORE OF KANSAS. Thank you, sir.
And do any other members have questions for Ms. Eshoo?
Mrs. MALONEY. I do.
Mr. MOORE OF KANSAS. Yes, Mrs. Maloney?
Mrs. MALONEY. Congresswoman, does the SEC need an act of Congress to raise the exemption, or could they do it by themselves and set the limit?
Ms. ESHOO. I believe the SEC can take this on itself; they have before. But I think the oversight of the committee is very important, as well. And I know that the next panel, especially Mr. Hambrecht, can talk about or raise the issue of where there could be potential abuses and the protection of investors. But I do believe that the SEC can take this on themselves.
Mrs. MALONEY. And how did you arrive at the $30 million number? How was that derived?
Ms. ESHOO. It really is—that number was arrived at by the needs of what small companies really need to help get off the ground. In other words, it is a workable number. Is it hard and fast? I don't think so, but I think that that range is very important.
Mrs. MALONEY. And how does Reg A work now?
Ms. ESHOO. It is not working. No one uses it. That is the problem.
Mrs. MALONEY. But I am told that eight companies used it last year.
Ms. ESHOO. Eight in our whole country.
Mrs. MALONEY. Yes.
Ms. ESHOO. That says something in and of itself.
Mrs. MALONEY. Okay.
Ms. ESHOO. When I have two firms in my congressional district, as I mentioned, Silicon Valley Bank and Wilson Sonsini—just between the two of them, they have about 9,000 company clients that are looking to make investments. So that is why this has collected dust. The ceiling on it simply doesn't work in the 21st Century. And there is pent-up demand, and we should want to meet that demand.
Mrs. MALONEY. Okay. I have no further questions.
Ms. ESHOO. Thank you.
Mr. MOORE OF KANSAS. Any more questions?
Mr. Scott?
Mr. SCOTT. Ms. Eshoo, could you walk us through and give a good example of just how this is a tool for job creation and, specifically, how the $30 million in increase would turn over into an increase of jobs, as specifically as you could?
Ms. ESHOO. It is a great question, because I think that, because we are so desperate for jobs, that whatever we do, we want to attach "and this will create jobs." And it seems to be illusory, in many instances.
It is important to understand how this money works. First of all, the regulation with a new cap would allow companies to seek these small infusions of funds as they go along. Then investors would demonstrate their confidence, as I said earlier, with their checkbooks. Now, what happens? Once these dollars are invested, that

is when the hiring starts taking place; that is how the companies actually start to grow.

And it is important to know that, even against the backdrop of an economy where investment funds are scarce, at the high end, in deals of $100 million or more, there is a lot of action. But at the low end, deals of $50 million or less, the traditional IPO capital has really disappeared, and it hasn't come back. And, as I said, in 2004, there were 40 IPOs at $50 million or less; in 2005, there were 38 IPOs at $50 million or less; and in 2009, there was one. So, clearly the existing IPO structure is not getting the job done for smaller companies.

And those innovative companies, those new companies that we want to be born and grow, as the dollars come in, they keep hiring.

I remember when Eric Schmidt, when I saw him somewhere some years ago, I said, "Eric, what is new? What are you doing?" And he said, "Well, actually, I am going off to this outfit called Google." And I said, "You have to be kidding." It was the first time I had heard the word "Google."

So we need new companies to be born, but these are the ingredients that help them grow. And, at this lower level of investment, nothing is going on. Essentially, the IPO market is—I don't want to use the word "dead," but, in 2009, one IPO? That says something.

Mr. SCOTT. Yes. I agree with you. And I think what you are saying in terms of almost any direct infusion of capital, the lead consequence has to be job creation. And it certainly does.

Would you not agree that the argument that the increase in this $30 million would pose a potential risk to investors, that argument is kind of weak and that the upside is and the benefit is this job creation that would be created? Is that the best way we can respond to the argument that some people might feel that there may be a risk to investors in this?

Ms. ESHOO. I think it is important for both the SEC and for Congress to examine what the risks could be. I think that is a very important thing to do. Here we are at the end of 2010. We know what the cost of risk is in this country. People in the country have paid a great price for risks that have been taken.

So I think that Mr. Hambrecht can better answer that. I think he knows in a broad and deep way what the risks could be and what areas need to be examined.

But I have no doubt that, if this is structured correctly, with the right oversight, and this committee has built in a lot of new enforcement mechanisms, that this can be carried out very well, without abuses, and rebuild the IPO market in our country—which, as I said, there is a pent-up demand for this, and I think that we can do something about it. And America will win.

Mr. SCOTT. I agree with you, Ms. Eshoo. Thank you very much.

Ms. ESHOO. Thank you.

Mr. MOORE OF KANSAS. Thank you.

Any other questions?

Thank you very much for your testimony, Ms. Eshoo.

Ms. ESHOO. Thank you, Mr. Chairman, and members of the committee. It was lovely to be with you.

Mr. MOORE OF KANSAS. And could the next panel of witnesses please be seated?

Thank you for being here today for this committee hearing.

And we will ask each of the witnesses please to give their statement, if they have a statement to make. We will start with Mr. Hambrecht, founder and chairman and chief executive officer of Hambrecht & Co.

Sir, if you would, please.

STATEMENT OF WILLIAM R. HAMBRECHT, FOUNDER, CHAIRMAN, & CHIEF EXECUTIVE OFFICER, WR HAMBRECHT + CO.

Mr. HAMBRECHT. Thank you, Mr. Chairman, for the opportunity to present our proposals to hopefully—how shall I put it—rebuild an IPO market that has basically been moribund for the past decade.

I think, rather than read my remarks, I would like to—I have submitted our answers to the questions that were directed to us from the committee. If I may, I would like to highlight a few of the points.

Mr. MOORE OF KANSAS. Please do.

Mr. HAMBRECHT. And then hopefully, if you have any questions, I would be happy to deal with them.

Mr. MOORE OF KANSAS. Yes, sir.

Mr. HAMBRECHT. First of all, the jobs question, which is really why we are all here.

I think there is significant data out there that very much shows that the major engine of job creation for the past 4 or 5 decades in this country has come from new entrepreneurial companies. The National Venture Capital Association has estimated that 90 percent of job creation has come from these companies. Living and working in Silicon Valley, it is so obvious that even the Hewlett-Packards and the Intels are really young companies. They started in our generation, and they have grown tremendously.

And it continues to happen. There are still some great young companies that come along. In our testimony, we pointed out three examples. Google, of course, is the obvious one. Ms. Eshoo brought it up. But when they went public 5 years ago, they had 1,628 employees. Today they have 19,800 employees.

Now, it is easy to say, well, Google is a very unusual company. And it is. But there are countless examples of it. Another one, Salesforce, which became public really, I guess, just a year or so before Google, they had 500 employees; they now have 4,000 employees.

But the one I do want to bring up, because I think it is more applicable to the world we are talking about, is Adobe, Adobe Systems. They went public in 1986, $5.5 million, a tiny little offering. At that time, they had 49 employees. Today they have 8,600 employees.

And that is the kind of company we are worrying about. The Googles and the Salesforces of the world will attract underwriters and will be able to go into the public market. But it is the small software company, like an Adobe, that does not have access to the public market.

Representative Eshoo, I think, described the IPO market for under $50 million better than I could. We have a chart in our testimony that shows it. It is basically a number of offerings—it is 3 percent of all public offerings in the past decade. And so, clearly, it just isn't working for small companies.

To move to the Regulation A exemption, the reason we focused on it is that, first of all, it is part of the regulatory landscape. It was written into the 1933 Act. It worked pretty well until, actually, 1996. And in 1996, under the Securities Markets Act that was passed then, it granted a blue-sky exemption to any company that was listed on an exchange. And what this did is it took the burden away of having to file with 48 different State regulators—a very expensive, very time-consuming process. And it streamlined the IPO process.

But the problem is, you really have to have an offering of somewhere between $20 million and $30 million to qualify to list on any of the exchanges, including NASDAQ. So to get the blue-sky exemption, you have to have an offering of $20 million or more. And this is what basically drove the Regulation A exemption into just an unworkable position.

When you look at it, it has some advantages. It is basically a simplified S-1 registration statement. For those of you who have read prospectuses, the way to describe it is it leaves the last 50 pages out, which are largely schedules, backup data that apply to big companies but really, for the most part, don't really apply to smaller companies.

Secondly, it allows you to test the market. It allows you to go out and talk to investors to see if they are interested before you commit to the expense of hundreds of thousands of dollars or, in an S-1 process, millions of dollars. You can find out whether you have a good chance of basically succeeding. This is particularly important now because, since 2007, over 30 percent of the S-1 filings have been withdrawn, they have been unsuccessful. So this was a tremendous burden on the companies that tried to do the deals.

And thirdly—

Mr. MOORE OF KANSAS. If you can, please wind up your testimony. Your time has expired, but if you could—

Mr. HAMBRECHT. Okay. Let me just close, then—

Mr. MOORE OF KANSAS. Sure.

Mr. HAMBRECHT. —with one set of data that I would ask you to look at. This is the data on M&A transactions versus IPO transactions. We have it in our testimony.

Effectively, what you will see is that the M&A number is a minimum of 10 times what the IPO volume is. And, as a result, virtually every M&A transaction results in job loss. It is the consolidation of two companies, and you have overlap of overhead, and people lose jobs. And that is what is happening in Silicon Valley today. That is the exit route people are taking because the IPO possibility is not there.

Thank you very much.

[The prepared statement of Mr. Hambrecht can be found on page 31 of the appendix.]

Mr. MOORE OF KANSAS. Thank you, sir, Mr. Hambrecht.

And next, Mr. Lempres, if you would please make your opening statement. And you are assistant general counsel and practice head for SVB Financial Group. Sir, you have 5 minutes.

STATEMENT OF MICHAEL T. LEMPRES, ASSISTANT GENERAL COUNSEL AND PRACTICE HEAD, SVB FINANCIAL GROUP

Mr. LEMPRES. Thank you very much.

As mentioned, I am here with SVB Financial Group and its subsidiary, Silicon Valley Bank. One of the things that is unusual about SVB is that we have an extraordinarily deep connection with emerging growth companies, not only in Silicon Valley but throughout the Nation and, increasingly, throughout the world. Our platform gives us insight into both debt and equity funding channels.

Through our subsidiary bank, Silicon Valley Bank, we are the premier provider of financial services for companies in the technology, life science, venture capital, and premium wine industries. We serve more than 13,000 client companies through 26 U.S. and 5 international offices. And we provide banking services for approximately half of the venture-backed technology companies in the world today.

In addition to our core banking service, SVB, the holding company, also sponsors or has sponsored venture capital funds through our SVB Capital Division and made investments in certain third-party venture funds.

One of the things we do is a survey of startup businesses annually. In our Startup Outlook 2010 survey, executives for early-stage growth companies cited access to capital as their number one concern. So the executives identified that as their biggest challenge going forward.

This is an accurate observation, in many ways: Both debt and equity to raise capital exists, but nearly all funding channels are currently under stress. You have heard some of the statistics about that already. Revising Regulation A could fill a need.

The impetus behind the creation of Regulation A was a very good one. Unfortunately, in recent years, as you have been hearing, Regulation A has not proven to be a useful capital-raising vehicle for small issuers. It was used only a total of 78 times during the 10-year period between 1995 and 2004. An average of 8 filings a year, with a maximum amount of $5 million each, really proves the irrelevance of Regulation A in today's economy. It is simply not a viable vehicle as currently structured.

The proposed revision of Regulation A strikes a better balance. If Regulation A is to become effective, the offering size will have to be raised. And $30 million seems an appropriate limit to increase Regulation A offerings. In our view, actually, $50 million would make the Regulation A offerings more useful to companies engaged in capital-intensive sectors. And, in the innovation economy, there are some very good examples of these capital-intensive companies. For example, clean-energy companies now require substantial capital at relatively early stages in order to establish that a new technology is commercially feasible.

I would also like to stress that many new products, new technologies are developed and implemented by emerging companies. High-growth small companies are more nimble, more entrepreneurial, and less invested in the status quo than larger companies as a general rule. Thus, it is the emerging company that often implements improvements and disruptive technologies that help revolutionize the way we work and live. And that is truly where much of the job growth comes from in America today.

I know the committee asked six specific questions, and I look forward to answering them in more detail, as we have in the record. But I do want to stress a couple of things.

You asked specifically about drawbacks to raising the limit under Regulation A. I think it has to be noted that smaller companies do tend to present different financial risks than bigger companies. They have, typically, a shorter financial history. But I would also say that the benefits of raising the limit to $30 million or $50 million, in our view, far outweighs any risks that would be presented. In job creation alone, it would be a significant step.

I just would like to thank you for this opportunity to present information on such an important topic. I believe the proposed revision of Regulation A could make a real difference to small businesses and the entire economy, particularly its innovation sector.

With that, I thank you and look forward to answering any questions.

[The prepared statement of Mr. Lempres can be found on page 49 of the appendix.]

Mr. MOORE OF KANSAS. Thank you, Mr. Lempres, for your testimony.

And next, the Chair will recognize Mr. Scott Cutler, executive vice president and co-head of U.S. listing and cash execution at New York Stock Exchange Euronext.

Mr. Cutler, you are recognized for 5 minutes, sir.

STATEMENT OF SCOTT CUTLER, EXECUTIVE VICE PRESIDENT AND CO-HEAD OF U.S. LISTINGS AND CASH EXECUTION, NYSE EURONEXT

Mr. CUTLER. Thank you, Mr. Chairman, and members of the committee.

I represent, as you said, NYSE Euronext, the world's leading and diverse exchange group with businesses in equities, futures, options, and markets throughout the United States and in Europe.

I appreciate the opportunity to testify today, and I applaud your strong commitment, even in the late days of this Congress, to promoting legislation that will help more American entrepreneurs access the capital that they need to expand their businesses and create jobs.

Across America's economy today, small businesses are struggling to find capital. A record 41 percent of small-business owners cannot get adequate financing, according to the most recent data of the National Small Business Association, up from 22 percent in 2008.

Regulation A was adopted to address this very challenge, specifically to provide small businesses with the opportunity to access capital markets without incurring the expense or meeting the regulatory burden of full registration under the Securities Act of 1933.

Increasing the SEC's Regulation A exemption from $5 million to $30 million would open the capital markets to more entrepreneurs—a vital step towards fueling America's most vigorous job-creation machine.

Oftentimes, the greatest acceleration in job growth occurs after a company's initial public offering. In fact, the National Venture Capital Association reports that 92 percent of all job growth within publicly traded companies occurs after the company's IPO.

Consider a few examples. When Pixar released its first full-length movie, a little animated film called "Toy Story," the company employed fewer than 100 people. Going public provided the financing for Pixar to grow from a small animator to a major motion picture studio. By the time the company released "Toy Story 3" last summer, the number of jobs at Pixar alone had grown more than eightfold.

Another growing company, Vitamin Shoppe, went public last year in 2009. In the 9 months that followed, the company created nearly 300 new jobs and opened 29 new stores, the fastest expansion in its history.

Congress has long recognized the benefit of helping small businesses secure capital through public offerings, yet, over the years, the Regulation A exemption has not been scaled to meet the demands of our modern economy. The $5 million exemption, which was last raised in 1980, is not indexed for inflation. It is now too small to warrant companies incurring the time and expense to satisfy the offering and disclosure requirements of Regulation A. As a result, between 1995 and 2004, as others have said, on average, only eight companies per year utilize Regulation A.

While some believe that Regulation D, which is the mechanism that most companies use for private placements, offers a viable means for small companies to raise capital, this provision has critical limitations. Regulation D offerings can only be made to a small group of qualified investors, and securities sold in such transactions are subject to transfer restrictions. A Regulation A offering, on the other hand, is a public offering, providing access to a large pool of investors.

Raising the Regulation A exemption to $30 million seems to be a reasonable maximum, although most full registration IPOs today involve significantly higher offering minimums. Thus, this still leaves a gap between the $30 million ceiling and the level at which a company can realistically access the full registration IPO market.

So, in order to be effective, any modification of Regulation A must be implemented in a way that promotes capital raising by smaller companies while also protecting investors. This is why NYSE Euronext believes Congress should also direct the SEC to avoid imposing disclosure, governance, and other burdensome provisions that may actually increase costs and reduce the attractiveness of Regulation A.

An exchange trading platform may have advantages for companies that issue securities in Regulation A offerings. Establishing a separate exchange trading platform may make these offerings more effective by providing some structural elements to improve liquidity, trading interest, and economics, as well as investor interest. However, we believe that further investigation would be required to determine if such platforms would be economically feasible.

We believe all the relevant data point to one direction: Entrepreneurs and small businesses cannot access the capital they need to grow and create jobs. And I urge you to revive Regulation A and dedicate it to the role Congress originally intended.

Thank you again for allowing me to testify, and I look forward to answering any questions.

[The prepared statement of Mr. Cutler can be found on page 28 of the appendix.]

Mr. MOORE OF KANSAS. Thank you, Mr. Cutler.

And thanks to all of our witnesses, including Representative Anna Eshoo, for your testimony here today.

And I would like to now begin my questions for Mr. Lempres. I appreciate the point you made on page 4 of your written statement that, "Small, growing companies need a variety of funding options, including equity-based financing, to compete and grow their businesses. Congress should continue doing all it can, as we have with legislation like the Small Business Jobs Act enacted into law earlier this year, to empower small businesses and give them every opportunity to succeed and create jobs."

On page 6 of your statement, sir, you indicate your support for increasing the Reg A threshold from $5 million to $30 million and even a further increase up to $50 million. It seems to me like an increase to $30 million make sense, but I think we should also make sure this increase is designed to help smaller issuers and not their mid-sized or larger competitors.

Mr. Lempres, would you support legislation that raises the threshold to $30 million for now but then require the SEC to review this threshold every 5 years or so, and if there is sufficient evidence to provide for a higher limit, they would be given flexibility to do so? Would you support that, sir?

Mr. LEMPRES. Yes. I think that is a good idea.

I don't think there is any magic to a $30 million or $50 million figure. But I do think that we should be aware that the world is changing and that there are companies now, as I mentioned earlier, particularly, for example, in the clean-energy sector, where it takes a great deal of capital to get going. We have some wonderful ideas, again, not just in Silicon Valley but around the country, and it is difficult to make sure those ideas are able to be fully funded.

I think $30 million is a reasonable number. I think it is certainly more effective, and I think you would see some real activity at that level.

Mr. MOORE OF KANSAS. Thank you, sir.

Mr. Hambrecht or Mr. Cutler, would you support providing the SEC with some flexibility on this threshold if they have strong evidence that raising it will benefit small issuers while not compromising oversight or adequate investor protection? Does $30 million strike the right balance?

Mr. Hambrecht, do you have a comment on that?

Mr. HAMBRECHT. Yes, I believe $30 million would allow companies to use it. The vast majority of companies that don't have access to the market, I think, could and would use the $30 million exemption.

I might add, if I could, on the risk side of it, the one criticism of Reg A is that it doesn't require audited financials. And I think it would be important to have the SEC implement it with whatever else they think is necessary. Because virtually every company that raises money outside has audited numbers, so it doesn't really mean anything. So I think applying a requirement for an audit would be a positive step, along with the $30 million.

Mr. MOORE OF KANSAS. Thank you, sir.

Mr. Cutler, any comments?

Mr. CUTLER. Yes, we would also be supportive of that.

I would note that becoming a public company is important because it provides permanent access to capital. And we noted earlier that most companies today are not able to access the public markets and access to permanent capital without raising $75 million to $100 million. And so, having a much lower threshold to be able to attract permanent capital in the public markets at $30 million is an adequate level.

I would note that still does create a gap between what is currently a standard IPO for most companies. And so I think we would be very supportive of that; as well, also supportive of what Bill had indicated. The need for audited financials and disclosure to protect investors for these types of offerings is also important.

Mr. MOORE OF KANSAS. Thank you, sir.

Mr. Hambrecht, on page 4 of your testimony, you lay out a rough estimate of about 750,000 jobs that could, in theory, be created by raising the Reg A limit to $30 million.

Do you have any sense of how long it might take to create that many jobs through adjustments to Regulation A? And is there anything Congress can do to speed up job creation through these or other adjustments to Reg A?

Mr. HAMBRECHT. First of all, I think it is important that this Regulation A adjustment be made as soon as possible. Right now, every day, you read more and more companies are being acquired. So I think it is a very real time problem today that has to be adjusted.

How long it will take to get going, it is hard to say. We have talked to literally dozens of companies that are very willing and able to move ahead as soon as this is implemented. I would hope that basically, the small-cap market declined by about 4,000 companies over the last decade. So that says to me there probably should have been 4,000 IPOs over the last decade. Which, incidentally, would be 400 a year, which is about equal to what it was in the 1990's and the 1980's.

So, to me, as soon as you can get it going, I would imagine—it is hard to imagine 500 offerings the first year, but I would be willing to bet it would happen over the next 3 to 4 years.

Mr. MOORE OF KANSAS. Thank you, sir.

And I would like to ask the same question of the other gentlemen, except my time has expired. And I would ask you, if you have any comments on that, to submit those in writing, please.

Next, the Chair will recognize Mr. Castle for 5 minutes. Sir?

Mr. CASTLE. Thank you, Mr. Chairman.

I want to try to take the conversation a little bit beyond some of the testimony and something that the chairman asked a moment ago that was the latter part of what he stated. But all of us here—it has been stated in both opening statements and by Congresswoman Eshoo—we are all concerned about job creation. Obviously, the whole country is, and Members of Congress are.

And my question to you is: Beyond the changes in Regulation A which you have discussed today, which seem to make sense to me, what could Congress do to enable our small companies to raise capital which would allow them to expand and create jobs? Or what else would you recommend Congress be doing in general for the creation of jobs and economic opportunity, perhaps even beyond the raising of capital?

And I ask that question to any one of you or all of you, if you are willing to take a shot at it.

Mr. LEMPRES. One answer I can offer up relatively quickly that undercuts the utility of Regulation A is the effect of State blue-sky laws on raising moderate amounts of capital. Complying with the various State blue-sky laws is a burden for companies that are seeking to access capital, particularly smaller companies. That should be addressed, it seems to me, as part of a look at Regulation A.

I think, more broadly, Congress should take a look at what is happening to our venture capital markets, what is happening to our innovation sector. It does not look the way it did 5 years ago or 10 years ago, and there is much more being done overseas than there was.

I think that a thorough review should look at the layers of regulations that have been added over the years to see if they are all still justified, because regulatory compliance does impose a burden, particularly on smaller companies as they begin to look to grow.

But rather than provide a solution for you at this time, unfortunately all I can do today is point out the issue and say I think it is an important one.

Mr. CASTLE. Very good.

Mr. Cutler?

Mr. CUTLER. I would comment that, when you look at the state of the capital markets, one has to have a global perspective. Today's capital markets are global. We have capital that is being created around the world. And, more importantly, the companies that are created here in the United States that are employing hundreds of Americans are also competing globally.

And so, any regulation that we can do to enable companies access to capital in a way that is efficient and cost-effective, where the regulatory and the tax burdens are competitive with what these companies are competing up against around the world, would certainly go a long way towards fostering more job-growth creation and innovation in our economy and also help allow the United States to compete globally.

Mr. CASTLE. Thank you.

Mr. Hambrecht, any thoughts?

Mr. HAMBRECHT. I know the Congress has been very active with the Small Business Act and have made more money available through the Small Business Act. My own personal belief is that if you really want companies to grow and be aggressive, you should allow them access to equity. Debt has to be paid back, and debt is something that controls growth and holds growth back.

And I think the great companies that have risen in Silicon Valley and elsewhere have largely done it with equity and have done it in equity markets. This was one of the great advantages we have had over the last 3 or 4 decades. And what we are trying to redress here is the fact that it isn't working right now for small companies.

I wish I had some other ideas. I keep asking, and, somehow or another you have to get the IPO market going. Congresswoman Eshoo asked me—that is what led to this hearing. She said, "How do you get the IPO market going?" This is the only way I know.

Mr. CASTLE. If you have other ideas after you leave here, please feel free to write to me and suggest some. As I indicated, we are all looking for these opportunities, and it makes a difference.

The other concern that I have is that, just listening to your testimony and the answer to your questions, while you are here to testify on behalf of $30 million, the concept of perhaps going higher than that is not something that you would object to; is that correct? Do any of you feel there should be a cap on how high we should go?

Mr. HAMBRECHT. I think $50 million would be great. Thirty million was arrived at by—that was the average size IPO in the 1980's and the 1990's. That worked well. That worked for so many of these companies. The $100 million and above was a creation of the Internet bubble that happened in the last 2 or 3 years of the 1990's. So, to me, $30 million would get us back to what used to be normal. It certainly wouldn't hurt; it would help. It would add to the companies that use it, and they would have the same characteristics as the smaller company, yes.

Mr. CASTLE. Thank you.

I yield back, Mr. Chairman.

Mr. MOORE OF KANSAS. I thank the gentleman for his distinguished service and for his questions here, and the Chair next recognizes Mrs. Maloney of New York for 5 minutes.

Mrs. MALONEY. Earlier, it was testified that the SEC could raise it if they saw fit, and due to the fact that we are still reeling from economic challenges and the financial crisis, what is the downside of doing this? Does the investor community support raising the offering or not? What are the protections for investors by exempting them from filing with the SEC?

Mr. HAMBRECHT. May I?

Mrs. MALONEY. Sure. Anybody.

Mr. HAMBRECHT. I think, first of all, the addition of an audit requirement would go a long way towards answering any questions people have about added risk into the marketplace. In our testimony we have some data that shows the historical performance of the small cap indexes in the market over the last 20 and 30 years, and while it is true that small cap markets are generally more volatile than larger ones, the performance has been as good as or better than large-company investors. So there are plenty of people out there, plenty of institutions that run very aggressive and very professional investment funds and small cap companies, and I think the protections that they have now in terms of transparency and reporting requirements has worked well, and I don't see why you would need any more.

Mrs. MALONEY. Under the Dodd-Frank bill, I join many of my colleagues in sponsoring the amendment that would exempt smaller companies under $75 million in market capitalization from the 404(b) audit—independent auditor requirement, because the small businesses in my district were telling me that it was onerous. So to replace the filing with an auditor requirement, I think we would hear the same type of resistance from small businesses. They were telling me this is very costly.

Could you explain exactly what how Reg. A works? It is merely filing with the SEC, correct? Why is that going to cost a company $2 million? Something is wrong with the filing requirement if we are asking them to spend $2 million to file. We should look at that. And, if you could explain exactly how it works and why is it so onerous that only eight companies filed under Reg. A.

Mr. HAMBRECHT. The first basic difference is that under Regulation A, you file an offering circular, not a prospectus, and there are some liability differences there, not just—not major, and if you look at it, it looks just like a prospectus, except it doesn't have all the supporting data in the back is about what it boils down to.

One of the great frustrations of my career has been dealing with the legal and accounting costs of an IPO. They just continue to multiply. And it is a system that has scaled up along with the underwriters, and it is very difficult to fight. There is no reason in the world why you shouldn't be able to file a Regulation A, almost without a lawyer.

Mrs. MALONEY. Why do you think—and I will ask all of you—companies are choosing not to list in the United States?

Mr. CUTLER. Companies that are domiciled in the United States are listing in the United States public markets. If they want to provide stock options to their employees, if they want to sell stock to U.S. investors, they have to list within the United States. So we are not actually seeing a trend of companies, entrepreneurial companies, from the United States listing in foreign markets.

We do continue to see a trend of nondomestic companies coming to the United States markets because of what they represent to the world: fair, transparent, deep, and liquid markets. And we want to continue to promote that opportunity that the United States capital markets continue to be competitive with other markets around the world.

Today, the leading markets for initial public offerings are actually Shanghai, Shenzhen, and Hong Kong. The New York Stock Exchange is number two.

Mrs. MALONEY. Your CEO, Mr. Cutler, recently said that this is the most robust IPO pipeline that we have seen in years, and I understand that companies are lining up to go public. Can you expand on this, what you attribute this to?

Mr. CUTLER. We have seen in the last 2 months, in October and November, more capital raised in those 2 months than we had seen in all of 2009 and 2008—or 2008, and so we see a very deep pipeline, and I think that is reflective of recovery in the markets, recovery from the financial crisis, and it is global and across all industries. But I will still note that companies that are trying to raise capital below a $50 million amount, we are not seeing that.

Mrs. MALONEY. My time is up, and let us end with that positive statement that the capital markets are rebounding.

Thank you, Mr. Chairman.

Mr. MOORE OF KANSAS. Thank you, Mrs. Maloney.

The Chair next recognizes the gentleman from North Carolina Mr. Watt, for 5 minutes, sir.

Mr. WATT. Thank you, Mr. Chairman.

Mr. Cutler, are there comparable limits on non-U.S. stock exchanges, comparable to the $5 million limit?

Mr. CUTLER. I am sorry, I don't understand the question.

Mr. WATT. On other stock exchanges, non-U.S. stock exchanges in other countries, are there comparable limits?

Mr. CUTLER. There are opportunities in other countries that have smaller marketplaces that are less regulated. For example, we operate a marketplace in Europe called Alternext that has sort of a nonregistration element to it which is accessible by companies, raising $5 million to $10 million—

Mr. WATT. I am talking about the regulatory structure now. Are there, on any of the other stock exchanges worldwide, comparable restrictions?

Mr. CUTLER. Yes, there are initial listing requirements, minimum thresholds in terms of the dollars amounts or market capital—

Mr. WATT. And what are they? I am just trying to figure out how we are comparing to other countries.

Mr. CUTLER. Every exchange around the world in every country has those requirements. They all differ. The ones with the lowest standards would be those markets that you find in Shenzhen, London AIM, the Alternext market in Europe that are available for—

Mr. WATT. And what are those limits? I am just trying to—what is the range of the limits?

Mr. CUTLER. I would have to get back to you with the exact details, but—

Mr. WATT. Okay. That is fine.

Mr. CUTLER. Very small companies are going public on those markets, below $50 million in market cap.

Mr. WATT. Okay. Let me ask you to discuss, Mr. Hambrecht, the interplay between Rule 506 of SEC Regulation D and what is happening here. I take it the whole reason for registration is to protect potential purchasers of stock, right? That is the rationale for it, and I am sympathetic to job creation. I am sympathetic to capital formation, capital raising, but what we don't want to do is compromise exposure of consumers, and rule 506 at least has some protections there. Should we be expanding those, the flexibility under rule 506, as opposed to raising this limit, or is that not an acceptable alternative?

Mr. HAMBRECHT. I think Regulation D basically regulates private placement, and as a result of a Regulation D filing, you do not get a public market afterwards. Stock is not freely tradable afterwards. This is the advantage of an IPO, and this is the process that leads a company to—

Mr. WATT. Okay. So I should be comparing this with other public offerings, not rule D, Regulation D?

Mr. HAMBRECHT. Exactly.

Mr. WATT. That is fine. All right. So then are there—you mentioned audits, an audit requirement you think ought to be one of the requirements, but then you turn around two or three sentences later and said you ought to be able to do this without even having a lawyer.

Mr. HAMBRECHT. Right.

Mr. WATT. I am a little perplexed about how you square those things now. You are not really serious about issuing a public offering of stock of any kind without the benefit of a lawyer, I assume. That was a little hyperbole, I take it.

Mr. HAMBRECHT. Yes and no. My philosophy has always been—

Mr. WATT. Let me ask a more direct question. If you are expanding this from $5 million to $50 million or $30 million, what are the other things that you would want to impose to protect potential buyers, if any? You mentioned the audit requirement, but are there other things that you would want as a precondition for doing that?

Mr. HAMBRECHT. Yes. I think, first of all, the registration process now in place in the United States works well. There have been very few fraudulent IPOs in the United States. It is a good process.

The reason I put the lawyer comment in is I have always felt it should be an investment document. It should be a document that gives the investor every fact that he should consider or want to consider before he makes his investment. That, to me, is the essence of a registration statement, and that is why they have to be done by the management and by the financial people, along with the lawyers to make sure they comply with the law. But it has to be an investment document. That is the whole point of it, because I think if the marketplace gets a complete information package, it will make good decisions. The market is pretty smart.

Mr. MOORE OF KANSAS. The gentleman's time has expired.

The Chair will next recognize the gentlelady from New York, Mrs. McCarthy, for 5 minutes.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman.

A number of my questions have already been answered, and just going over some of the background that I had in a meeting last night, I guess the question I would like to ask all three of you is that if we do specific terms and conditions that should be imposed in connection with an increase in the offering limit, should Congress stipulate those terms, or should we be looking at those terms and conditions and leave them to the SEC? Which basically would work out better, and what are the drawbacks, and what are the positive aspects on Congress or the SEC?

Mr. LEMPRES. I can say from my standpoint, the imposition of terms and conditions is the kind of thing a regulatory agency, the SEC, is better positioned to do for a number of reasons. One would be they have greater flexibility. They can go through a regulatory reform process, issue proposed rules, take comments from the public, and adjust more readily than Congress can. I think that the imposition of these kinds of terms and conditions is the kind of detail that is appropriately left to the regulators. I think the SEC generally handles those kinds of things quite well.

Having said that, I would stress that there is an important role for Congress here. The need for congressional involvement is shown simply by the state of Regulation A today, because the SEC does have the authority to take the kinds of actions that we have been talking about, and it has chosen not to do so. I think it is very important for Congress to step in and say this is a priority. Congress can provide the impetus to get helpful reform going. But I do believe the SEC has real expertise, and it should be tapped.

Mrs. MCCARTHY OF NEW YORK. Do you think that then the SEC would need more resources to basically go forward with that?

Mr. LEMPRES. I can't say off the top of my head that the answer is yes. My gut is probably not, but I think that one of the problems, we are measuring it against something that doesn't exist now, because Regulation A filings are essentially not occurring, so they are not applying resources to them today.

I don't know the answer to that. I don't think it would require any substantial increase in resources.

Mrs. MCCARTHY OF NEW YORK. Being that there is a little bit of time left, which usually never happens, is there anything that was in your testimony that you couldn't talk about that you would want to bring out in front now?

Mr. HAMBRECHT. I would just add one addition to the SEC. In the 1990's, the SEC would process 500 to 600 S-1 registration statements a year. Now that—they are under 100. I know they are doing a lot of other things because of the financial crisis, but a Regulation A registration is much simpler. It has a 28-day reporting requirement back, and it used to work pretty well. They used to actually do them in their regional offices. I don't know if they would do that now, but it is less of a burden than a lot more S-1.

Mrs. MCCARTHY OF NEW YORK. Thank you for your testimony.

Mr. MOORE OF KANSAS. I thank the gentlelady, and the Chair next recognizes the gentleman from Massachusetts, Mr. Lynch, for 5 minutes, sir.

Mr. LYNCH. Thank you, Mr. Chairman, and I want to thank Mr. Castle as well for his leadership here, and I want to thank our witnesses for helping us with this work.

I tend to think that the lack of applications or interest in this is more to do with the economy than some of the limitations at the current time, but I am with you. I believe that this is something that has not been changed since 1980, and I think that an increase is certainly a reasonable request. I am not so sure that $30 million is the number.

But I am concerned about the fact that we are now going to open this up to unsophisticated investors, and while I know that in your testimony, you mentioned companies like Pixar and Twitter and Facebook, there are also a lot of dogs out there that probably weren't thoroughly vetted and yet were launched. And so I am concerned about the consumer protection angle of this. I think we can strike a balance, however.

Let me ask you, have you actually reached out to the SEC given the new responsibilities that we are giving them under the Dodd-Frank Act? Have you asked them about concerns that they might have in terms of raising this exemption from $5 million to $30 million?

Mr. CUTLER. Thank you, Congressman.

What I would comment about that is if you look at the requirements of the offering circular under Regulation A, there is a section in there that requires the issuer to identify risks associated with the offering, which are very similar requirements that you would see in an S-1 full registration statement. So the similar sort of identification of risks to the offering, risks to the issuer would be required in an offering circular under Regulation A as you do have under a full registration statement.

So I think when we talk about additional risks to investors, I don't think that we are adding any more risk than a regular public offering, which also discloses risk factors of the company. The only thing you are introducing is earlier-stage companies which, by their nature, are more risky investments by themselves as a class, but the adequacy of this disclosure on the risk factors is actually required in their offering circulated already under Regulation A.

Mr. LYNCH. Right. You are getting to my point. The newness or the lack of history, financial history, here often makes these companies a real gamble, and I am just trying to figure out if there is a way that—in addition to the audited financials that you mentioned earlier, I think that is a great suggestion, are there other precautions that we might take proactively to say, okay, we are going to lift this limit; however, here are some additional safeguards so that we don't end up with folks really going into this completely in the dark; that there is—it almost asks for some type of not a rating agency, but some type of vetting process given the larger amount that we are authorizing here under the exemption.

Mr. HAMBRECHT. The problem that I have always seen from trying to quantify the risk is—or set a set of standards, which a lot of countries do—a lot of countries will have certain numerical standards for companies in terms of operating income and history and everything else—it is difficult, very, very difficult, to do that in an economy that has moved as fast as the technology world has.

Mr. LYNCH. Sure.

Mr. HAMBRECHT. To me, the answer has always been transparency. The answer has always been an absolute commitment to presenting every fact you have and everything you can about that company, and I find that the investors generally make pretty good decisions. The latest financial crisis really has had nothing to do with really small consumers. It was really markets that lacked transparency, dealer markets, and a lack of information, and frankly, as you know, poor rating agencies.

Mr. LYNCH. Let me just close by saying I appreciate those remarks. I think you help your cause very much by having Congresswoman Eshoo speak on your behalf. I think the fact that she came forward today, she has a lot of credibility with the people on this committee on both sides of the aisle, and I think you are well served by having her speak on your behalf.

I yield back.

Mr. MOORE OF KANSAS. I thank the gentleman.

The Chair next recognizes for 5 minutes the gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you very much.

We have heard a lot of very good information in the question-and-answer period. I think now, though, we might want to examine what do we do now and how do we craft the proper legislative vehicle to move forward. Do we language it in such a way as we authorize the SEC to raise this limit, or do we require them to do it? And the history of the SEC and the Securities Act of, I think, 1930, 1933, that language was not clear. At one point when we changed it last, I think about 1992, it took them a while before they actually implemented it.

So I would like to get each of your thoughts on—I think we all agree this is great, we are going to do it, but it is up to us now to craft the best legislative vehicle to get the job done. So what would be your recommendation there, particularly on the language of whether we authorize them to do it or we require them to?

Mr. LEMPRES. In my view, sir, the ideal solution would be a mandate from Congress to raise the offering limit for Regulation A and to set a minimum ceiling figure. I do like the idea of revisiting it periodically and deferring to SEC the terms and conditions. I also think, however, that through oversight and other means, Congress should keep an eye on those terms and conditions, because oftentimes the layering of very well-intentioned individual regulatory obligations can undercut a legislative goal. So in this case what I would urge is that Congress mandates the higher limits and permits the SEC to set the terms and conditions.

Mr. SCOTT. All right. Mr. Hambrecht?

Mr. HAMBRECHT. I would agree with that. I have great respect for the SEC. They are a fine regulatory body. I do think, though, that there are some time pressures here, and that everybody would like to see this get going quickly.

I think if the SEC has a rule change, they have to go through a process that could take some time, and I would think a congressional mandate would move it quickly, and then definitely leave the SEC to implement it and to change whatever they see fit to change to make sure that they live up to their regulatory responsibilities.

Mr. CUTLER. I would say this is an opportunity to address an economic and political challenge, and that is creating a job growth opportunity engine, and the opportunity of the committee here is to recognize the role of the public markets in the creation of jobs, and mandating a part of a solution to encourage more efficient and more accessible public markets, and then leaving the discretion with the SEC in terms of how that is implemented. But the opportunity to act now, I think, is real.

Mr. SCOTT. All right. How deeply do you think Congress should go in this? Do you think we should stipulate terms and conditions, such as a requirement for audited financials?

Mr. HAMBRECHT. I would leave that up to the SEC really. I think it would be beneficial. I would think that their natural reaction would be to do it that way. But they have dealt with Sarbanes, they have dealt with all the accounting issues. I would leave it to them.

Mr. SCOTT. So, in other words, what you are saying, all of you, is that we should craft this legislation, we should mandate that they do it, but we should leave the discretion up to them in terms of the specific particulars.

Mr. CUTLER. The only caveat I would add, Congressman, is the fact that we should be promoting investor protection, but at the same time avoiding imposing disclosure, increased governance or burdensome provisions that would actually increase the costs of the application of Regulation A as it currently stands. That would be the only risk.

Mr. SCOTT. And then finally, just for your opinions, do you feel that $30 million is the adequate figure we need? You have a chance here to make a statement on whether or not each of you feel this is the right number. Or is there any feeling among you that it needs to be larger?

Mr. LEMPRES. As I have said, Congressman, from our standpoint the $30 million figure is a workable figure, but $50 million would be a better figure. After transaction costs, it would provide sufficient resources to startups, particularly startups in the innovation industry that sometimes are quite capital-intensive.

Mr. SCOTT. Okay.

Mr. MOORE OF KANSAS. The gentleman's time has expired. I thank the gentleman for his questions.

And the Chair has just been advised that there will be votes called between 11:30 and 11:45, so we will move right along here. We have time to give the two additional members time to ask their questions.

The Chair next recognizes the distinguished gentleman from Florida, Mr. Klein.

Sir, you are recognized for 5 minutes.

Mr. KLEIN. I have no questions.

Mr. MOORE OF KANSAS. The Chair will next recognize Mr. Foster.

Sir, you have 5 minutes.

Mr. FOSTER. Thank you.

Is there a best method for indexing this limit? Is it simple inflation, total market capitalization so you don't have to revisit this every decade or two?

Mr. HAMBRECHT. I personally don't think it is a question of inflation. It is much more a product of consolidation and of a change in the makeup of the distribution mechanism for equity.

Mr. FOSTER. But still, $5 million was set in 1980, if I remember right.

Mr. HAMBRECHT. Yes.

Mr. FOSTER. So simple inflation, we would be up near 10- or 15-, which at least would do something for you.

Mr. HAMBRECHT. The problem with that is that it still would not get you to a large enough offering to allow you for the blue-sky exemption and the exchange base listing. So you would still have that same problem of having a limited aftermarket, and it would help on the expenses, sure, but you would have the limited aftermarket.

Mr. FOSTER. My next question is about the Alternext exchange and that sort of approach. Has it been tried and failed in the United States? Is it successful at providing an alternate exit route for startups and so on?

Mr. CUTLER. In the United States, we have not had a regulation light exchange platform; that is, an exchange platform that would allow companies to sell to public investors in a lightly regulated fashion that exists in other markets around the world. I mentioned both the AIM marketplace in London as well as our marketplace, Alternext, which is really only applicable to the smallest of issuers, and in some instances they are actually regulator overseen by representatives who represent them.

Mr. FOSTER. My question is, is that an effective exit route for startups or not? What is wrong with that? Is that what you anticipate would happen if we raised it to $50 million, that there would be a much more active market here? Or what is the change, if any, that you anticipate in the structure of things?

Mr. CUTLER. It essentially enables smaller companies' access to the public markets as a public offering where today they don't have the similar access. That is the big change.

Mr. HAMBRECHT. If I may, for example, the AIM market has been looked on as an example of regulation light opening for small companies. And it is interesting, the performance of AIM—and I believe—they have had, I believe, about 1,800 listings in the U.K.—the performance of the investors has been not statistically different than the London Stock Exchange, pretty much the same.

Mr. FOSTER. The business of testing the waters, what is the argument against that for very large IPOs; or is that something where there is sort of an insider abuse thing that people are worried about, and could that morph into existence if you raise it up to $50 million?

Mr. HAMBRECHT. Traditionally, the SEC used to be very sensitive to any pre-filing publicity. They still are. The rules are against it because they didn't want, in effect, companies out there promoting their stock before a registration statement was available to investors. So the whole point is a quiet period where you are not allowed to talk.

To be candid, most companies now try to read the market somewhat before moving ahead, but do it through investor relations firms, not underwriters. It is happening anyway, and I think the Reg. A rule is actually a very practical rule. It allows you to go out and talk to a small group of people or, you know—

Mr. FOSTER. You don't think we should be worried about some sort of abuses as that threshold goes up?

Mr. HAMBRECHT. I would say, to be candid, it is being used in most S-1 registration statements now probably to the advantage of both parties.

Mr. FOSTER. Okay. And I guess just one last question. It is sort of my impression, without having to tell you, that the whole malaise in the VC industry has to do with the fact that there are not that many great investments, and the overall return on investments has not been that great for the last decade. Is that just my impression, or is there some element of truth to that that is really driving a lot of the difficulty in raising money here?

Mr. CUTLER. I would say that this is not related to venture returns, although that statement would be true. This is more about access to permanent capital in the public markets, and that it is related to how is it that we can help the venture capital industry.

Mr. FOSTER. Exiting is very relevant, and so—

Mr. CUTLER. And exit does provide liquidity for the initial investors, but probably, more importantly to this discussion, creates access to the long-term, permanent capital as a public company for the issuer to then be able to reinvest in the business, hire more people, expand operations.

Mr. FOSTER. Okay. Thank you. I yield back.

Mr. MOORE OF KANSAS. I thank the gentleman.

The Chair notes that some members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

The Chair thanks the witnesses for their appearance today before this committee and for answering our questions.

This hearing is adjourned.

[Whereupon, at 11:27 a.m., the hearing was adjourned.]

APPENDIX

December 8, 2010

TESTIMONY OF SCOTT CUTLER
EXECUTIVE VICE PRESIDENT, NYSE EURONEXT
COMMITTEE ON FINANCIAL SERVICES,
U.S. HOUSE OF REPRESENTATIVES
DECEMBER 8, 2010

Chairman Frank, Ranking Member Bachus, Members of the Committee: My name is Scott Cutler, Executive Vice President of NYSE Euronext – the world's leading and most diverse exchange group with equities, futures and options markets throughout the United States and Europe.

I appreciate the opportunity to testify today – and I applaud your strong commitment, even in the late days of the current Congress, to promoting legislation that will help more American entrepreneurs access the capital they need to expand their businesses and create new jobs.

Across America's economy today, small businesses are struggling to find capital. A record 41 percent of small business owners cannot get adequate financing, according to the most recent data of the National Small Business Association – up from 22 percent in 2008.[1]

Regulation A was adopted by the Securities and Exchange Commission pursuant to Section 3(b) of the Securities Act of 1933. The purpose of Regulation A is to enable small businesses to offer their securities publicly in accordance with streamlined offering and disclosure requirements, as compared to the requirements for a full registered offering under the 1933 Act. Increasing the SEC's Regulation A exemption from $5 million to $30 million would open America's capital markets to more entrepreneurs. By reducing the regulatory burden and expense of raising capital from the investing public, as compared to full registration under the Securities Act, Congress can boost the flow of capital to small businesses and fuel America's most vigorous job-creation machine. Regulation A can provide a reasonable alternative means for smaller companies to access the capital markets; it can also help entrepreneurial businesses attract private capital by providing liquidity opportunities at a lower level than might be feasible for an IPO using full registration.

Oftentimes, the greatest acceleration in job growth occurs after a company's initial public offering – in fact, the National Venture Capital Association reports that 92 percent of all job growth within publicly traded companies occurs after the company's IPO.[2] Let me give you just a few concrete examples.

- In 1995 when Pixar went public and released its first full-length movie – a little animated film called Toy Story – the company employed fewer than

[1] http://www.nsba.biz/docs/nsba_2010_mid-year_economic_report.pdf
[2] http://nvcatoday.nvca.org/index.php/nvca-releases-recommendations-to-restore-liquidity-in-the-us-venture-capital-industry.html

100 people. Going public provided the financing Pixar needed to grow from a small animator into a major motion picture studio. By the time the company released Toy Story 3 last summer, the number of jobs at Pixar had grown more than eight-fold.

- Another growing company many have seen in your local mall – Vitamin Shoppe – went public in 2009. In the nine months that followed, the company created nearly 300 new jobs and opened 29 new stores – the fastest expansion in its history.

Of course, not every small business in America will grow into the next Pixar or Vitamin Shoppe – but American job creation depends on giving every entrepreneur and small business that opportunity.

Congress has long recognized the economic benefit of helping small businesses secure capital through public offerings of securities – which is why your predecessors authorized the SEC to create the Regulation A exemption back in 1933. Congress gave the SEC the power to exempt securities from registration under the 1933 Act based on the small amount involved or the limited character of the public offering. Yet over the years, the Regulation A exemption has not been scaled to meet the demands of our modern economy.

Between 1995 and 2004, on average only eight companies per year utilized Regulation A. Simply put, the $5 million exemption – which was last raised in 1980 and is not indexed for inflation – is now too small to warrant companies incurring the time and expense to satisfy the offering and disclosure requirements of Regulation A, even though the costs of Regulation A offerings may be lower than those associated with a full registration under the 1933 Act. In addition to the stagnation in Reg A, we have seen very few IPOs below the $50mm level and even fewer below $30mm. A higher hurdle for entrepreneurial, venture backed companies is evident in the public markets as the median IPO deal size has been above $100mm for years.

All the relevant data point in one direction: Entrepreneurs and small businesses cannot access the capital they need to grow and create jobs. A critical source of financing – the public capital markets – has been largely closed off to America's proven job creators. An increased Regulation A ceiling may provide a valuable alternative for smaller, entrepreneurial companies that want to access the public capital markets even when the larger IPO market may remain limited. It may also enable smaller, growth-oriented companies to access the public market at an earlier stage in their growth cycle.

With respect to some of the Committee's specific questions:

- We believe that $30 million is a reasonable maximum amount for Regulation A offerings, though we note that most full-registration IPOs involve significantly higher offering amounts. Therefore, there may still be a "gap" between the $30 million ceiling and the offering amount at which a company can realistically access the full-registration IPO market.

- While Regulation D is an alternative means for small companies to raise capital, it has limitations. Regulation D offerings can only be made to a small group of qualified investors, and securities sold in such transactions are subject to transfer restrictions. A Regulation A offering is a public offering and therefore can be made to a larger pool of investors.

- We believe that any increase in the ceiling for Regulation A offerings should be coupled with direction to the SEC to implement it in a manner that will promote capital-raising by smaller companies, while at the same time protecting investors. The SEC should avoid imposing disclosure, governance and other burdensome provisions that may increase costs and reduce the attractiveness of Regulation A as an alternative to a full-registration IPO under the 1933 Act.

- An exchange trading platform may have advantages for companies that issue securities in Regulation A offerings. Establishing a separate exchange trading platform may make these offerings more effective by providing some structural elements to improve liquidity, trading (broker dealer) interest and economics, and investor interest. However, we believe that further investigation would be required to determine if such platforms would be economically feasible.

Mr. Chairman, during the financial services reform debate, this committee took the lead in reducing the regulatory burden on small businesses wishing to go public by permanently exempting companies with market capitalizations of $75 million or less from one of the most onerous demands of Sarbanes-Oxley.

I urge you to continue your leadership in this area by reviving Regulation A and rededicating it to the role Congress originally intended: Promoting the vital flow of capital to the entrepreneurs and small business owners who transform it into economic growth and new jobs.

Thank you again for allowing me to testify. I look forward to answering any of your questions.

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December 6, 2010

Barney Frank, MA, Chairman
U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, D.C. 20515

Dear Mr. Chairman,

Thank you for your invitation to testify at the hearing, "A Proposal to Increase the Offering Limit under SEC Regulation A" on Wednesday, December 8th.

To facilitate the discussion, I attach the original paper titled *"A Silver Bullet: How to Promote Capital Formation, Job Creation and Technological Innovation – All in One Legislative Shot"*, dated May 3, 2010. Additionally, I have also attached several schedules which include data to support our conclusions below, as follows:

- Schedule A – Exchange Listing Requirements
- Schedule B – Average IPO Size Since 2001
- Schedule C – VC Backed Companies – IPO Activity Since 2004
- Schedule D – Leveraging the IPO – Selected Data
- Schedule E – Return on Russell 2000 vs. S&P 500 Since March, 2009 Low
- Schedule F – Relative Price to Book Value – Russell 2000 vs. S&P 500

In addition, I give our response below to your questions outlined in your invitation dated December 2, 2010. I group our responses into three categories:

I. Why Reg A doesn't work in its current format
II. Recommended Changes to the Reg A
III. The Positive Impact of Raising the Reg A Exemption to $30 million

I. Why Reg A doesn't work in its current format

In your letter, you asked the following questions:

(1) Under the current offering limit of $5 million, is Regulation A a useful capital raising vehicle for small issuers? Will increasing the offering limit to $30 million materially enhance its utility as a funding source? Is $30 million an appropriate limit for Regulation A offerings? Please address factors such as inflation and the cost of developing products and technologies.

Our response: The Reg A under its current offering limit of $5 million to the public is not useful for issuers. In order to qualify for a small cap listing on the NYSE Amex and NasdaqCM, there is a requirement for a minimum $50 million market capitalization and a $15 million public float. While there are several other sets of listing standards that a company may qualify under on these exchanges (See Schedule A, "Exchange Listing Requirements", attached hereto), the above standards appear to be the most likely ones to be met by smaller companies, and with a $5 million offering under the current regulation A, there is no chance of that. If a company issues stock to the public and does not have an exchange listing, it will be left with a limited aftermarket (as many institutions cannot buy stocks that are not exchange listed), and would also be required under Blue Sky regulations to conduct a costly and laborious state-by-state registration process. A confluence of the reasons stated above has made Regulation A a poor alternative for small growth-oriented companies seeking to raise development capital and also explains why the offering mechanism has virtually disappeared from the capital raising landscape. According to public records, since 2005 there have only been 153 Reg A filings and of those 153, an astoundingly low number of 13 have actually priced.

(2) Please comment on the availability of alternative funding sources for small issuers, such as offerings under SEC Regulation D and credit facilities. Please provide any views you have on how an increase in the Regulation A offering limit could complement these other funding sources.

Our response: We believe that raising the limit on Reg A, and thereby making it a more actionable funding source for small companies, will serve as an excellent complement to alternative funding sources such as Reg D offerings. Indeed, with Regulation A structured as a realistic potential mechanism for gaining liquidity, we believe that venture capitalists and other early stage investors will be more likely to invest in a private placement under Reg D as they will know that there is a greater likelihood for going public than currently exists via the traditional S-1 route. In short, the possibility of a quicker entry into the public markets will encourage VC's to deploy capital into enterprises at earlier stages of development. While Reg D and Reg A offerings may complement each other in this respect, we do not believe that Reg D alone is an effective replacement for a Reg A public offering for several reasons, as follows: (i) Reg D offerings reach out to a far smaller universe of investors than can be approached via a public offering, (ii) Private markets inherently have lower valuations than public markets, and (iii) Securities offered under Reg D are not free tradable on an exchange post-offering. Alternatively, securing a credit facility, while certainly a viable option, is especially difficult for small technology-focused companies, since intellectual property is not often deemed as acceptable collateral.

II. Recommended Changes to the Reg A

(3) Should Congress simply authorize the SEC to increase the offering limit under Regulation A, or should Congress affirmatively require the SEC to do so? Should Congress give the SEC discretion to establish the terms and conditions under which the increase is implemented, or should Congress stipulate those terms and conditions? What would be the impact if Congress

or the SEC were to require the submission of audited financial statements in connection with Regulation A offerings?

Our response: We recommend that Congress authorize the SEC to increase the offering limit under Regulation A, and give the SEC discretion to establish the terms and conditions under which the increase is implemented. If this increase is granted, we also agree that the SEC should require audited financial statements in connection with a Regulation A offering. In fact, the overwhelming majority of companies that have raised outside investment capital already produce audited financials. Except for the limit on the amount of capital that can be raised under Regulation A, we believe that there is nothing inherently wrong with the current statutes. A Regulation A offering will be less costly in terms of legal expense and audit expense while allowing a company to test the public markets before filing. That has always been the spirit and underlying purpose of the statute; all that is required is that we update it so that it may be a useful capital raising tool for companies in our markets today. The inability for small businesses to access capital at acceptable terms has had and will continue to have a cascading and negative effect on the health of both our job market and the economy overall.

III. The Positive Impact of Raising the Reg A Exemption to $30 million

(4) What are the benefits of raising the offering limit under Regulation A? Please address factors such as the potential impact on job growth and the development of products and technologies by emerging companies. Please quantify your responses if possible.

Our response: Today, we find ourselves embroiled in one of the most challenging times for the economy in our nation's history. As one of the direct results of the financial crisis, we have seen a tidal wave of consolidation. This trend is nowhere more evident than in the financial services world, where we now find that America's 5 largest banks control approximately 46% of all U.S. deposits, up from only 12% in the early 90's.[1] Alarmingly, two of these are Goldman Sachs and Morgan Stanley, leaders in IPO underwriting. The investment banking business has scaled up in order to meet business model expectations, and average deal sizes have grown accordingly. (See Schedule B, "Average IPO Size Since 2001", attached hereto). This consolidation and subsequent scaling has taken its toll on U.S. public listings. A decade ago, 9,100 companies filed proxy statements with the SEC while more recently in 2010, only 6,450 have done so.[2] This decrease in listings stems from the disappearance of the small cap listing on our exchanges.

Indeed, smaller private companies have especially suffered, as they have seen their ability to access the capital markets dwindle. It is a breakdown in the system, because VC and early stage investors rely upon an exit via a liquidity event four to six years out, and with this exit increasingly difficult to come by via an IPO, the investment cycle, which drives innovation, has ground to a virtual halt. The data appears

[1] "Jamie Dimon, America's Least-Hated Banker," The New York Times, December 1, 2010.
[2] "The Demise of the IPO – and Ideas on How to Revive It," The Wall Street Journal, June 25, 2010.

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to support this conclusion, as it shows a consistent increase in the median age of companies before their IPO. (See Schedule C "VC Backed Companies – IPO Activity Since 2004", attached hereto)

The lack of this exit in the form of a public offering in the capital markets has left many companies with few funding options beyond the M&A sector. (Item 1, "M&A Activity vs. IPO Activity – 2007 to 2009", below)

Item 1 - M&A Activity vs. IPO Activity - 2007 to 2009

M&A Activity vs. IPO Activity - Since 2007

	Total M&A Deals	M&A w/ Disclosed Values	Total Disclosed Value $M	Number of IPOs	Total IPO Offer Amt	Average IPO Offer
2007	379	168	29,460.0	86	10,326.3	120.1
2008	351	119	13,775.4	6	470.2	78.4
2009	273	92	13,552.7	12	1,642.1	136.8

Source: Dealogic; excludes ADRs and foreign issuers.

As you can see clearly in the chart above, the total value of only the disclosed M&A deals (such transaction values were not disclosed in many instances, and so it is safe to assume that the total value is in reality much higher) dwarfs the total amount raised under via IPOs over the same period. If this trend continues, there is a very real probability that it would lead to a sharp decrease in jobs, since acquisitions generally lead to contraction of the work forces involved. Indeed, if M&A stands as the only option available for small companies, the job creation machine that was Silicon Valley will consolidate around the larger, more dominant companies, leading to a simultaneous loss of both jobs and innovation. We believe that raising the limit of Regulation A will go a long way in creating jobs, reinvigorating the innovation cycle, and ensuring that US technology and innovation do not fall behind the rest of the world.

With regard to IPOs in the United States in general, regardless of their original sources of funding, we find that offerings under $50 million are virtually nonexistent in comparison with offerings above that threshold, indicating the under servicing of that sector by our capital markets (again, see Schedule B attached hereto).

The research department at the National Venture Capital Association estimates the total number of companies that have sought late stage financing, but would have been able to go public given more favorable regulatory/economic conditions to be over 2,000. What makes this number even more astounding is that it does not take into account private companies that are not backed by venture capital. Many estimate that the number of non-venture capital backed companies is at least as large as the VC-backed universe. If even just 500 of these 4,000 companies took advantage of a Regulation A offering of $30 million, a total of $15 billion would be raised. Assuming that half of that amount flows back into company payrolls, it could be utilized to create 750,000 jobs at $100,000 in annual salary per job. If we then assume that a portion of this capital will be reinvested by these new hires via retail and/or securities purchases, we will see a significant multiplier effect in which this new capital will across the economy.

In addition to the data summarized above, there is ample data to establish the correlation between the growth of small companies and the creation of jobs/growth of the overall economy. Over the last 40 years, over 90% of the jobs created by venture capital backed companies occurred AFTER their initial public offering.[3] (See Schedule D, "Leveraging the IPO – Selected Data", attached hereto) Schedule E illustrates how Adobe, Salesforce.com, and Google's number of employees, total revenues, and net income have increased dramatically since their respective IPOs. These constitute only a small sampling of the vast universe of companies that have been able to make the transformation from innovative start up to large diversified corporate entity with strong, consistent cash flows. As these companies expand their business horizons, new jobs are created and capital flows back through the economy. If not for the opportunity to access the public capital markets, it is very unlikely that these companies would have ever realized their true potential.

We believe that a preponderance of the data above point to the absolutely vital importance of our nation's small growth-oriented companies to the health of the job market and overall economy. Raising the limit on Regulation A will allow smaller companies to gain liquidity, and allow them to aggressively pursue growth opportunities. Moreover, this will free up investment capital to be redeployed towards the next cycle of innovation, producing an environment in which we can be confident that our technology companies will be in a position to compete and win on a global scale well into the future.

"Beyond the statistics, small businesses are important because they often produce new technology and innovations – like computers, robotics, and pharmaceuticals – that enable us to make strides in our standard of living, as well as compete in a global economy that rewards new ideas with new jobs. For all these reasons, historically, U.S. federal policy makers have been committed to ensuring the vitality of small business." These are not our words, but rather are the words of then SEC Commissioner Mary L. Schapiro (currently SEC Chairwoman) in a release entitled, "Promoting Small Business Capital Formation: The Role of the SEC", dated November 13, 1992. The truth and import of these words are as undeniable now as they were in 1992, and we ask that today's policy makers re-affirm their commitment to innovation and the growth and well being of small businesses.

(5) Are there any drawbacks to raising the offering limit under Regulation A? Will raising the limit increase risks to investors? What safeguards might be necessary to mitigate those risks? Would requiring audited financial statements in connection with Regulation A offerings be sufficient to address any increased risk to investors?

Our response: While we do not deny that small cap capital markets are inherently more volatile than the larger cap universe, we firmly believe that the returns for such an early stage investment far outweigh the risks. (See Schedule E, "Return on Russell 2000 vs. S&P 500 Since March, 2009 Low", attached hereto) Further, we believe that the fact that absolute valuations for small cap companies

[3] Concept Release on Equity Market Structure, Re: File Number S7-02-10.

appear to be fairly valued in relation to large-cap stocks demonstrates that the market has the capabilities and rationality to accurately judge the merits of a potential investment in a small company with a potentially more speculative future. (See Schedule F, "Relative Price to Book Value – Russell 2000 vs. S&P 500", attached hereto) Indeed, a multitude of companies that currently populate the space of "large cap" did not start off as such, and relied upon the forward thinking and risk taking of a myriad of investors in order to get there. It is our hope that with the amendment of Regulation A, it will be possible for so many more of those companies to make that transformation.

(6) What would be the impact of establishing an exchange trading platform for Regulation A offerings? Would exchange trading enhance the value of Regulation A as a capital raising device? What benefits or risks would it pose to investors? How would exchange trading affect the applicability of state law to Regulation A offerings?

Our response: Without doubt, it is essential for the securities of offerings made under Regulation A to be freely tradable on an exchange. Such liquidity enables a company to remain visible in the marketplace and drives future financings by allowing the market itself, rather than a few select private investors, to assign a valuation. More importantly, the realistic prospect of exchange trading gives initial investors more confidence that they will have the freedom to exit their position post-offering should they elect to do so. As to state law, under present requirements, companies that are exchange-traded are exempt from blue sky regulation, which would allow issuers to take full advantage of the Regulation's exemptions regardless of the level of capital raised without fear of costly registrations on a state by state basis. Our recommendation is to maintain the same regulations regarding transparency and liquidity that were recently put into effect concerning Reg FD, free writing, and other investor protections.

Respectfully submitted,

William R. Hambrecht
Chairman and CEO
WR Hambrecht + Co

WRHAMBRECHT+CO

May 3, 2010

A Silver Bullet: How to Promote Capital Formation, Job Creation and Technological Innovation – All in One Legislative Shot

There is a general consensus that the credit crunch and ensuing recession were caused by a meltdown of systemic trust at the highest echelons of the United States financial system. When big banks and other large financial institutions lost confidence in the viability of their counter-parties, the system froze, credit dried up, asset valuations plummeted and millions of workers lost their jobs. As Congress, the Administration and their European counterparts struggle to agree on a plan to reform the financial regulatory system, and as the unemployment rate stays persistently high, a simple legislative solution to at least part of the problem can be found by fixing a relatively obscure provision of the federal securities laws and thereby invigorating the jobs-creation machine at the other end of the financial spectrum. This provision, which was enacted during the Great Depression to facilitate the flow of capital into small businesses, is called Regulation A.

Regulation A

The Securities Act of 1933 gives the SEC the authority to exempt small businesses from the general requirement that a company must register a securities offering with the SEC before offering and selling it to the public. Congress enacted this provision because the registration process is so complex, time-consuming and expensive that small issuers are otherwise effectively cut off from the public capital markets. Between 1933 and 1945, the maximum issuance allowed under this exemption was $100,000; more recently, Congress increased the statutory ceiling to $5 million.

The SEC used this authority to promulgate Reg. A, which offers an economical process for raising capital from the investing public without the burdens of the registration process. Instead of filing a registration statement, companies eligible for the exemption can file a much simpler offering circular for the SEC's review. Audited financial statements are not required. In contrast to the usual prohibitions against pre-filing offers, Reg. A issuers may "test the waters" to solicit potential investors to gauge their receptivity before incurring the legal, accounting and other costs of filing a registration statement with the SEC.

Unlike securities offered and sold under the exemption that covers private placements, securities issued under the Reg. A exemption are not subject to resale restrictions. They are freely tradable, as though they had gone through the registration process. Reg. A is available to issuers who have not been subject to the periodic reporting provisions of the Securities Exchange Act of 1934 (which apply to companies with over $10 million in total assets and more than 500 shareholders), and they are not required to be reporting companies after the offering if they do not meet those criteria. Financings under Reg. A are capped at $5 million within any 12-month period, including no more than $1.5 million by selling shareholders. While exempt from the normal registration process, Reg. A transactions are

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nevertheless subject to the anti-fraud provisions of the federal securities laws, and they are also subject to state "blue sky" registration unless the issuer's securities trade on a national securities exchange immediately after the offering. So-called "bad boy" provisions exclude companies, affiliates or underwriters with criminal or disciplinary records from using the exemption.

The main problem with Reg. A is that hardly anybody uses it. Between 1995 and 2004, the number of Reg. A filings averaged only eight per year. In contrast, in 2004 alone, there were 94 venture-backed IPOs in the U.S., with an average size of $111.5 million per offering. Apparently, the costs of the Reg. A process are perceived to outweigh the potential benefits. The $5 million cap makes the exemption too small to interest most venture-backed companies. Furthermore, if an issuer keeps its assets and shareholder base small enough to avoid the Scylla of the post-Enron Sarbanes-Oxley accounting regime, it will face the Charybdis of the blue-sky registration maze. Reg. A is well-intentioned, but its flaws prevent it from doing any good.

A Modest Proposal

A few simple modifications could make Reg. A an engine for capital formation and economic growth. First, a higher financing ceiling is required. If the annual cap were increased from $5 million to, say, $30 million, Reg. A could provide a meaningful route to liquidity for venture-backed companies. This would require an act of Congress to amend Section 3(b) of the Securities Act, which currently caps the SEC's exemptive authority at $5 million per issuer per year.

Second, Congress should amend Sarbanes-Oxley to provide an exemption from the more onerous accounting requirements for Reg. A issuers for a period of at least two years. Otherwise, the cost savings of avoiding the Securities Act registration process are illusory because of the immediate costs of complying with the requirements applicable to reporting companies.

Third, Congress should amend the National Securities Markets Improvements Act of 1996 to preempt blue sky regulation of Reg. A offerings. This relief will enhance the feasibility of Reg. A for smaller issuers.

Taken together, these changes could substantially increase access to the public capital markets by venture-backed issuers. These are precisely the kind of companies that create jobs and innovation, particularly in the information technology, life sciences and clean tech sectors – areas in which the U.S. needs continue to invest to maintain its world leadership. These are the sectors that can help our country avoid economic stagnation and at the same time drive the innovations we need to achieve energy independence and solutions to our carbon-based energy/environment conundrums.

An example of a robust small-issuer regulatory program is the Alternative Investment Market ("AIM") of the London Stock Exchange. Launched in 1995, AIM has raised almost 24 billion pounds for more than 2,200 companies, of which almost 1,600 are currently listed and trading. AIM's flexible regulatory approach has resulted in a thriving market and enhanced opportunities for companies and investors alike.

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Do the potential risks to investor protection outweigh the potential benefits associated with making Reg. A a meaningful capital conduit as was originally intended? Not if the SEC uses its recently reinvigorated enforcement program to prevent abuses. The need is too great and potential benefits are too real not to give it a shot.

William R. Hambrecht
Chairman and CEO
WR Hambrecht + Co

Steven N. Machtinger
General Counsel
Code Advisors LLC

See Schedule A: Venture Capital Backed Companies: Financial Highlights

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Schedule A

Venture Capital Backed Companies:
Financial Highlights

- Since 1970, venture capitalists have invested $456 billion into more than 27,000 companies *(Source: National Venture Capital Association)*

- Companies founded with venture capital include such great and innovative success stories as FedEx, Starbucks, Google, Microsoft, eBay, Genentech, Intel, Apple and Facebook, among a multitude of others *(Source: National Venture Capital Association)*

- 13,314 jobs were posted by venture capital backed companies during Q1 2010, an average of more than 4,400 new positions each month, which represents a 16 percent increase since the end of 2009 *(Source: StartUpHire.com)*

- Public companies founded with venture capital today employ more than 12.1 million Americans *(Source: IHS Global Insight)*

- Current private venture capital backed companies such as Facebook, Twitter, and Fisker Automotive employ approximately half a million people *(Source: Dow Jones Venture Source)*

- Venture capital backed companies account for 21% of U.S. GDP *(Source: IHS Global Insight)*

- Over the last 40 years, over 90% of the jobs created by venture capital backed companies occur AFTER their initial public offering *(Source: Concept Release on Equity Market Structure, Re: File Number S7-02-10)*

- The venture capital industry is constructed on 10-year limited partnerships whose investors expect returns of capital from liquidity events 4 to 6 years from the inception of any given partnership so that they can re-invest in the next cycle of innovation *(Source: Concept Release on Equity Market Structure, Re: File Number S7-02-10)*

- Lack of IPO's in the U.S. also leads to inferior merger and acquisition exit prices for venture-backed companies. You need a healthy IPO market to keep the M&A market honest *(Source: Concept Release on Equity Market Structure, Re: File Number S7-02-10)*

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Schedule A – Exchange Listing Requirements

NYSE AMEX

Quantitative Standards

Criteria	Listing Standards			
	Standard 1	Standard 2	Standard 3	Standard 4
Pre-tax income[1]	$750,000	N/A	N/A	N/A
Market capitalization	N/A	N/A	$50 million	$75 million **OR** At least $75 million in total assets and $75 million in revenues
Market value of public float	$3 million	$15 million	$15 million	$20 million
Minimum price	$3	$3	$2	$3
Operating history	N/A	2 years	N/A	N/A
Shareholders' equity	$4 million	$4 million	$4 million	N/A
Public shareholders/Public float (shares)[2]	Option 1: 800/500,000 Option 2: 400/1,000,000 Option 3: 400/500,000[3]			

[1] Required in the latest fiscal year, or two of the three most recent fiscal years.

[2] Public shareholders and public float do not include shareholders or shares held directly or indirectly by any officer, director, controlling shareholder or other concentrated (i.e. 10 percent or greater), affiliated or family holdings.

[3] Option 3 requires a daily trading volume of 2,000 shares during the six months prior to listing.

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Schedule A – Exchange Listing Requirements (cont.)

NasdaqCM

NASDAQ Capital Market Initial Listing Requirements[1]

Requirements	Equity Standard Listing Rules 5505(a) and 5505(b)(1)	Market Value of Listed Securities Standard Listing Rules 5505(a) and 5505(b)(2)[2]	Net Income Standard Listing Rules 5505(a) and 5505(b)(3)
Stockholders' equity	$5 million	$4 million	$4 million
Market value of publicly held shares	$15 million	$15 million	$5 million
Operating history	2 years	N/A	N/A
Market value of listed securities[3]	N/A	$50 million	N/A
Net income from continuing operations (in the latest fiscal year or in two of the last three fiscal years)	N/A	N/A	$750,000
Bid price	$4	$4	$4
Publicly held shares[4]	1 million	1 million	1 million
Shareholders (round lot holders)[5]	300	300	300
Market makers[6]	3	3	3
Corporate governance[7]	Yes	Yes	Yes

[1] Companies must meet the bid price, publicly held shares, round lot holders, and market makers requirements as set forth in Rule 5505(a) and at least one of the Standards in Rule 5505(b).

[2] Seasoned companies (those companies already listed or quoted on another marketplace) qualifying only under the Market Value of Listed Securities Standard must meet the market value of listed securities and the bid price requirements for 90 consecutive trading days prior to applying for listing.

[3] The term, "listed securities", is defined as "securities listed on NASDAQ or another national securities exchange."

[4] Publicly held shares is defined as total shares outstanding, less any shares held directly or indirectly by officers, directors or any person who is the beneficial owner of more than 10% of the total shares outstanding of the company. In the case of ADRs, at least 400,000 shall be issued.

[5] Round lot holders are shareholders of 100 shares or more. The number of beneficial holders is considered in addition to holders of record.

[6] An electronic communications network (ECN) is not considered a market maker for the purpose of these rules.

[7] In addition to the above quantitative requirements, companies must comply with all corporate governance requirements as set forth in the Rule 5600 Series.

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Schedule B - Average IPO Size Since 2001

IPO's in the United States by Size - Number of Deals										
Deal Size	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
0-$25 million	9	10	6	7	19	12	9	2	1	2
$25-$50 million	8	7	4	33	19	22	12	1	0	3
$50-$100 million	20	16	20	52	44	38	44	7	7	25
$100+ million	43	35	38	82	79	78	91	13	31	43
Total	**80**	**68**	**68**	**174**	**161**	**150**	**156**	**23**	**39**	**73**

IPO's in the United States by Size - Related Percentage of Total Number of Deals										
	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
0-$25 million	11%	15%	9%	4%	12%	8%	6%	9%	3%	3%
$25-$50 million	10%	10%	6%	19%	12%	15%	8%	4%	0%	4%
$50-$100 million	25%	24%	29%	30%	27%	25%	28%	30%	18%	34%
$100+ million	54%	51%	56%	47%	49%	52%	58%	57%	79%	59%

Source: Dealogic, excludes ADRs and foreign issuers

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Schedule C - VC Backed Companies - IPO Activity Since 2004

VC Backed Companies - IPO Activity						
Year	# IPOs	Total Deal Value	Average Deal Value	Median Deal Value	Average Age @ IPO	Median Age @ IPO
2004	43	$4,827.1	$112.3	$66.0	9.2	8.0
2005	50	4,511.8	90.2	63.4	10.3	8.0
2006	61	5,586.4	91.6	82.8	12.3	8.0
2007	52	6,626.4	127.4	97.8	9.1	7.0
2008	7	896.1	128.0	94.5	9.7	9.0
2009	11	1,696.8	154.3	101.4	11.3	10.0

(Deal values in $M)

Source: Dealogic and CapitalIQ

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Schedule D - Leveraging the IPO - Selected Data

Leveraging the IPO - Selected Data	Exchange: Ticker	Pricing Date	IPO Size	# of Employees at IPO	Current # of Employees	Total Revenue at IPO	Current Total Revenue	Net Income at IPO	Current Net Income
Adobe Systems Inc.	NasdaqGS: ADBE	8/20/1986	$5.5	49	8,660	$4.6	$2,945.9	$0.5	$386.5
Salesforce.com	NYSE: CRM	6/22/2004	126.5	518	3,969	96.0	1,305.6	3.5	80.7
Google Inc.	NasdaqGS: GOOG	8/18/2004	1,916.4	1,628	19,835	1,465.9	23,650.6	105.6	6,520.4

Source: Public filings. Historical data is for the last completed fiscal year before the IPO, while current data is as of the most recently completed fiscal year. Dollar values are in millions of USD.

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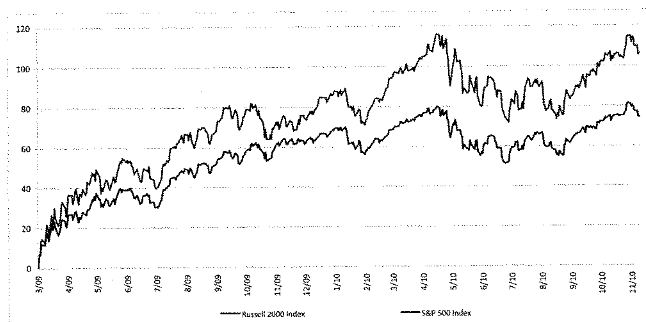
Schedule E - Return on Russell 2000 vs. S&P 500 Since March, 2009 Low



Source: CapitalIQ

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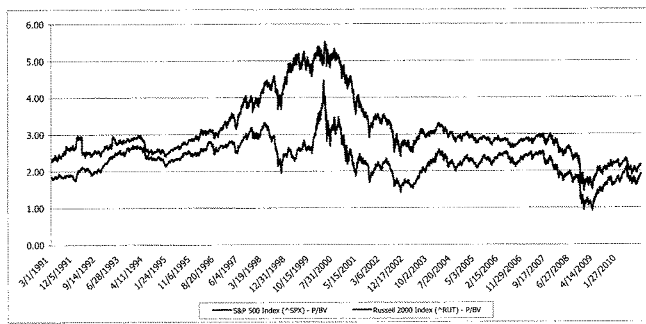
Schedule F - Relative Price to Book Value - Russell 2000 vs. S&P 500



Source: CapitalIQ. Russell 2000 Index - P/BV was calculated using Market Cap-weighted current constituents.

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SVB›Financial Group

TESTIMONY OF MICHAEL T. LEMPRES
ASSISTANT GENERAL COUNSEL & PRACTICE HEAD
SVB FINANICAL GROUP, INC.

BEFORE THE
U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING ON:
A PROPOSAL TO INCREASE THE OFFERING LIMIT UNDER SEC REGULATION A

DECEMBER 08, 2010

Chairman Frank, Ranking Member Bachus and Members of the Committee:

Thank you for the opportunity to speak with you today on the topic of providing access to capital for start-up and emerging growth companies, an issue that affects every American and every part of our economy. My name is Mike Lempres, and I represent SVB Financial Group and its subsidiary, Silicon Valley Bank. Thank you for allowing me to submit my full statement for the record.

In your invitation to testify, you asked witnesses to address six specific questions about SEC Regulation A and its possible revision. For your convenience, I reproduce the questions and provide responses at the end of this statement. In the rest of my statement, I provide the Committee with my views about the potential revision of Regulation A and the broader issue of improving access to capital for high-growth small businesses.

<u>SVB Financial Group</u>

As you may know, SVB Financial Group has a deep connection with emerging growth companies across the United States, and our platform gives us insight into both debt and equity funding channels. We are the premier provider of financial services for companies in the technology, life science, venture capital and premium wine industries.

SVB is a bank holding company and a financial holding company. Our principal subsidiary, Silicon Valley Bank, is a California-chartered bank and a member of the Federal Reserve System. As of September 30, 2010, SVB had total assets of $14.75 billion. Through Silicon Valley Bank and our other subsidiaries, we provide a comprehensive array of banking services including lending, treasury management, trade finance, and foreign exchange services to our clients worldwide.

We began serving the technology and life science markets in 1983. Over nearly three decades, we have become the most respected bank serving the technology industry and have developed a comprehensive array of banking products and services specifically tailored to meet our clients' needs at every stage of their growth. As a result, today we serve more than 13,000 clients through 26 U.S. offices and international offices located in China, India, Israel and the United Kingdom and provide banking services for approximately half of the venture-backed technology companies across the country.

In addition to our core banking business, SVB (the holding company) also has sponsored venture capital funds, through our SVB Capital division, and made investments in certain third-party venture funds. We conduct our funds business in accordance with applicable law and use shareholder (not depositor) money for our fund investments.

The Importance of High-Growth Small Businesses and Their Access to Capital

The health and growth of small companies is critical to the competitiveness of the American economy and to the quality of our lives. President Obama recently described the importance of small businesses to the American economy, as follows:

> Over the past fifteen years, small businesses have created roughly 65 percent of all new jobs in America. These are companies formed around kitchen tables in family meetings, formed when an entrepreneur takes a chance on a dream, formed when a worker decides its time she became her own boss. These are also companies that drive innovation, producing thirteen times more patents per employee than large companies. And, it's worth remembering, every once in a while a small business becomes a big business – and changes the world.[1]

The President is absolutely right that America needs healthy, growing small businesses. SVB's particular focus is on high-growth small businesses. As recent studies have

[1] Address by President Barack Obama before the Brookings Institution (Dec. 8, 2010).

demonstrated, these businesses (rather than small businesses more broadly) are the principal force behind both gross and net new job creation.[2]

One statistic in particular highlights the powerful effect investments in high growth companies have on our economy. Investments by venture capital funds in these businesses represent only roughly 0.2% of U.S. GDP. Yet, as of 2008, venture-backed companies employed more than 12 million people (approximately 11 percent of total private sector employment) and generated the equivalent of 21 percent of U.S. GDP. In other words, capital that flows into small high-growth businesses is capable of returning to the broader U.S. economy approximately 100 times the amount originally invested, in the form of new jobs and higher revenues.

In order to grow, small companies need to have access to appropriate funding at each stage of their development. As a country, we have demonstrated our ability to innovate. We can generate the ideas that will continue to transform how we care for illnesses, how we communicate, how we generate and use energy, and the myriad other areas in which technology shapes our economy and our lives. Yet to maintain our global leadership in the innovation and technology sector, and to allow companies to grow from ideas into large, robust enterprises, our economy must also provide them with an efficient way to access suitable capital at each stage of their growth.

<u>Access to Capital is a Challenge for Emerging Growth Companies</u>

Access to capital is a major concern for small issuers. In the spring of 2010, we surveyed more than 300 emerging and early-stage companies with annual revenue of less than $5 million. These companies said that access to capital was their number one concern. That concern is well-founded, as the systems that fund high growth businesses are under stress.

Companies turn to a variety of sources of capital, beyond Regulation A. (In fact, as discussed below, Regulation A typically is not used and does not contribute in a meaningful way to capital formation for small companies.)

One source of capital is debt. Silicon Valley Bank exists largely to make loans to high growth technology companies, and we do so robustly. For example, in 2009 we made 407 new loans to business clients, for a total of $977 million in new loan activity, and in the most recent quarter of this year we extended 423 new loans to business clients. Overall, SVB's loan portfolio has grown from $2,843,353,000 at year-end 2005 to $4,859,205,000 at September 30, 2010. While our experience is not representative of the broader financial services sector given our focus on technology clients, our history does illustrate that debt has continued to be available

[2] J. Haltiwanger, R. Jarmin and J. Miranda, *Who Creates Jobs? Small vs. Large vs. Young,* NBER Working Paper No. 16300 (Aug. 2010).

to growth companies throughout the financial downturn and has grown substantially over the past five years.

Even where credit is available to growing companies, it is not the right solution for the funding needs of all companies. Indeed, credit is only one of the options available to companies that seek capital. Equity based financing options are critical to growing companies. Companies can obtain capital through a number of equity channels, including private investors (often referred to as angel and super angel investors), venture capital funds, initial public offerings *("IPOs")* and Regulation D issuances.

Venture capital financing has been an essential component of the innovation sector for decades. While venture funds invest in a relatively small number of companies (experts estimate that approximately 1% of companies that seek venture funding actually receive it[3]), these companies outperform the broader economy in both job creation and revenue growth.[4] As a result, while venture capital is critical to our economy, individual emerging companies cannot rely on obtaining its benefits and it alone cannot be seen as the sole source of capital for startup companies.

Public capital markets traditionally have been a core source of growth capital for U.S. companies. In recent years, however, accessing these markets through IPOs has been very challenging. For example, in 1999 there were 269 IPOs of venture-backed companies. In 2009, there were twelve. This reflects, among other things, the dramatically higher costs of taking a company public today as well as structural changes in the underwriting and capital markets businesses.[5] We encourage the Committee to consider ways to strengthen the IPO process at another time.

Regulation D provides another set of paths to access capital, which do not carry the same regulatory requirements as public offerings. Rule 504 provides an exemption from SEC regulations for offerings up to $1 million, and Rule 505 provides an exemption for offerings up to $5 million. Rule 506 provides no cap on the offering amount. All Regulation D offerings prohibit any general advertising of the offering, and all impose resale restrictions on the securities. In exchange for the higher offering limits, both Rule 505 and Rule 506 limit the

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[3] 2010 National Venture Capital Association Yearbook, at page 7.

[4] HIS Global Insight, *Venture Impact: The Economic Importance of Venture-Capital Backed Companies to the U.S. Economy (5th Ed.)* (2009).

[5] The IPO process has become an expensive one for many reasons, including underwriting, legal and other fees associated with the offering itself as well as compliance costs for public companies. The end result is that the traditional IPO is generally only appropriate for companies with a market value of approximately $250 million or more.

investor pool. Rule 506 requires that all investors be either accredited or sophisticated. Despite these restrictions, Regulation D is used, particularly Rule 506. Regulation D offerings provide a useful option to both companies and investors. Like other options, Regulation D is not appropriate for most companies, and it is not a substitute for the proposed revision to Regulation A.

Regulation A Aims at the Right Target, but Misses and Should be Revised.

The impetus behind the creation of Regulation A was a good one. Congress properly recognized a stage in the growth cycle of companies that was not being met. Emerging growth companies seeking a moderate amount of capital face different challenges than either very small startups or larger companies.

Unfortunately, Regulation A has not proved to be a useful capital raising vehicle for small issuers. It was used only a total of 78 times during the ten years between 1995 and 2004. An average of eight filings a year, with a maximum amount of $5 million each, proves the irrelevance of Regulation A as it stands today. It simply is not a viable vehicle for raising funds and is providing benefit to neither companies nor investors.

The SEC used its discretion to reach the Regulation A offering size ceiling of $5 million in 1992, and it has stayed there since. The $5 million ceiling was never high enough to warrant the costs and burdens of going public through a Regulation A offering, and the effect of inflation since 1992 has exacerbated that core problem. Quite simply, the transaction costs and costs attended to being publicly traded are too high to justify Regulation A offerings with a $5 million ceiling.

The proposed revision of Regulation A strikes a better balance. If Regulation A is to become effective, the offering size limit must be raised. In addition, the proposal would give regulatory discretion to the SEC in implementing the revised Regulation A. Such discretion is needed so that rules can be amended to strike the proper balance between protecting investor confidence and providing an effective means to access capital for growing companies. It is important that the SEC consider the cumulative impact of individual mandates so that the revised Regulation A can become an effective capital raising vehicle for small issuers.

Other Issues that Affect the Ability of Small Issuers to Raise Capital

A major issue for Regulation A offerings and other SEC-exempt offerings is the applicability of state blue sky laws. A small company that is exempt from SEC registration pursuant to Regulation A must still either register its securities with each state in which it offers the securities or qualify for a state exemption from registration. This is a cumbersome and expensive effort. Raising the Regulation A offering limit will make the process more attractive to issuers, but the applicability of state blue sky laws will continue to discourage use of even a revised Regulation A.

Congress may chose to exempt state registration laws that otherwise apply to securities issued under SEC exemptions. In the past, Congress has considered amending the National Securities Markets Improvement Act of 1996 ("NSMIA") to preempt state blue sky laws for securities exempted from registration by the SEC. Such a state preemption is not in the discussion draft proposal we have been asked to discuss. A broad-based exemption from state registration requirements would greatly reduce the transaction costs associated with raising capital through an SEC registration exempt issuance.

Responses to the Committee's Questions

(1) Under the current offering limit of $5 million, is Regulation A a useful capital raising vehicle for small issuers? Will increasing the offering limit to $30 million materially enhance its utility as a funding source? Is $30 million an appropriate limit for Regulation A offerings? Please address factors such as inflation and the costs of developing products and technologies.

As I have indicated in my general comments, Regulation A, as currently structured, is not a useful capital-raising vehicle for small issuers. The proof is in the pudding: Regulation A is simply not used.

I believe that increasing the offering limit to $30 million would materially enhance Regulation A's utility as a funding source. Moreover, I believe that Congress and the SEC could further increase the utility of Regulation A by reviewing the federal and state compliance and other costs associated with a Regulation A issuance.

In terms of the size of the Regulation A limit, while a $30 million is helpful, a $50 million limit would make Regulation A offerings more useful. The additional capital would make a real difference in some sectors of the broader innovation economy that are more capital intensive. Clean energy companies, for example, will tend to require substantial capital to establish that a new technology is commercially feasible. Similarly, life science companies may face substantial costs even beginning the regulatory approval process required to develop a new product. Permitting issuances up to $50 million will help companies establish themselves in these capital intensive sectors, and issuances of that size present a fundamentally similar risk for investors.

(2) Please comment on the availability of alternative funding sources for small issuers, such as offerings under SEC Regulation D and credit facilities. Please provide any views you have on how an increase in the Regulation A offering limit could complement these other funding sources.

Access to capital is a major concern for small issuers. As discussed above, SVB's *Startup Outlook 2010* survey, conducted in February of 2010, indicated that access to capital was the number one concern for early stage technology companies.

As discussed above, small issuers do have alternative funding sources, but the needs of companies of different types and at different stages of their growth require a wide variety of alternatives. Credit facilities play a significant role, and in some sectors (such as the ones we serve) credit is flowing. Regulation D, angel investors, venture capital, intrastate offerings and private offerings all present additional options for small issuers. Each presents different benefits and limitations. As discussed above, however, many of these funding channels are currently facing stresses, and access to capital presents a challenge to emerging growth companies.

Increasing the Regulation A offering ceiling will open doors for some companies by making access to capital more efficient, and therefore, more attractive. A more robust Regulation A funding channel should not cannibalize other funding sources. Instead, it should help the economic pie grow by providing additional capital to some who would otherwise not obtain it or not obtain it as efficiently.

(3) Should Congress simply authorize the SEC to increase the offering limit under Regulation A, or should Congress affirmatively require the SEC to do so? Should Congress give the SEC discretion to establish the terms and conditions under which the increase is implemented, or should Congress stipulate those terms and conditions? What would be the impact if Congress or the SEC were to require the submission of audited financial statements in connection with Regulation A offerings?

It is important for the offering limit to be raised, and it is appropriate for Congress to legislate the increase. Once that clear policy directive is established, the SEC is the appropriate entity to establish terms and conditions for implementation. The balancing required for effective implementation will be best achieved through a rulemaking process and the expertise of the SEC. Moreover, specific rules can be modified more easily to adapt to changes or unanticipated consequences if they are established by regulation than if they require legislation.

The decision about whether to require audited financials should be made as part of a broader decision that considers the totality of the requirements imposed by a revised Regulation A. In isolation, requiring audited financial statements may be a rational, reasonable requirement. However, a regulatory process that layers a series of rational, reasonable requirements on Regulation A issuers can quickly vitiate Regulation A's effectiveness. For that reason, the SEC should be tasked with determining what terms and conditions, including audited financials, best balance the objective of providing efficient access to capital for small businesses with the objective of protecting investors.

(4) What are the benefits of raising the offering limit under Regulation A? Please address factors such as the potential impact on job growth and the development of products and technologies by emerging companies. Please quantify your responses if possible.

If the offering limit under Regulation A is raised and companies find it a practical and efficient way to raise funds, the benefits are potentially enormous. Growing companies are the engine of job growth for our economy. If Regulation A is accessed viable vehicle, companies will have a means to obtain capital that they otherwise would not have been able to access. That capital will permit investments in growing companies and lead directly to job growth.

Moreover, as the President recognized, a disproportionate amount of new products and new technologies are developed and commercialized by emerging companies. These companies are often more nimble, more entrepreneurial and less invested in the status quo than larger companies. Thus, it is the emerging company that often implements improvements and disruptive technologies that help revolutionize the way we work and live.

Finally, some sectors within the broader innovation economy are capital intensive and, today, struggling with "valleys of death." In the clean energy sector, for example, it is very difficult for companies to obtain adequate, appropriate funding to finance their first commercial-scale facility. These companies have demonstrated the viability of their technologies through a prototype, but unless they are able to take the next step – building a commercial-scale facility – the benefits of their innovation will not be realized.

(5) Are there any drawbacks to raising the offering limit under Regulation A? Will raising the limit increase risks to investors? What safeguards might be necessary to mitigate those risks? Would requiring audited financial statements in connection with Regulation A offerings be sufficient to address any increased risk to investors?

Congress' goal should not be on eliminating risk from our economy – rather, it should be to ensure that risks are well understood, accurately communicated and effectively managed. This issue is illustrated by the current state of Regulation A. It is not used; therefore, it presents virtually no risk. In a technical sense, raising the Regulation A offering limit will by definition increase risks to investors; it will also create a benefit that doesn't exist today.

An appropriately designed Regulation A offering process will allow investors who like the risk-reward potential of a growth company to make investments in these companies. The investment risk in smaller companies cannot be mitigated fully, but it can be disclosed and priced appropriately.

Any drawbacks to raising the offering limit under Regulation A are far outweighed by the benefits of raising the limit. The basic trade-off for all registration exemptions is the efficiency of raising funds versus the perception of investor confidence. Funds can be raised and used to invest in capital, hire employees, and growth businesses more efficiently when there are fewer transaction costs to obtain the funds. The goal is to optimize the trade-off, so that companies can access necessary funds and investors can make informed and accurate choices about investing.

As discussed above, providing audited financial statements may increase investor confidence and provide some incremental risk-reduction to investors. Unfortunately, it will also increase the costs and burdens of raising funds through Regulation A. The SEC is in the best position to balance these objectives as part of a comprehensive review of how a revised Regulation A should be implemented.

(6) What would be the impact of establishing an exchange trading platform for Regulation A offerings? Would exchange trading enhance the value of Regulation A as a capital raising device? What benefits or risks would it pose to investors? How would exchange trading affect the applicability of state law to Regulation A offerings?

A Regulation A exchange could be beneficial for both companies and investors. Even if amended, Regulation A funding would likely not qualify companies for trading on the existing major exchanges. Exchanges typically require a minimum market capitalization of $50 million. An exchange geared toward smaller companies could increase the protections available to investors and deepen the liquidity available to smaller company stocks.

We can learn from the experience of the London Stock Exchange in creating a small issuer exchange. The Alternative Investment Market ("AIM") provides some lessons about the trade-offs of reduced regulatory compliance costs for companies and the provision of accurate, sufficient information for investors. AIM has faced substantial challenges in providing adequate liquidity and developing investor confidence, and a U.S. based exchange would require some regulatory flexibility to meet those challenges.

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I applaud this Committee for recognizing the essential place that availability of capital for emerging growth companies occupies in our economy. Thank you for this opportunity to present information on such an important topic. I will be pleased to answer any questions.