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Hearing on Legislative Proposals to Enhance Capital Formation and Reduce Regulatory Burdens, Part II

Statement of David Weild, Founder, Chairman & CEO of Weild & Co., Inc.,
before the U.S. House of Representatives Financial Services Committee, Capital Markets and Government Sponsored Enterprises Subcommittee, May 13, 2015.

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Contents

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Introduction

Chairman Garrett, Ranking Member Maloney and members of the Subcommittee, thank you for again inviting me to speak at this important hearing. My name is David Weild. I am Chairman & CEO of Weild & Co., which we founded to improve equity capital formation and support for corporate issuers and their investors. As many of you know, I was formerly vice chairman of The NASDAQ Stock Market with responsibility for all of its listed companies, and I ran the equity new issues business of Prudential Securities, back when Prudential Securities was one of the ten largest underwriters of new issues equities in the United States. We've written extensively on capital formation and recently appeared before the G-20, the Securities & Exchange Commission's Advisory Committee on Small & Emerging Companies and have authored work for the Organization of Economic Cooperation and Development ("OECD") entitled, "Making Stock Markets Work to Support Economic Growth."

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The Need for Venture Exchanges

Improving access to equity capital in the United States is, we believe, still a critical need for our economy. Small companies are the job creators of our economy and small companies are started with equity capital – not debt. For all the quantitative easing of the Federal Reserve, banks won't lend to small businesses on the scale necessary until we improve their access to equity capital. For all the good work that this Subcommittee has done – including The JOBS Act and the recently announced SEC Tick Size Pilot - we still have not answered the question that former Democratic Senator Ted Kaufman posed from the floor of the U.S. Senate in 2009, namely, "How can we create a market structure that works for a $25 million IPO — both in the offering and the secondary aftermarket. If we can answer that question, Mr. President, this country will be back in business."[1]

The "Main Street Growth Act," which would establish a new class of stock exchanges catering to the needs of small cap companies, has the potential, with some modifications, to get this country back in business. It has the potential to go down as one of the most important Acts to come out of this, or any, Congress by creating essential infrastructure in support of U.S. economic growth. It has the potential to bring back American entrepreneurial swagger and to reignite the American Dream. It has the potential to create jobs on a scale that will improve labor participation rates and hourly wages and help lift many middle class and lower income people to reach their aspirations of financial well-being.

When corporations access capital they hire people. Those people spend money in the economy on everything from lawyers and accountants to construction and restaurant workers - a "multiplier effect" is created. The benefits become widespread.

The Subcommittee through its work on The JOBS Act and Tick Sizes has done much with the SEC to lay the groundwork to improve equity capital formation. However, the data shows that while small business and IPO activity has improved modestly, it still has a long ways to go. What is needed, is an institutional solution – Venture Exchanges – to an institutionalized problem:

- The economist Robert Litan recently wrote in Foreign Affairs that "In 1978, start-ups—defined in the database as companies less than a year old—accounted for nearly 15 percent of all U.S. firms; by 2011, that figure had slipped to just eight percent. For the first time in three decades, business deaths exceeded business births."[2]
- In our earlier work[3], we concluded that the collapse of aftermarket economic incentives to support small cap companies, brought on by Reg. ATS in 1998, precipitated a collapse in the ecosystem of dealers and in turn the small IPO market. As a result,

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[1] See http://green.lib.udel.edu/webarchives/kaufman.senate.gov/press/press_releases/release/-id=352c7e34-1cad-4ad3-b31c-c267bd492d1a.htm

[2] *Foreign Affairs,* January/February 2015, "Start-Up Slowdown: How the United States Can Regain Its Entrepreneurial Edge" *By Robert Litan*

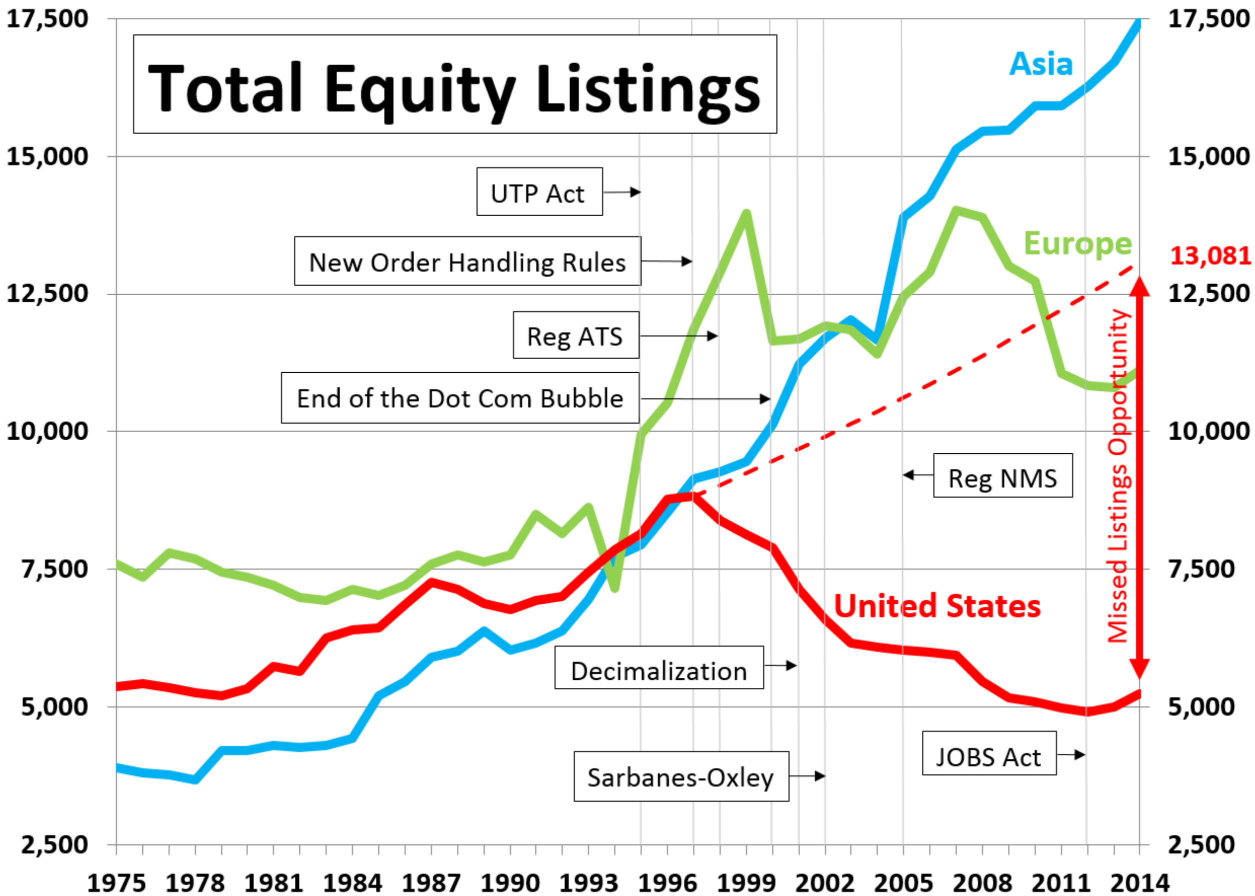
[3] See "Market structure is causing the IPO crisis – and more" by Weild & Kim (Grant Thornton – 2010) and "The U.S. Need for Venture Exchanges" by Weild & Kim (Weild & Co. – 2015).

- The U.S. has averaged only 150 IPOs per year since 2000 versus what was 500 IPOs a year prior to the Dot Com Bubble and should be 950 IPOs a year on today's larger economy.
- The number of small IPO book running managers collapsed from 164 book runners in 1994 to only 31 for all of 2014. Of the 164 book running investment banks in existence in 1994, only 34 of these firms are in existence today.

The Main Street Growth Act (Recommendations)

U.S. stock markets have become one-size-fits-all stock markets optimized to trade large cap stocks. The structure and rules have been a disaster for small cap companies, entrepreneurship and job creation. The "Main Street Growth Act" would change this by establishing a second stock market structure – one allowing its sponsors broad discretion in addressing the needs of small-cap companies, their investors, and the ecosystem of value providers – broker-dealers, research providers and market makers - needed to support them. This is a noble and important Act for the American people and deserves the attention and support of both parties.

The United States once had a very successful venture exchange that gave us companies like Intel, Microsoft, Staples and Starbucks. That venture exchange was called the National Association of Securities Dealers Automated Quotation System or the original "NASDAQ." The "Main Street Growth Act" proposes to allow "Venture Exchanges" to write rules that would be exempt from many of the very changes that caused NASDAQ to quote stocks in penny increments and cater to High-Frequency Traders. This Act establishes a clean canvas on which Venture Exchanges would be able to "paint" solutions designed to meet the needs of small cap growth companies and their investors.



Sources: Weild & Co., World Federation of Exchanges, CFA Institute

My primary concern is that the Act does not go far enough: Many currently public companies are struggling against the current market structure. With that in mind, we offer the following improvements for inclusion in the current Act:

1) **Venture Exchanges should be opened up to all currently reporting (SEC registered) U.S. companies that are under $2 billion in equity market value <u>or</u> have less than $1 billion in revenue and are public for 5 years or less.** Many public companies are struggling to find research coverage and real market making support under the current one-size fits all stock market regime. Not allowing already public companies to have a choice in listing (trading) venue is not fair to those companies and their investors. A venture exchange could help already public companies attract new investors, attract research coverage, improve share prices and lower the cost of growth capital.
2) **Create an orderly transition for companies to graduate from a Venture Exchange – Companies should be permitted to stay on a venture exchange until they have exceeded some higher threshold (say $2.5 billion) for twelve consecutive months.** Stocks frequently trade above and below thresholds – especially in bull markets. Higher prices must be sustainable and there must be a seasoning or "grace" period to allow companies to prepare for a transition and to prepare shareholders for that transition.
3) **Explicitly permit broker-dealer member-owned venture exchanges.** The profitability of the ecosystem of broker-dealers will determine the success of venture exchanges. Stock exchange profitability is much less important than dealer profitability because it is the dealers, and not the exchanges, that support small-cap stocks. In our research, we spoke to participants in the London AIM market, the Toronto TSX Venture Exchange and the Frankfurt Neuer Markt. These markets experienced problems when stock exchange profitability was put ahead of the needs of the dealer system. For this reason, we believe that the most successful model will be one that embraces member-owned exchanges.
4) **Finally, we recommend that listing thresholds be adjusted annually for inflation.**

Benefits to Consumers, Investors and the Poor

Consumers, Investors and the Poor are all indirectly harmed by low-cost, one-size-fits-all stock markets. This is what we refer to as the "*Low-Cost Paradox"* of small-cap markets: Large cap markets are naturally liquid. They don't depend on intermediaries. In this case, low-cost trading benefits consumers. However, small-cap markets are naturally illiquid. Without intermediaries to provide research, marketing, and capital commitment to support liquidity, small-cap markets deteriorate. The lack of sufficient aftermarket economic incentives causes broker-dealers to pull out from these markets. As a result, the capacity to take companies public declines, and share prices decline (through lack of support) harming investors as institutional investors shift capital allocations away from small cap illiquid stocks to large cap naturally liquid stocks.

Stock markets should not be looked at through the lens of other consumer-oriented businesses. They are unlike other products and services because the proper functioning of small-cap stock markets is essential to support access to capital, job creation, economic growth and the very competition from which consumers will benefit broadly throughout the economy.

How do consumers, investors and the poor indirectly benefit from by higher economic incentives? Bear with me, because this many be counterintuitive:

Consumers Benefit

Consumers benefit as more companies are able to access equity capital. More new companies means more competition and innovation. More competition and innovation means consumers benefit. Thus, the apparently simple, unarguable benefit of low cost trading has paradoxically harmed the consumer by causing a collapse in the capital formation infrastructure of our economy.

Venture Exchanges, by improving access to equity capital, will support the scientists, engineers and entrepreneurs who will find cures to cancer, global warming and the other great challenges we face.

Investors Benefit

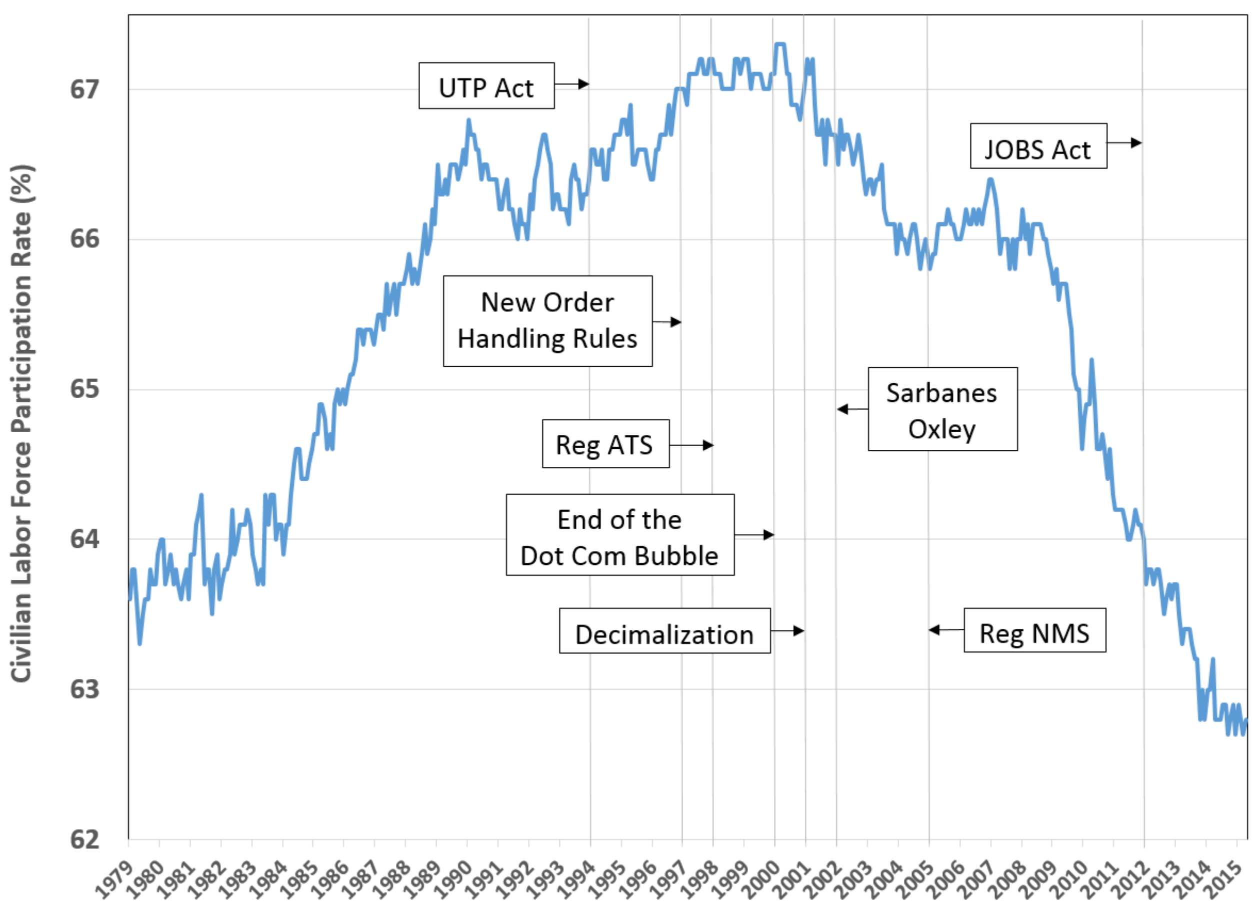
Long-term investment returns are dependent on long-term economic growth. The trajectory of long-term economic growth can be tilted upward by improving the rate at which start-ups are created and by improving the rate at which companies go public to free up more equity capital for investors to reinvest and start new companies – thereby creating a so-called "Virtuous circle."

The Poor Benefit

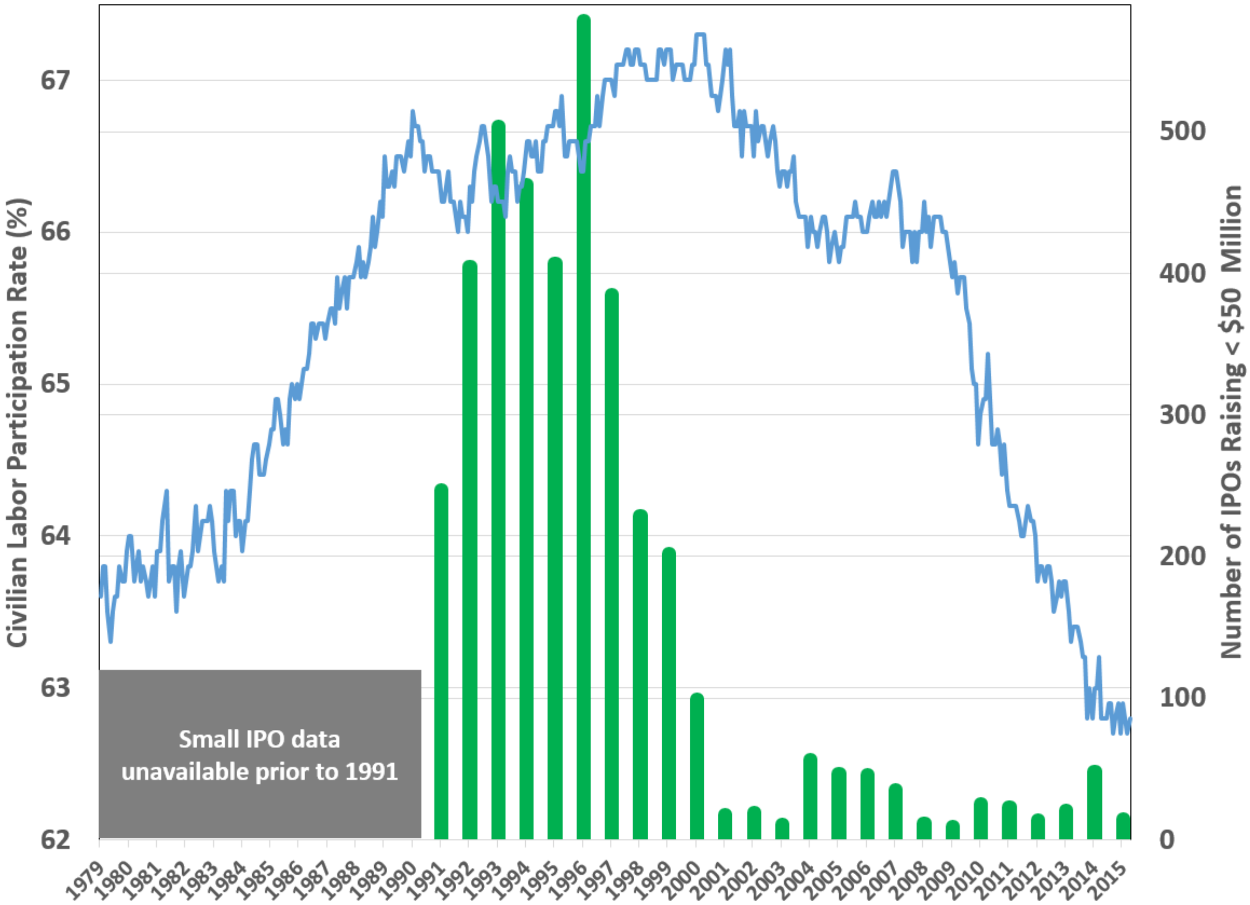
It is very clear that labor participation rates for 16 to 19 year olds, and 25 to 54 year olds – workers in their prime – have been declining since roughly the time that the bottom fell out of the small IPO market. It is also clear that workers of retirement age – 65 and older – are holding onto their jobs longer. The two trends combined – young workers working less and old workers working more – is a sign of a job market and economy under stress. I have said this to members of the Black Caucus and I will repeat it here – African Americans according to the Pew Institute, have an average net worth of somewhat more than $11,000 as of 2013. They are not day-trading stocks, as they simply do not have enough money to be invested in the stock market. Thus, they derive no personal benefit from low-cost trading. But poor people do need jobs. They need higher wages. And these are things that venture exchanges and the "Main Street Growth Act" can bring, in time.

Overall U.S. labor participation rates are now below where they were in 1979.

Labor participation rates stalled when aftermarket incentives were collapsed by Reg. ATS in 1998 and the bottom dropped out of the small IPO market. We believe the two (labor participation rates and the loss of the small IPO) are to some degree related.



Source: US Bureau of Labor Statistics. Seasonally adjusted.

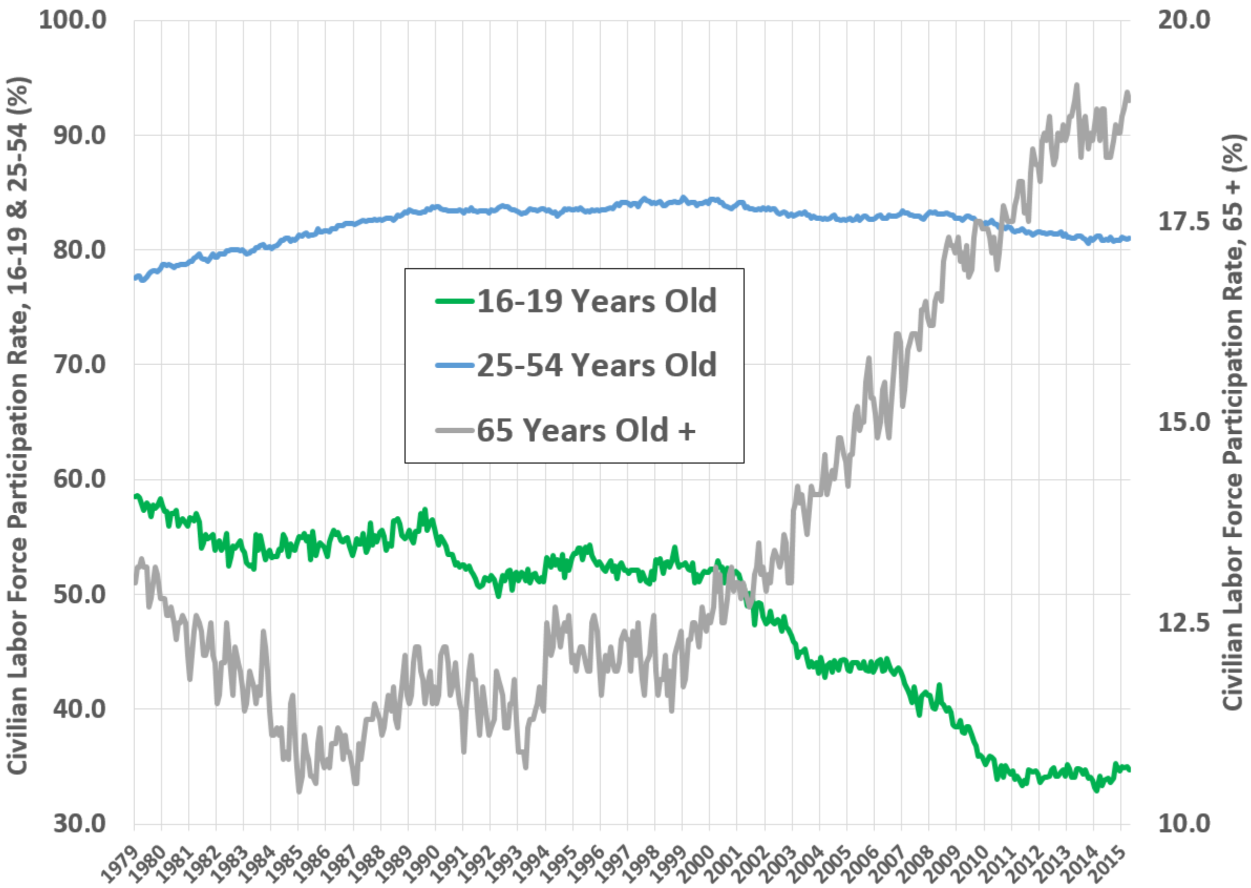


Sources: Labor data from US Bureau of Labor Statistics, seasonally adjusted. Transaction data from Weild & Co. and Dealogic, corporate IPOs only, excluding closed-end funds, REITs, SPACs and other financial vehicles.

Labor participation rates for young people (16-19) and people in their prime (25-54) have declined significantly since the late '90s.

The only segment of the population seeing a steady increase in labor participation rates is workers over retirement age (65+) – A sign, we believe, that older workers can't afford to retire.

Venture exchanges through the "Main Street Growth Act" will help reverse these disturbing trends.



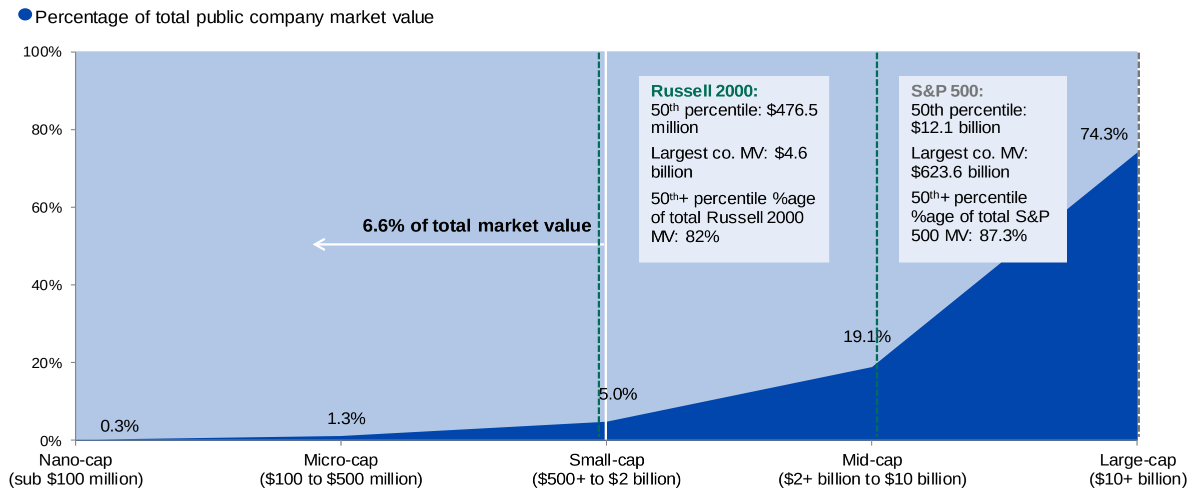
Source: US Bureau of Labor Statistics. Data for 16-19 year olds and 25-54 year olds is seasonally adjusted.

A vibrant capital market is the engine of a healthy economy that creates jobs. We estimate that, if not for the scarcity in public offerings, 3.1 million to 9.4 million additional U.S. jobs might have been created by companies after going public. If we assume a multiplier effect where higher IPO activity accounts for a like-kind number of jobs created in the private market (a conservative effect of only one for one), the range of 3.1 million to 9.4 million jobs created jumps to between 6.2 million and 18.8 million.

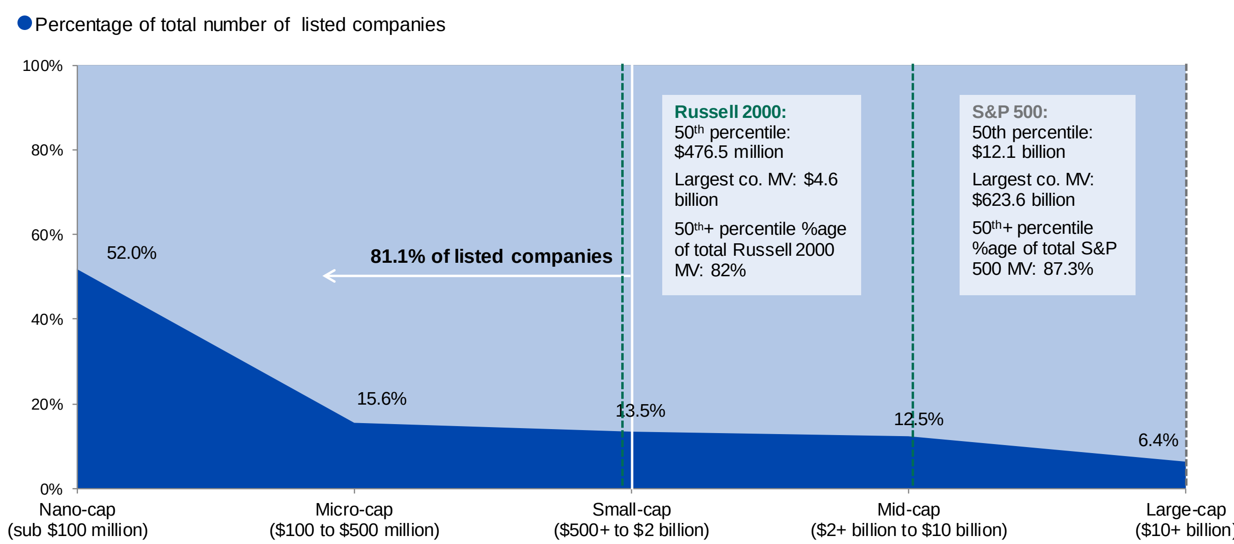
A major contributor to employment

In fact, the so-called multiplier effect may be much larger than we estimate above. Enrico Moretti, Professor of Economics at Berkeley, has estimated that as many as five local service sector jobs — ranging from doctors and teachers to wait staff and sales clerks — are created for every one technology and biotechnology sector job produced. These are the very industries that once sought out public offerings as their preferred strategy to raise capital (and exit). This five-to- one ratio of job formation has served to increase the number of employment opportunities at all skill levels and, ultimately, the U.S. standard of living.

Sub $2 billion market value public companies represent a small percentage of total stock market market value yet drive most job growth (directly or indirectly).



Sources: IssuWorks and Capital IQ
Includes NASDAQ, NYSE (including AMEX) and OTC listings. Corporate issuers only, excluding holding companies, funds, MLPs, SPACs, REITs and other trusts.



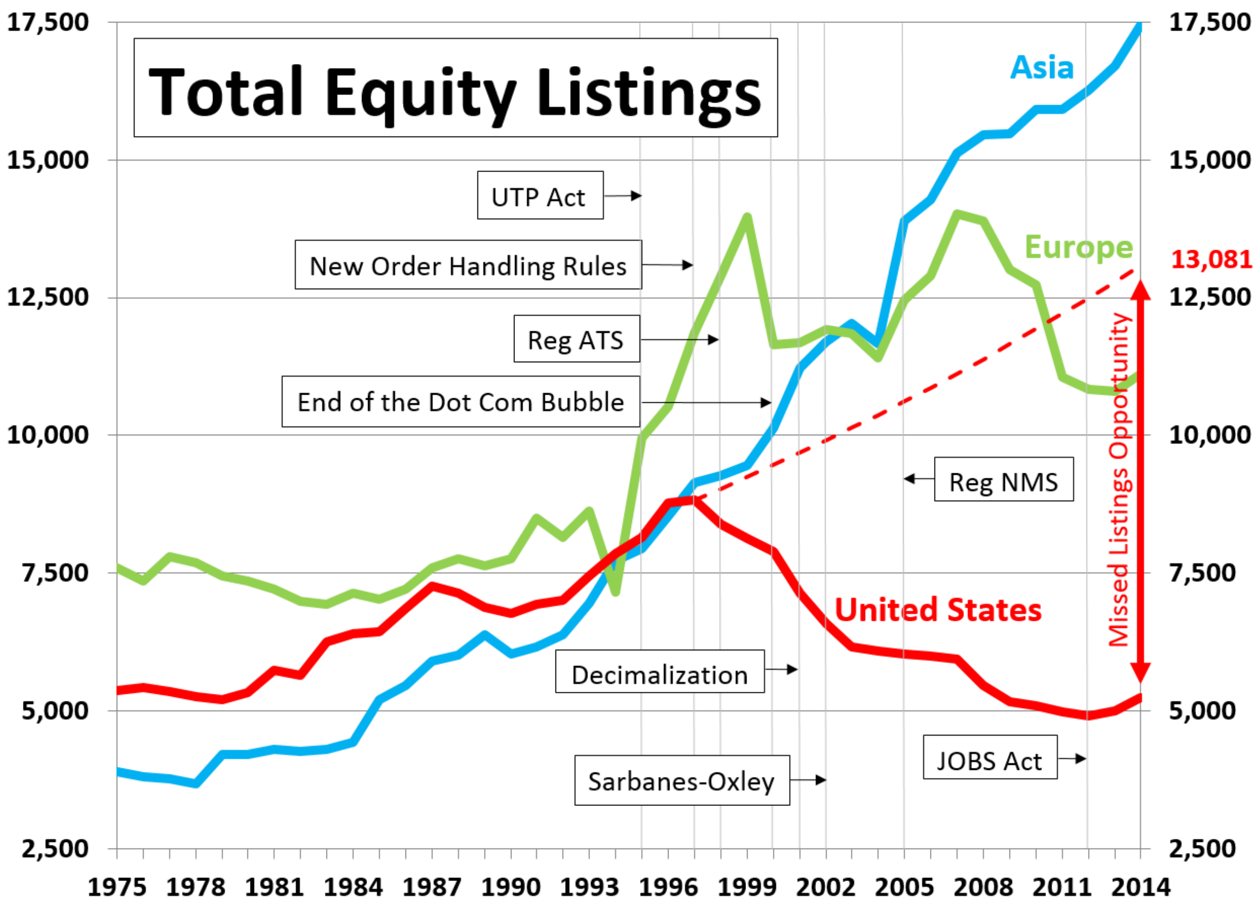
Sources: IssuWorks and Capital IQ
Includes NASDAQ, NYSE (including AMEX) and OTC listings. Corporate issuers only, excluding holding companies, funds, MLPs, SPACs, REITs and other trusts.

Specific responses to legislative proposals

H.R.____, the "Main Street Growth Act" (Chairman Garrett)

We support this Bill with enhancements as outlined above. This is an essential Bill for its potential to improve capital formation broadly and to create jobs in the United States. Our listed stock markets are in the midst of a long-term and protracted collapse which has been self-inflicted. As seen from data originally compiled by the CFA Institute's Jason Voss, the United States today has fewer publicly listed companies than we did at any point since 1975 (see Figure 1).

Figure 1: U.S. stock market listings have collapsed since 1997
The United States has just over 5,000 listed companies when it should have over 13,000.



Source: Weild & Co., World Federation of Exchanges, CFA Institute

In fact, we have slightly more than 5,000 publicly listed companies, when we should have more than 13,000 public companies, but for the fact that changes to market structure gutted the aftermarket support model in 1997 with the implementation of the Order Handling Rules followed by the shift to electronic markets in 1998 with Regulation ATS (Alternative Trading Systems) and one-size-fits-all penny stock trading in 2001 with "Decimalization."

H.R._____, the "Fair Access to Investment Research Act of 2015."

We abstain from comment on this bill. ETF research is not our area of expertise.

However, we would hasten to point out that ETFs are now a more than $3 trillion AUM industry. As ETFs (and other Index Funds) grow compared to actively managed mutual funds and direct stock ownership, they will close off an increasing percentage of equity capital from corporate America.

We urge Congress to consider requiring that all ETFs create a mechanism to participate in equity new issues so that ETFs can not undermine capital formation and economic growth.

H.R._____, To direct the Securities and Exchange Commission to review all its significant regulations to determine whether such regulations are necessary in the public interest or whether such reguolations shold be amended or rescinded.

We support this bill. As a general principle, we are supportive of most measures in government that require the scheduled, but not-too-frequent and burdensome, review and determination of whether each regulation is no longer necessary in the public interest or is outmoded, inneffective, insufficent or excessively burdensome.

H.R._____, the "Accelerating Access to Capital Act of 2015."

We support this bill. It appears to accelerate the availability of Form S-3 "Shelf Registrations" for public companies. The combination of short-selling and penny tick sizes has made it easier for predatory hedge funds to put pressure on stock prices ahead of an offering. Thus, the flexibility, speed and costs savings afforded by Form S-3 "Shelf Registrations" helps corporate issuers to improve their cost of equity capital.

We would also support the expansion of Form S-3 and other shelf registration approaches to improve access to capital for smaller public companies that are current with their SEC filings.

Conclusion

In our work for the Organization of Economic Cooperation and Development (OECD), we examined IPO markets throughout the world. It became obvious to us that the incentives and disincentives created by governments and regulators are the major determinant of the success (or lack thereof) of small IPO markets (and the aftermarket). The inescapable conclusion is that the collapse of the small IPO market in the United States was caused by ill-conceived and nearsighted public policy and that it can be rectified by improved and farsighted public policy that includes the creation of a regime designed to meet the very different needs of small-cap public companies. Intelligently designed "Venture Exchanges" would create a foundation for a resurgence in entrepreneurship, innovation and job creation. We believe that, once established and after perhaps a decade of operation, Venture Exchanges would lead to the creation directly (by companies accessing and investing capital) and indirectly ("muliplier effect" of jobs being created in the service sector of the economy because of the money spent by these companies and their employees) of 10 million jobs for the U.S. economy.

The ability of the United States to sustain itself as a world leader may rest on our ability to reverse the decades long trend of lower company start-up rates and lower IPO rates. Higher levels of entrepreneurship are the bedrock of a vibrant economy. The creation of Venture Exchanges, and the natural advocacy for entrepreneurship that would emerge from these exchanges, is one of the single most important actions that policy leaders can take to reignite the American Dream and restore America's position as the "Capital market envied by capital markets throughout the world."

About David Weild

David is the Chairman & CEO of Weild & Co., which he recently founded to create technologies and services to improve equity capital formation and aftermarket support. Weild & Co., Inc. owns Weild Capital, LLC. (Formerly IssuWorks Capital), a FINRA-registered broker-dealer.

Experience

David is an internationally recognized expert in how market structure affects capital formation. His work has been cited by academics, regulators and lawmakers in the US and overseas and the IPO Task Force Report to the U.S. Treasury. He was the former vice-chairman and executive vice-president of The NASDAQ Stock Market, with oversight of the more than 4,000 listed companies. Prior to NASDAQ, he spent 14 years at Prudential Securities in a number of senior management roles, including president of ecommerce, head of corporate finance, head of technology investment banking and head of equity capital markets in New York, London and Tokyo. He worked on more than 1,000 IPOs, follow-on offerings and convertible transactions and was an innovator of new issue systems and securities underwriting structures, including the use of Form S-3s to mitigate risk for small capitalization companies raising equity and convertible debt capital. He created the Market Intelligence Desk — or MID — while at NASDAQ to support issuers in their quest to better understand what was impacting trading in their stocks.

Education

David holds an MBA from the Stern School of Business and a BA from Wesleyan University. He has studied on exchange at The Sorbonne, Ecole des Haute Etudes Commerciales and The Stockholm School of Economics.

Industry participation

David has participated in the NYSE's and National Venture Capital Association's Blue Ribbon Regional Task Force to explore ways to help restore a vibrant IPO market and keep innovation flourishing in the United States, and is Chairman of the International Stock Exchange Executives Emeriti (ISEEE) Small Business Financing Crisis Task Force. He has spoken at the G-20 in Istanbul and the OECD (Organisation for Economic Co-operation and Development) with the 35 member nations in attendance, plus the European Commission and the IOSCO (International Organization of Securities Commissions). David testified before the CFTC-SEC Joint Panel on Emerging Regulatory Issues in the wake of the May 2010 flash crash, and has spoken at the SEC a number of times, including the SEC Small Business Forum, the

SEC Advisory Committee on Small and Emerging Companies and the SEC Roundtable on Decimalization. David is often interviewed by the financial news media. He has served as a Director of the National Investor Relations Institute's New York chapter, and he is the Chairman of the Board of Tuesday's Children, the non-profit that serves 9/11 families, and recently expanded its charter to make its long-term programs available to first responders, wounded warriors, families of the fallen and those touched by other acts of political and apolitical terrorism (e.g., Newtown).

Publications

David and Edward Kim have co-authored a number of studies, including *The U.S. Need for Venture Exchanges* published by Weild & Co. in March of 2015, *The trouble with small tick sizes: Larger tick sizes will bring back capital formation, jobs and investor confidence (Grant Thornton)* (with Lisa Newport) in 2012 and *Why are IPOs in the ICU? (Grant Thornton)* in 2008. Released in the fall of 2009, *Market structure is causing the IPO crisis (Grant Thornton)* (updated by *Market structure is causing the IPO crisis — and more* in 2010) and *A wake-up call for America (Grant Thornton)* have been entered into the Congressional Record and the Federal Register. They also authored *Making Stock Markets Work to Support Economic Growth (OECD)* (with Lisa Newport) and the chapter, *Killing the Stock Market That Laid the Golden Eggs (FT Press)* in the recent book on high frequency and predatory practices entitled, *Broken Markets,* by Sal Arnuk & Joseph Saluzzi, published in May 2012.

The *Wall Street Journal* published an Op-ed by David Weild entitled, *How to revive small-cap IPOs* on October 27, 2011. This Op-ed called for the establishment of small-cap (venture) exchanges.

I would like to thank Edward Kim, my partner and co-author, for his many contributions to this work.

About Weild & Co.

Weild & Co. is developing next generation equity distribution and aftermarket support platforms to improve new issue performance and revitalize capital formation. Weild & Co.'s goal is to help investment banks, issuers, and the venture capital and private equity communities drive superior results by reducing the cost and complexity of new issue preparation while improving the distribution and aftermarket support of new issues. The combined effect will keep IPO "windows" open longer, resulting in higher throughput (more new issues).

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The U.S. Need For Venture Exchanges

Recommendations for the creation of Congressionally-mandated stock exchanges designed to support small-cap companies and their investors and provide the necessary infrastructure to support a resurgence in innovation, job growth and the American Dream.

March 4, 2015

By David Weild and Edward Kim

WEILD&CO.

Contents

Executive Summary

The United States needs a "Venture Exchange" construct that will expand access to capital for entrepreneurs, enable earlier public participation in the company life-cycle, and attract aftermarket support (e.g. research, sales and capital commitment by market makers). One-size-fits-all-stock markets, optimized for large cap trading, have been a significant growth deterrent in the U.S., causing a dramatic and abrupt decline in small IPOs. The U.S. fell from 1st place to 12th in small IPO output behind many smaller economies, and fell to 24th out of 26th in small IPO output on a GDP-weighted basis ahead of only Mexico and Brazil[1] dating back to the 1990s and the widespread adoption of low-cost electronic markets. Certain foreign markets have benefited from their regulators and legislators recognizing the fundamentally different needs of small cap stocks by creating entirely separate markets (what the authors refer to as "Small-cap" or "Venture" exchanges) that embrace lower-cost disclosure models and and higher per share market-making incentives. The authors make recommendations for legislators convinced that the United States can reestablish the small IPO market and its associated ecosystem to its former luster as "The stock market that was the envy of stock markets across the world."

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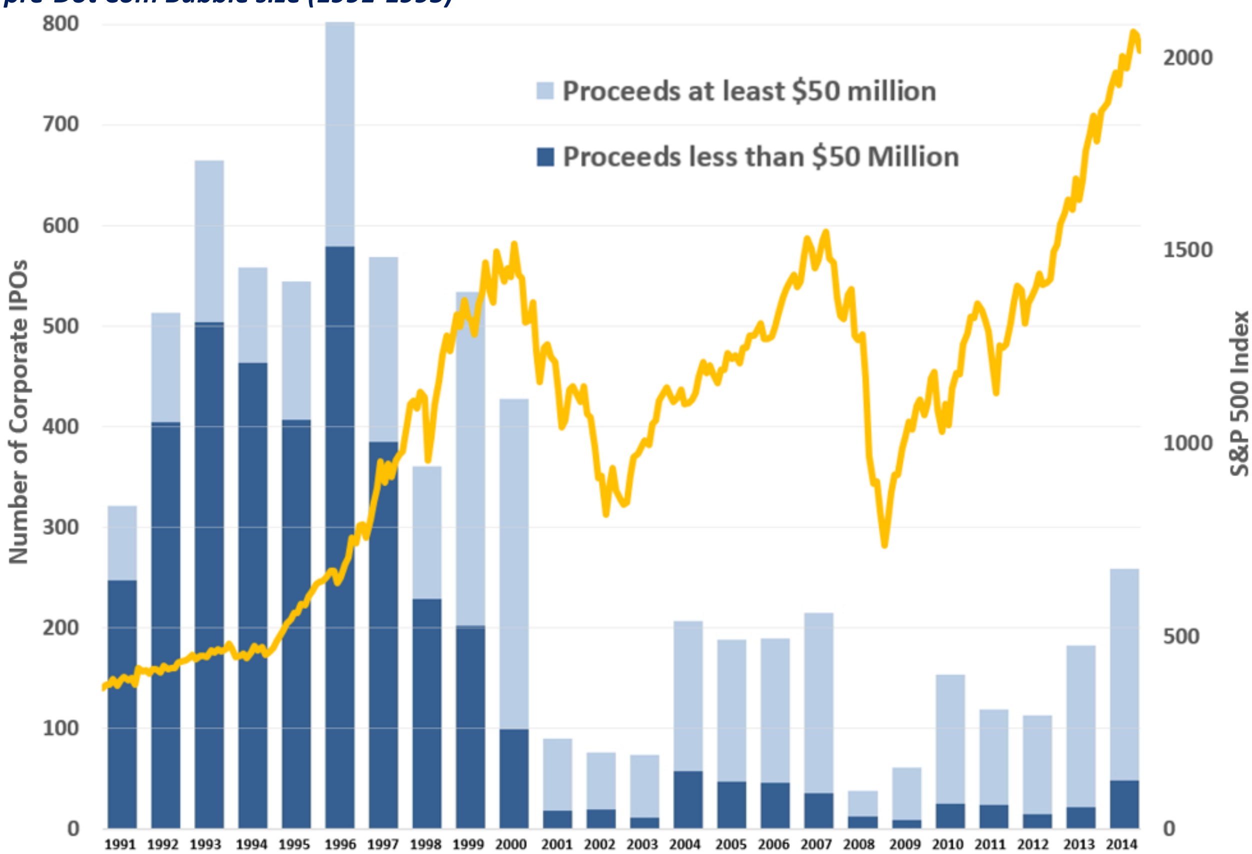
[1] *Making Stock Markets Work to Support Economic Growth: Implications for Governments, Regulators, Stock Exchanges, Corporate Issuers and their Investors*, by Weild, Kim & Newport, OECD Publishing (Organization of Economic Cooperation and Development), July 2013. See http://www.oecd-ilibrary.org/governance/making-stock-markets-work-to-support-economic-growth_5k43m4p6ccs3-en

Need for Dedicated Small-Cap (Venture) Exchanges

While pundits are popping champagne corks in celebration of the best IPO market since the dot com bubble ended in 2000, we sound a note of alarm: While 2014 was the best IPO market in 14 years, it generated fewer IPOs than what is required to stop the U.S. listed markets from shrinking. There were 284 operating company IPOs in 2014 – a pitiful number for a 'bull market' (see stock chart below). It takes 360 new listings per year for U.S. stock markets to break even[2] and it takes 520 IPOs a year to keep up with 3% GDP growth rates.[3] We have the largest economy in the world. On a GDP weighted basis, if the United States was performing at the level of some of the better markets (e.g. Canada, U.K., Singapore), the United States would be enjoying an average of 950 IPOs a year. We estimate that the difference between the number of IPOs that we have been doing since 2001 (approx. 150 per year), and what we believe we should be doing (upwards of 950 per year) is worth an incremental 10 million jobs to the U.S. economy.

Despite major bull markets from 2002-2007 and 2010-2014, the IPO market has not recovered to its pre-Dot Com Bubble size (1991-1995)



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[2] Exhibit 10, page 12, *A wake-up call for America*, by Weild & Kim, published by Grant Thornton, November 2009. See https://www.grantthornton.com/staticfiles/GTCom/Public%20companies%20and%20capital%20markets/gt_wake up_call_.pdf

[3] Ibid.

The inescapable conclusion is that while the JOBS Act has helped IPOs, it only scratches the surface of what must be done to regain our stature. Speak with current and former stock exchange officials anywhere in the world, and most foreigners say that we've overregulated, overcosted and stifled the very IPO market that once was the source of their envy: The IPO market of the 70's, 80's, and 90's which was the bedrock of U.S. economic leadership in such industries as software, semiconductors, personal computers and biotechnology.

On October 11, 2011, the Wall Street Journal published an OpEd by one of the authors of this paper entitled, "How to revive small-cap IPOs." In it, we first called for the creation of dedicated "small-cap" or Venture Exchanges:

> *One-size-fits-all stock trading has become a disaster for all but our nation's largest companies. Our rush to cut trading spreads and commissions has made large caps even more active—but we've abandoned the entrepreneur in the process. These are the people who take on most of the business risk and job creation in this country. With such inhospitable stock markets, mergers and acquisitions have become virtually their only outlet to realize value for their hard work.*
>
> *And as we've so often seen during this tough economy, M&A generates job cuts, not new jobs. That's why young, dynamic companies need renewed capital-market support so they can grow independently without being forced to sell.*
>
> *What's needed now is a new, parallel market for public companies under $2 billion in value. Trading rules in this new market would allow for higher commissions, which would provide adequate incentives for small investment firms to get back into the business of underwriting and supporting small-cap companies.*

Small capitalization stocks have strikingly different characteristics from large capitalization stocks. Small cap stocks generally lack natural visibility, natural followings and natural liquidity. Small cap stocks trade assymetrically: Big buyer, no seller. Big seller, no buyer. So, it should come as no surprise that today's "one-size-fits all" market structure, optimized for low-cost trading, index funds and computer-based trading, has precipitated a collapse in the ecosystem that supports these companies. Logically, this is why the United States has seen a decline from nearly 9,000 listed companies in 1997 to approximately only 5,000 today. If the SEC and Congress had not changed market structure beginning with the Order Handling Rules in 1997 and Regulation ATS (Alternative Trading System) in 1998, culminating in Decimalization in 2001, Sarbanes Oxley in 2002 and Regulation NMS (National Market System) in 2006, the American people would enjoy more than 13,000 listed companies versus the current 5,000 we currently have – and more than 10 million incremental jobs.

Prior to 1997, the United States had a small-cap "exchange" with a different structure: It was the dealer market, otherwise known as NASDAQ or the National Association of Securities Dealers Automated Quotation System. Stock trading on this market was quoted, not electronic. The NASD (now FINRA), of which NASDAQ was a subsidiary, was "member-owned." The NASDAQ of today, just like the NYSE, looks nothing like it did in 1997. Today, both are for-profit stock-held corporations whose primary objective is to grow shareholder value rather than to advocate for the members of the ecosystem (the many small investment banks, institutional investors and corporations whose confidence is required to support small cap markets).

Prior to 1997 there existed a vibrant ecosystem of many small investment banks. These banks thrived in small-cap-stock market making and reinvested profits in equity research analysts, research, salesforces, market makers and investment bankers. The most notable of these firms were the so-called "Four Horsemen" –Alex Brown, Montgomery Securities, Robertson Stephens and Hambrecht & Quist. None of these firms could exist on the same scale today. The economic incentives are wholly inadequate to support the required infrastructure. This is the so-called "Ecosystem theory of small IPO decline," attributed by academics to the work of the authors.

Stated simply, low-cost trading – publicized as a boon to consumers - gutted U.S. capacity to take companies public and to support them. The U.S. stock market no longer has the capital formation capacity that once made it "The stock market that is the envy of stock markets throughout the world."

In 1994, 162 Banks Acted As A Bookrunner On A Small IPO (< $50 million). Only 34 Of These Are in Existence Today.

AB Capital & Investment
Advest
AG Edwards & Sons
Allen & Co
Americorp Securities
Anderson & Strudwick
AR Baron
AT Brod
Auerbach Pollak & Richardson
Banc of America Securities
Baraban Securities
Barber & Bronson
Baring Securities
Barington Capital
Barron Chase Securities
Beacon Securities
Bear Stearns
Brenner Securities
Chase H&Q
CIBC World Markets
Citigroup Global Markets
Commonwealth Associates
Comprehensive Capital
Craig-Hallum Group
Credit Suisse First Boston
D Blech
Dain Rauscher Wessels
Daiwa Securities America
Dean Witter Reynolds
Deutsche Bank Securities
Deutsche Morgan Grenfell
DH Blair
Dickinson
Dillon-Gage Securities
Donaldson Lufkin & Jenrette
Equity Securities Investment
Everen Securities
FAC/Equities
FEB Investments
First Asset Management
First Equity Corp of Florida
First Hanover Securities
First Marathon
Friedman Billings Ramsey
Gilford Securities
GKN Securities
Glaser Capital
Global Capital Securities
Goldman Sachs
Grady & Hatch
Greenway Capital
Hamilton Investments
Hampshire Securities
Hanifen Imhoff
Harriman Group
Harris Nesbitt Gerard
HJ Meyers
Howe Barnes Investments
IAR Securities Inc
ING Barings
International Assets Advisory
Investec
Investors Associates
J Gregory
James Capel
Janney Montgomery Scott
JC Bradford
Joseph Stevens
Josephthal
JP Morgan Securities
JW Charles Securities
Keane Securities
Kennedy Mathews Landis Healy
Kensington Wells
Kidder, Peabody
Kleinwort Benson Securities
Ladenburg Thalmann
Laidlaw Global Securities
Lam Wagner
Lazard Freres
LC Wegard
Legg Mason Wood Walker
Lehman Brothers
LH Alton
Mabon Securities
Marleau Lemire Securities
Mathews Holmquist
McDonald Investments
Merrill Lynch
MH Meyerson
Miller Johnson & Kuehn
Montgomery Securities
Morgan Keegan
Morgan Stanley
Murchison Investment Bankers
NatCity Investments
NatWest Securities
Needham
Neidiger Tucker Bruner
Nesbitt Burns
Nomura Securities
Norcross Securities
Oak Ridge Investments
Oppenheimer
Oscar Gruss & Son Inc
Pacific Crest Securities
Pacific Growth Equities
PaineWebber
Paragon Capital Markets
Paribas Capital Markets
Parker/Hunter
Patterson Travis Securities
Paulson Investment
Piper Jaffray
Principal Financial Securities
Prudential Securities
RAF Financial
RAS Securities
Raymond James
Redstone Securities
Rickel & Associates
RJ Steichen
Robert W Baird
Robertson Stephens
Robinson-Humphrey
Rocky Mountain Securities
Rodman & Renshaw
Roney Capital Markets
Roth Capital Partners
Royce Investment Group
RvR Securities
Ryan Lee
Salomon Brothers
Sands Brothers
Schneider Securities
Schroder
SG Cowen
Smith Barney
Spectrum Securities
Spelman
Stephens
Sterling Foster
Sterne Agee & Leach
Strasbourger Pearson
Stratton Oakmont
Summit Investment
Texas Capital Securities
Thomas James
Toluca Pacific Securities
Tucker Anthony
UBS Securities
VTR Capital
Wachovia Capital Markets
Wedbush Morgan Securities
Wells Fargo Securities
Werbel-Roth Securities
Wertheim Schroder
Westfield Financial
Whale Securities
William Blair
Yamaichi Securities
Yee Desmond Schroeder

In 2014, Only 31 Banks Acted As A Bookrunner On A Small IPO (< $50 million) and the Number of Bookrunners Declined 81% From 1994 to 2014.

Aegis Capital	Feltl	Newport Coast Securities	Scarsdale Equities
Barclays Capital	Henley	Northland Capital Markets	Stephens
Capitol Securities Mgmt	Jefferies	Oppenheimer	Stifel Nicolaus / Keefe
Chardan Capital Markets	JMP Securities	Piper Jaffray	Summer Street
Cowen	Laidlaw	Raymond James	UBS Securities
Credit Suisse Securities	Leerink Partners	Robert W Baird	Wells Fargo Securities
Dawson James Securities	Maxim Group	Roth Capital Partners	William Blair
Deutsche Bank Securities	MDB Capital Group	Sandler O'Neill	

Viewed the World Over

The United States is still the world's largest capital market. Our innovations in markets, for better or worse, are frequently exported (e.g., derivative securities that contributed to the World Financial Crisis of 2007-2008 which still lingers; Knight Securities once occupied the floor of the old London Stock Exchange) but not always worth emulating.

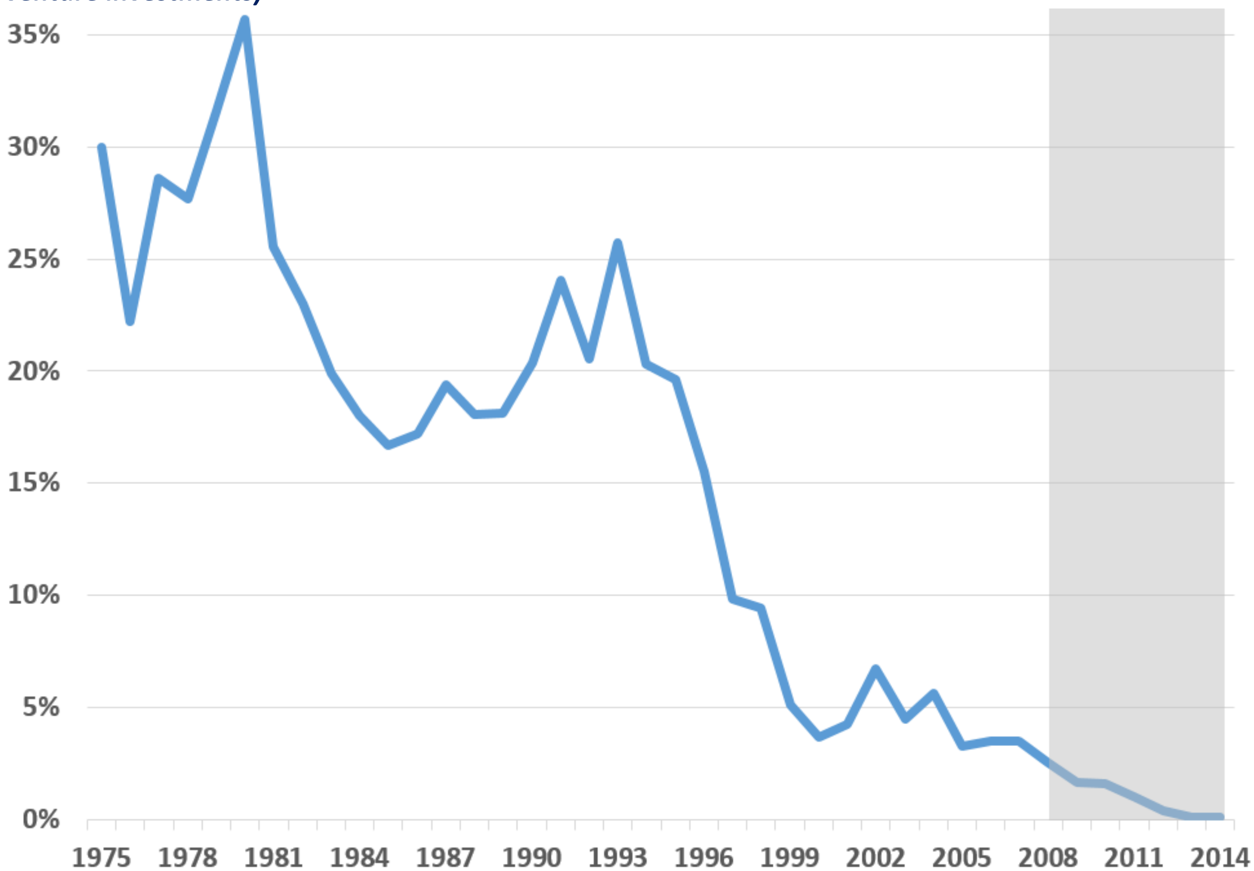
Do not take for granted that the United States will remain the world's largest capital market. Institutional capital is highly mobile. Whether it is Fidelity Investments with operations across the globe, or whether it is Alibaba coming to the U.S. for $25 billion in capital to be journaled into China, the trends clearly point to increasing globalization of institutional capital. We must make the United States a place that attracts "sticky" capital and where entrepreneurs easily congregate to create jobs through innovation and implementation.

We have a responsibility to get it right and to acknowledge when we get it wrong. The world is watching.

Much like a twelve-step program on the path to recovery, the SEC should acknowledge that the U.S. stock markets are no longer the envy of stock markets across the globe. We know. We ask. We listen. Yet Americans, including SEC Chairs, often repeat this claim even to Congress.[4] However, when we ask overseas stock exchange executives, equity capital markets professionals in London and institutional investors, whether they envy U.S. stock markets, foreigners generally react with incredulity. What they once envied was Silicon Valley and the IPO market that birthed entire new industries. They cite U.S. leadership in semiconductors, personal computers and biotechnology as prime examples. In the same breath, however, they note the decline in our small IPO markets, the expansive reach and costs of Sarbanes Oxley and Dodd Frank, and the rise of high-frequency trading. They are deeply concerned.

[4] Chair Mary Jo White, "…the U.S. markets are the envy of the world…" from *Testimony on SEC Budget,* Before the Subcommittee on Financial Services and General Government, Committee on Appropriations, United States Senate, on June 25, 2013 see http://www.sec.gov/News/Testimony/Detail/Testimony/1365171606059#.VLwM29g5A5s

Percentage of Venture-Funded Companies that have Gone Public
(Note-shaded area highlights those years that are understated given the relative youth of those venture investments)



Source: National Venture Capital Association, based on number of first venture fundings each year

Large Cap Bias Everywhere We Look

Because of the decline in the small cap ecosystem and the shift to for-profit, stock-held exchanges, U.S. markets are dominated by thought leaders, institutions and regulatory bodies with experience, expertise and economic incentives derived disproportionately from large cap stocks and the firms that focus on them.

In our view, large-cap bias permeates the SEC (Securities & Exchange Commission), FINRA (Financial Industry Regulatory Authority), the NYSE, NASDAQ, SIFMA (Securities Industry Financial Markets Association) and DTCC (Depositary Trust Company) – every institution that has a voice. Small cap companies (and their investors and their intermediaries) by contrast, are inadequately represented, and their voices are drowned amid the preponderance of large cap trading-oriented investors. Regulators have pursued an ideology that low-cost trade execution is the only measure that matters. Even that measure is perversely off the mark: Best execution is defined as the price of trade execution relative to the NBBO (National Best Bid and Offer) at the time of execution when in reality it should be measured from the time at which the order is received (not executed). Large orders take time and care to execute and information leakage can cause the stock to move adversely in one direction or the other. This is known as "slippage." Small orders are sold (payment for order flow) and sometimes shopped across venues looking for the "best return" (not "best execution") to the originating broker dealer.

The most recent example of domination by large capitalization interests is revealed in an examination of the SEC's much trumpeted "Market Structure Advisory Committee"[5] – announced just this January 13, 2014:

Members of the Equity Market Structure Advisory Committee are:

- **Matthew Andresen**, Co-Chief Executive Officer, Headlands Technologies LLC
- **Reginald Browne**, Senior Managing Director & Global Co-Head, ETF Group, Cantor Fitzgerald & Co.
- **Kevin Cronin**, Global Head of Trading, Invesco Ltd.
- **Brad Katsuyama**, President and CEO, IEX Group Inc.
- **Ted Kaufman**, Professor, Duke University Law School and former U.S. Senator from Delaware
- **Richard Ketchum**, Chairman and CEO, FINRA
- **Manisha Kimmel**, Managing Director, Financial Information Forum
- **Mehmet Kinak**, Vice President and Head of Global Equity Market Structure and Electronic Trading, T.Rowe Price Group
- **Andrew Lo**, Charles E. and Susan T. Harris Professor of Finance and Director, Laboratory for Financial Engineering, MIT Sloan School of Management and Chairman and Chief Investment Strategist, AlphaSimplex Group
- **Joseph Mecane**, Managing Director, Barclays PLC
- **Jamil Nazarali**, Senior Managing Director & Head of Execution Services, Citadel Securities
- **Eric Noll**, President & CEO, Convergex Group
- **Maureen O'Hara**, Robert W. Purcell Professor of Finance, Johnson Graduate School of Management, Cornell University and Chairman of the Board, Investment Technology Group Inc.

[5] See SEC Press Release at http://www.sec.gov/news/pressrelease/2015-5.html#.VLmjuNg5A5s entitled, *SEC Announces Members of New Equity Market Structure Advisory Committee*: *Committee Comprised of Experts with Diverse Backgrounds and Viewpoints*

- **Joe Ratterman**, CEO, BATS Global Markets Inc.
- **Nancy Smith**, Corporate Secretary & Chief Integration Officer, AARP
- **Chester Spatt**, Kenneth B. and Pamela R. Dunn Professor of Finance, Tepper School of Business, Carnegie Mellon University and Director of its Center for Financial Markets
- **Gary Stone**, Chief Strategy Officer, Bloomberg Tradebook LLC

We applaud the inclusion of institutional investors who have knowledge of small cap investing, namely Kevin Cronin of Invesco and Mehmet Kinak of T. Rowe Price.

We applaud as well the inclusion of Ted Kaufman who, in his December 16, 2009, speech on the floor of the United States Senate asked,

> *"How can we create a market structure that works for a USD 25 million IPO — both in the offering and the secondary aftermarket? If we can answer that question, Mr. President, this country will be back in business.[6]"*

We are extremely concerned, however, by the absence of participation by middle market investment banks including such firms as Piper Jaffray, Cowen & Company, William Blair, Leerink Partners, Robert W. Baird, Pacific Crest Securities (recently acquired by KeyCorp) and Stifel Financial. Middle market investment banks, whose numbers were once great, are now an endangered species. These firms reflect and are emblematic of the dwindling infrastructure (ecosystem) that the United States depends upon to support a robust small IPO and aftermarket. Their decline dates back to the disappearance of the Four Horsemen and has continued unabated into recent years with the sale (some would say collapse) of firms like Keefe Bruyette & Woods and Think Equity as well as the January 8, 2015, announcement that Standard Chartered Bank would close its equity sales and research business.[7]

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[6] See University of Delaware Library, Ted Kaufman, United States Senator for Delaware, *Kaufman Calls Decline in IPOs "Choke Point" to Job Creation, Economic Recovery* : "The failure of Wall Street to provide capital to small companies may be costing our economy millions of foregone jobs," December 16, 2009 at http://green.lib.udel.edu/webarchives/kaufman.senate.gov/press/press_releases/release/-id=352c7e34-1cad-4ad3-b31c-c267bd492d1a.htm

[7] New York Times Deal Book, January 8, 2015, *Standard Chartered to Close Equity Sales and Research Business,* by Neil Gough. See http://dealbook.nytimes.com/2015/01/08/standard-chartered-will-close-equity-sales-and-research-business/

The Early NASDAQ, London AIM and Toronto TSX Venture Exchanges

A number of small-cap or Venture Exchanges have been successful in the past. Today, all have converted to for-profit public shareholder models contributing to the deterioration in the small cap ecosystem in each of the US, U.K. and Canada. As the small-cap ecosystem shrinks, so do research, sales and marketing support and capital available to support liquidity. When the "aftermarket" declines, IPO production declines.

The Early NASDAQ – Nasdaq was established in 1971 as a member-owned trade reporting facility. It was not a "stock exchange" in the legal sense (not an SRO or Self-Regulatory Organization) but was a facility of the NASD (National Association of Securities Dealers) which itself was "Member-owned" (no public shareholders). Trades did not occur on Nasdaq in its infancy but occurred in the over-the-counter market between and within broker-dealers (its member firms). The primary innovation of Nasdaq in the early years was to create price transparency and to allow members to advertise their activity (volume) in any given Nasdaq stock.

The Intel Corporation went public on Nasdaq in 1971. It did not meet the qualifications of the listed stock exchanges at the time. The early Nasdaq was in essence a Small-Cap Exchange. It was the original U.S. Venture Exchange.

Notably, in the early years of NASDAQ, market makers could advertise their markets but they were not formally obligated to buy significant amounts of stock. The market was a telephone "quoted" market where dealers could back away from orders and thus manage their risk. Their quotes were not live orders that anyone could "hit" electronically, as they can today. When companies had poor results, dealers would short or back away and stock prices would decline. When companies had good results, dealers would get on the phone and "talk the stock up." Wide quoted spreads which created "effective"[8] tick sizes of as much as 25 cents per share, provided ample incentives for market makers to commit capital – whether to short stock to provide an institution with an initial position (to "get the investor going"), or to buy a block of stock from an investor at or below the "bid" side of the market and offer it to brokers to make sales calls "net" with 25 cents per share to the stockbroker as a maximum incentive. Liquidity in small-cap stocks was thus "manufactured" by the dealers and their salesforces.

Admittedly, there was quite a bit of conflict here. Salesmen (brokers) were motivated by money. Firms tried to control for this by investing in equity research and the so-called "Competition of ideas" – the fact that the typical firm had many stocks from which to choose under research coverage, caused them to disproportionately market their "buy" rated ideas while shying away from "hold" or "sell" recommendations.

Reg. ATS came in 1998 and represents the dawn of widespread electronic order book markets in the United States. These caused the effective tick size, the smallest increment in which a stock can trade, to drop from 25 cents per share to 3.125 cents per share – at the same time that the internet enabled

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[8] While the actual permissible minimum "tick" size was in the pre-decimalization period 3.125 cents (1/32nd), the markets of the 70s and 80s were quoted and the convention was to quote in 25 cent increments. Thus, while an institution might be able to negotiate less than a 25 cent increment (usually 1/8 or 1/16), many orders would be marked up a ¼ point or 25 cents which was thus the "effective" tick size.

widespread self-directed discount retail investing collapsing the commissions charged by retail brokers. While many micromarket economists will argue cause-and-effect here, for those of us that ran these businesses (David Weild co-chaired strategy for investment banking, equity research, institutional sales and equity trading at Prudential Securities), we reacted to the changes by cutting research commitments, capital commitments, and investment banking support of small capitalization companies. The profitability of $50 million IPOs was suddenly one-third of what it had been pre-Reg. ATS. The collapse of the ecosystem accelerated while a series of new trading-focused for-profit competitors to Nasdaq forced Nasdaq to convert to a for-profit company itself with public shareholders in order to raise adequate capital to remain competitive.

Today, small capitalization companies are frequently seen to announce good news but not enjoy the benefit of a positive reaction by the stock. Why? Because intermediaries are needed to market small cap stocks to investors, and under the current system, no one can earn a living bringing new buyers into smaller stocks.

LSE's AIM (London Stock Exchange's Alternative Investment Market) – AIM was founded in 1995 as a submarket of the London Stock Exchange. As of December 2014, there was a total of 1,104 companies listed on the AIM market including 885 from the U.K. and another 219 International.[9] The U.K. population is one fifth that of the United States so on the domestic side alone, this would be the equivalent, in U.S. terms, of contributing 4,425 (885 x 5) listed companies to the U.S. markets. An AIM-type market thus has the potential to nearly double the current population (approximately 5,000) of publicly listed companies in the United States. The AIM peaked in 2007, before the Financial Crisis, at 1,694 public companies – nearly twice the current number of listed companies. On a population-weighted basis, this would be the equivalent of adding 8,470 publicly listed companies to the U.S. listed markets – a number not seen in the United States since before the introduction of Reg. ATS in 1998.

Students of stock market history will note that most of AIM trading is based on a clone of the original NASDAQ dealer system called SEAQ. "NASDAQ" stands for "National Association of Securities Dealers Automated Quotation" system while "SEAQ" stands for "Stock Exchange Automated Quotation" system. Ironically , representatives of the London Stock Exchange now travel to the United States to solicit U.S. companies to list on the AIM.[10] U.S. companies cite the lack of Sarbanes-Oxley in the U.K., lower ongoing reporting costs on AIM, and market making as attractants. However, the company review process skips the FSA (the U.K. equivalent of the SEC) and is outsourced to underwriters who are known as NOMADs or Nominated Advisors. These NOMADS are responsible for due diligence and disclosure but critics say that the process is uneven and stigmatizing. For this reason, we would prefer to keep the SEC in this role in the United States.

Actual Invitation to an Upcoming AIM New Business Event to be Held in Miami, Florida on March 10, 2015.

[9] See http://www.londonstockexchange.com/statistics/historic/aim/aim-statistics-archive-2014/dec-14.pdf

[10] *London Stock Exchange officials recruit businesses in Denver*, January 19, 2015, by Aldo Svaldi, The Denver Post, see http://www.denverpost.com/business/ci_27351789/lodon-stock-exchange-officials-recruit-businesses-denver

Hello,
You are invited to the following event:

THINK BIG, AIM HIGHER: RAISING CAPITAL THROUGH LONDON'S INTL GROWTH MARKET

Event to be held at the following time, date, and location:

Tuesday, March 10, 2015 from 8:00 AM to 10:00 AM (EDT)

The Beacon Council
80 Southwest 8th Street
#2400
Miami, FL 33130

View Map

Attend Event

Share this event:

For more details please contact: Rebecca Mowat HM Consul & Head UKTI Southeast rebecca.mowat@fco.gov.uk / (786 223 3713) Twitter @UKTIUSA

Criticisms of AIM – In 2007, The Guardian reported that SEC Commissioner Roel Campos created a stir in London when he likened AIM to a casino saying, "I'm concerned that 30% of issuers that list on AIM are gone in a year." The article[11] went on to say that "The LSE, which controls AIM, retorted that the number of companies that go into liquidation or administration in a year is actually fewer than 2%." What people generally don't understand is that the "expected life" of a listing, even in the United States, where companies are more mature, is only approximately 7 years. It stands to reason that smaller companies will be merged and delisted from exchanges at higher rates than larger companies. From a public policy perspective, however, they also represent materially less risk exposure to the public exactly because they are smaller: On February 27, 2015, the market value of Apple Computer was approaching $750 billion. This is the equivalent of the combined values of 7,500 companies of $100 million in market value (the United States only has 5,000 listed companies). Clearly, the bigger systemic threat to the U.S. economy is not the churn in small companies, but in not providing a suitable "Venture Exchange" for them to list. Intel Corporation, which went public in 1971 in an $8 million IPO, was only three years old and unprofitable on an operating basis. It missed delivery of its first product and the stock price was cut more than fifty percent. Intel listed on the early Nasdaq – the original U.S. Venture

[11] The Guardian, *City hits out over US 'casino' jibe at Aim*, by Jill Treanor, March 10, 2007 See http://www.theguardian.com/business/2007/mar/10/1

Exchange – that inspired President Jiang Jemin in 1998 to call the NASDAQ Stock Market, "…the crown jewel of the U.S. economy."

One of the authors of this study conducted a series of meetings several years ago with the then-head of the AIM market in London, AIM market makers and institutional investors on AIM. Dealers and institutional investors both said that dealers were feeling pressure as the LSE, in pursuit of its own profits, moved the largest AIM stocks from the dealer trading platform to the electronic bulletin board or CLOB (central limit order book). These more liquid AIM stocks were said to be still "AIM Listed" but now trading on the same platform as stocks in the Major Market (the LSE version of the "Big Board" in the United States). The impact was said to be greater profits for the LSE and lower profits for the dealer (market maker) community.

TSX Venture Exchange (TMX Group's small cap exchange) – The TSX Venture Exchange traces its roots to the merger of the Vancouver Stock Exchange and the Alberta Stock Exchange in 1999 to form the Canadian Venture Exchange. In 2001, the TSX Group (Toronto Stock Exchange, now known as TMX Group) purchased the Canadian Venture Exchange, converting it at some point from a dealer market to an auction-style electronic stock market. We believe that, while this move was in the best economic interests of TMX Group, it likely siphoned off economics from the dealers (market makers) and put pressure on the Canadian small cap ecosystem. In a recent article[12] in the Financial Post, "Can the once mighty TSX Venture Exchange be saved?" it is clear that the cumulative market value of the exchange is less than in 2001 when it was acquired by TMX Group, and market participants are voicing concern that access to capital and liquidity are extremely poor. Despite this, the TSX Venture Exchange still has over 2,100 listed companies with an aggregate value of approximately CAD$33.1 billion (U.S.$26.5 billion). 2,100 listings is astonishing when one considers that the Canadian economy is one ninth the size of the U.S. economy, making it a 19,000 U.S.-listed-company weighted equivalent, and yet the entire U.S. listed stock market (NASDAQ plus NYSE) consists of only 5,000 listed operating companies.

We believe that the member-owned model was and would be superior to balancing interests and that stock exchanges with public shareholders will inevitably be tempted to siphon economics in ways that undermine the ecosystem required to support a vibrant small cap marketplace.

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[12] Financial Post, December 27, 2014, *Can the once mighty TSX Venture Exchange be saved?,* by Peter Koven, see http://business.financialpost.com/2014/12/27/can-the-once-mighty-tsx-venture-exchange-be-saved/

Recommendations for Venture Exchanges

RECOMMENDATIONS FOR PUBLIC MARKET VENTURE EXCHANGES – Our discussion of Small-Cap or "Venture Exchanges" generally presupposes public markets (e.g., the Nasdaq Stock Market of the '70s and '80s, the London AIM and the Toronto TSX Venture). Public Venture Exchanges are essential to restore higher economic growth rates. Moreover, Private Market Venture Exchanges may also fill another void in the U.S. arsenal of infrastructure required to support the entrepreneurial economy. As a result, we are also making recommendations for Private Market Venture Exchanges (see "Recommendation for Private Market Venture Exchanges" below).

Governance – "Venture Exchanges" should be chartered separately by the SEC. A distinct set of rules – apart from traditional stock exchanges and ATSs (Alternative Trading Systems) – For example, "Reg. Venture Exchange," would be enacted – either in Congress with the support of the White House, or through the SEC's broad exemptive authority (which they have historically been reticent to use without clear signals from Congress).[13] In order to sustain and nurture small-cap liquidity:

- **Venture-Exchanges Should be <u>Member-Owned Exchanges</u> –** As seen from our preceding discussion of early Nasdaq, the LSE AIM and the TSX Venture Exchange, the for-profit, stock-held ownership structure of the U.S. stock exchanges puts stock exchanges in competition with value providers[14] (broker/dealers that provide research, sales and capital to support liquidity). As a result, the for-profit shareholder model puts shareholders' needs for profits ahead of the health and well-being of the ecosystem and the well-being of small cap companies that generate very little trading profit. As a result, we believe that Venture-Exchanges should be Member-Owned and that members should be Broker-Dealers who can receive capital calls in line with their size – broken into three tiers – Large, Medium and Small – to provide balanced representation on the Board of Directors. There should also be an Investor Advisory Committee and a Corporate Issuer Advisory Committee, each with the right to review all material rule changes and make recommendations to the Board.
- **Creation of a Separate <u>Venture Exchange Division</u> at the SEC –** A separate Venture Exchange Division of the SEC should be established to put focus on the specialized and distinct needs of the small-cap marketplace. It should be staffed with financial professionals (and not simply lawyers) and should be tasked to nurture a revival in small IPOs. The division would ensure a balancing of interests among the Venture Exchanges themselves, corporate issuers, intermediaries (the broker-dealers who provide research, sales and marketing and liquidity) and investors. It would horizontally integrate disciplines in:
    - **Listings rules, disclosure, and use of shelf registrations to facilitate lower cost capital formation** (currently within the Division of Corporation Finance) – We need lower cost disclosure (possibly along the lines of Reg. A+) for the smallest companies and broad allowance of shelf registrations for any issuer that is current with disclosure.

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[13] Congress appropriates the SEC's budget. The SEC is naturally hesitant to take controversial positions where the SEC Chair is called to defend the SEC's actions and risk cuts to the SEC's budget.

[14] See "SIFMA Calls For Review of SRO Structure" at http://www.sifma.org/newsroom/2013/sifma-calls-for-review-of-sro-structure/ "**Exchanges Compete with the Broker-Dealers they Regulate.** Combined with the transformation of exchanges into for-profit enterprises in search of ways to expand their businesses, exchanges and broker-dealers have become direct competitors in many aspects of their businesses. Most prominent is the competition for order flow between exchanges and broker-dealers."

- SEC review of disclosure will support confidence.
- The disclosure regime should be scaled – Reg. A+ disclosure adopted at the low end. Something stronger for larger listed companies.
- State regulation should be pre-empted by an "Exchange Listing" exemption for all Venture Exchange listed securities.

- **Trading rules** (currently within the Division of Trading & Markets) - Trading in U.S. equities markets is "one-size-fits all" optimized for the trading of large-cap stocks - a description that was first coined[15] by us and has subsequently been repeated in Congress and at the SEC. Why is this important? Because small cap markets are "asymmetrical" order-book markets with no "network effect." They lack the natural visibility and liquidity of large cap stocks. By applying a highly price-competitive market structure to small cap trading, the U.S. has experienced a deterioration in large-buyer (and seller) liquidity and a contraction in the small-cap ecosystem (IPO on-ramps). In addition, because well more than 90% of stock trading occurs in stocks that are larger than $2 billion in market value, we find that many regulators bring large cap bias in their approach to small cap stocks. Venture Exchanges should be:
  - **Exempt from the Order Handing Rules (but not the Manning Rule).**
  - **Exempt from Reg. ATS and Reg. NMS.**
  - **Exempt from UTP (Unlisted Trading Privileges – Rule 12f-2).**
  - **Exempt from Decimalization.**

  Venture Exchange listed companies should be:
  - **Exempt from Sarbanes-Oxley.**
  - **Exempt from State Blue Sky.**
- **Enforcement** (currently within the Division of Enforcement) – Small cap markets need to prioritize enforcement over prevention. In our dealings with former SEC Commissioners, it became apparent that high cost regulation and low-cost trading may have been intended by some at the SEC and FINRA to prevent sales practice abuses. However, this cure was worse than the disease because it gutted the capital formation engine and source of economic renewal for the entire U.S. economy. When policymakers incentivize more research, sales and trading, there will undoubtedly be more sales abuses - including so-called "pump and dump" schemes. The SEC and FINRA must not be shy about putting flagrant offenders out of business and, for this reason, we think that a special Enforcement Group within a Venture Exchange Division and at FINRA, may be needed.
- **ETFs and Index Funds** (currently within the Division of Investment Management) – ETFs and Index Funds are harmful especially to progressively smaller capitalization stocks. By taking a supply of securities off the market, they undermine liquidity in already less liquid stocks. They also cause consumers to take short-cuts in investing by buying "themes" and "baskets" in lieu of understanding company fundamentals. This likely undermines the "entrepreneurial IQ" of the American populace, dulling the appetite for education about business and entrepreneurship. Worse, most ETFs and Index Funds are market cap weighted. While they purport to invest in indices,

[15] *A wake-up call for America*, by Weild & Kim, p. 20, November 2009, "In an epic case of unintended consequences, one-size-fits-all market structure added liquidity to large cap stocks, but…created a black hole for small cap listed companies. In addition, public companies find themselves in a market environment with a lack of research support, greater systemic risk and volatility, and structural impediments that block them from going private."

for a variety of liquidity and cost issues, most intentionally avoid investment in the smallest stocks, thus further siphoning capital away from this market segment. Finally, ETFs and Index Funds don't buy new issue stock offerings. The more ETFs and Index Funds grow, the more capital is taken away from capital formation and job growth. Policymakers, at a minimum, should require that all ETFs and Index Funds place standing orders on all offerings.

- **Creation of Separate Venture Exchange Groups within FINRA and DTCC –** Again, we need to keep the focus on the needs of this ecosystem. Smaller FINRA member firms complain that FINRA and DTCC are creating unnecessary cost and friction in the small cap ecosystem. Broker-Dealers complain, for example, that they are searching for compliance vendors to improve compliance, but FINRA, as a matter of policy, refuses to share its knowledge of outside compliance service providers. As a consequence, well-intended broker-dealers make completely avoidable mistakes in compliance. This is not in the best interests of anyone. Most in the industry understand that FINRA and DTCC's revenues are largely derived from the big Wall Street firms and that the big Wall Street firms' business is disproportionately large-cap. Most in the industry also understand that SIFMA (the major industry trade association) is dominated by the big Wall Street firms. Clearly, Congress and the SEC must come up with a construct that institutionalizes and perpetuates a discipline in small-capitalization stocks and the care and feeding of the small-capitalization ecosystem. It should be mandated that:
    - **DTCC is required to provide electronic settlement to Venture Exchange listed stocks.**
    - **Broker-dealers with equity powers are required to allow stock brokers to solicit all Venture-Exchange listed stocks.**
    - **Broker-dealers are required to allow customers to buy Venture-Exchange listed stocks on margin.**
    - **Broker-dealers and investors are required to "Hard locate" shares to borrow before shorting any common stock.**
    - **Market Makers are given an exemption whereby any investor that fails-to-deliver securities must be issued a "buy-in" 24 hours after the failure-to-deliver and cut off from further activity with the broker-dealer until such time as the failure is rectified.**
- **Adequate Ecosystem Economics –** Intermediaries and service providers are essential to providing support for small cap companies. That support comes in three forms – sales and marketing support, equity research coverage and market making that employs capital to shoulder risk (drive large buyer liquidity – more liquidity drives more institutional investment in these stocks). Unlike large-cap markets where liquidity is naturally occuring due to the so-called "network effect," small-, micro- and nano-cap liquidity has always needed to be supported. That support must be paid for through some combination of higher commissions, higher tick sizes and trading spreads, or direct subsidies (the old specialist system on the NYSE required specialists to subsidize liquidity in small cap stocks in exchange for making excess profits in large cap, naturally liquid stocks) and affirmative obligations on market makers. As a result: Venture Exchanges must be:
    - **Allowed to list stocks up to $2 billion in market value – $2 billion is still considered small-cap by most institutional investors. A population of larger than $250 million market value stocks (the ceiling for the SEC Advisory Committee on Small and Emerging Companies) will be essential to generate enough economics to grow**

the ecosystem and create sufficient on-ramps to drive IPO production and support.
- **Allowed to compete for listings up to $2 billion in market value (with a CPI escalator) and larger (higher profits in larger stocks creates higher economics to build bigger IPO on-ramps) – Venture Exchanges must be allowed to recruit listings from other stock exchanges and vice versa. This will enable the Venture Exchange ecoystem to obtain critical mass much sooner than if it was dependent on the IPO market.**
- **Given the authority to set minimum commissions charged by participating brokers.**
- **Given the authority to set minimum tick sizes and trading spreads by market makers.**
- **Given the authority to set affirmative requirements of market makers.**

Ultimately, the success of Venture Exchanges hinges more on the profitability of the Ecosystem (Intermediaries and value providers) than it does on the profitability of the Venture Exchange itself. This is why public-shareholder based stock exchanges are poor custodians of venture-exchanges because they are naturally more interested in shareholder profitability than in ecosystem profitability. ***As a practical matter, this will require an absolute exemption from such pro-price competition rules as OHR and Regulations ATS, NMS, Decimalization and Unlisted Trading Privileges (UTP).***

- **Extension of Title 1 JOBS Act Research Rules to All Venture Exchange Listed Companies –** The JOBS Act improved the ability and lowered the cost, of sell-side equity research analysts, to work with investment bankers. These liberalizations should be extended to all Venture Exchange listed companies – not just on the IPO. Specifically,
  - **Investment bankers should be able to arrange analyst communications with investors.**
  - **Analysts should be able to join investment bankers in meetings with company management.**
  - **Analysts should be able to participate in road shows (this would go beyond the JOBS Act)**
  - **Research on Venture Exchange listed companies should be permissible before and after any IPO or follow-on offering.**
  - **Congress should limit liability for research published before an IPO - We understand that the reason why EGC (Emerging Growth Company) IPO research has not been published before the IPO, as is the case in Europe, is because of concerns over liability.**
- **Clarity On What Constitutes Equity Research –** Congress or the SEC should specifically exempt published materials that do not include securities price targets or recommendations (e.g., Buy, Sell, Hold) from the definition of "Research." FINRA rule 2711 is ambiguous as to what constitutes equity research, thereby restricting the flow of information in support of smaller market capitalization stocks.
- **Disclosure of Investor Long Positions –** SEC Form 13F ownership information and transparency breaks down in small-cap stocks because quarterly reporting is limited to investors with more than $100 million in qualifying assets. Most micro- and nano-cap investors manage less than $100 million in assets because of liquidity constraints. We believe that managed portfolios all the way down to $10 million in size, including family offices, should disclose all long (and short) positions on a quarterly basis.

- **Disclosure of Investor Short Positions –** We continue to be disturbed that the SEC does not require the disclosure of short positions on the same basis as long positions. Corporate issuers have the right to decline a meeting with an investor who has established a short position in the stock. Corporate issuers have the right to spend their time in ways that are not contrary to the interests of the Company's owners (investors). However, without the disclosure of which investors short stock and the types of stock that they short, management's limited and valuable time – time that would be better put to use managing the Company and creating jobs – is squandered. Worse, some short sellers spread rumors, knowing that it is virtually impossible for the public to attribute the source. Just as there is information value to the rest of the market in who is long a stock (high quality investors attract other long investors), there would also be information value to the rest of the market in who is short a stock. We believe that the lack of disclosure around short-selling undermines investor confidence and the rights of corporate issuers.

RECOMMENDATIONS FOR PRIVATE MARKET VENTURE EXCHANGES - While most students of stock market structure will view "Venture Exchanges" as a public market construct, enhancements to the regulatory framework for private markets are also needed. However, we view Private Market Venture Exchanges, open to only accredited investors and institutional buyers, to represent a partial remedy to the collapse in the small IPO market. "Private Market" Venture Exchanges should not be seen as a substitute for a well-thought out "Public Market" Venture Exchange construct. Private markets would benefit from the inclusion of:

- **Basic disclosure** – The requirement of annual financial statements (not audited) for any company that has raised over $1 million from outside investors.
- **A consolidated tape** – Activity in all secondary markets should be reported centrally by all market participants, and this information feed should be broadly distributed. The simple distribution of pricing information broadly should not be deemed a "solicitation."
- **Freedom to solicit accredited investors** – States' regulations should be pre-empted and brokers should be free to solicit in the private aftermarket any accredited or institutional investor. Non-accredited investors should be off limits.

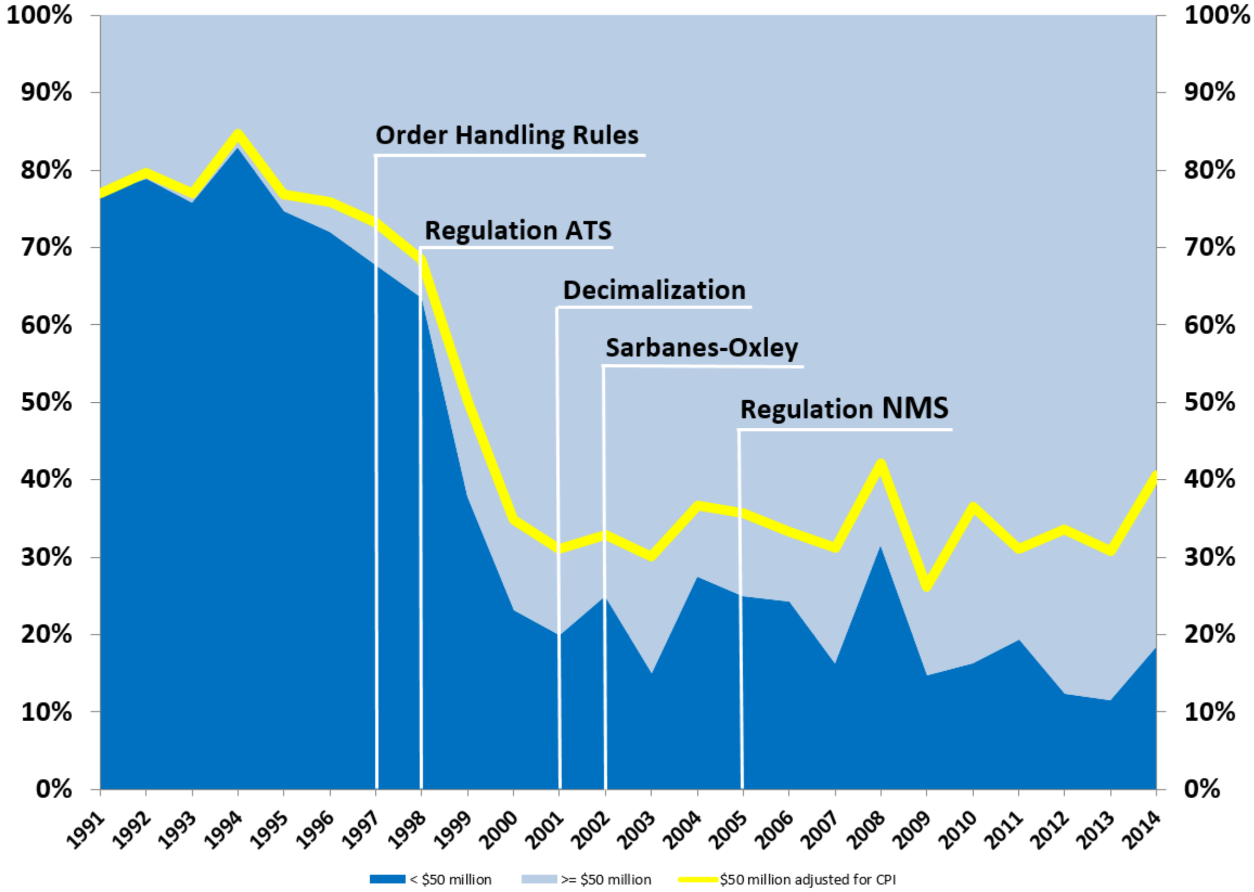
Conclusion

In our work for the Organization of Economic Cooperation and Development (OECD), we examined IPO markets throughout the world. It became obvious to us that the incentives and disincentives created by governments and regulators are the major determinant of the success (or lack thereof) of small IPO markets (and the aftermarket). The inescapable conclusion is that the collapse of the small IPO market in the United States was caused by ill-conceived and nearsighted public policy and that it can be rectified by improved and farsighted public policy that includes the creation of a regime designed to meet the very different needs of small-cap public companies. Intelligently designed “Venture Exchanges” would create a foundation for a resurgence in entrepreneurship, innovation and job creation. We believe that, once established and after perhaps a decade of operation, Venture Exchanges would lead to the creation directly (by companies accessing and investing capital) and indirectly (“muliplier effect” of jobs being created in the service sector of the economy because of the money spent by these companies and their employees) of 10 million jobs for the U.S. economy.

The ability of the United States to sustain itself as a world leader may rest on our ability to reverse the decades long trend of lower company start-up rates and lower IPO rates. Higher levels of entrepreneurship are the bedrock of a vibrant economy. The creation of Venture Exchanges, and the natural advocacy for entrepreneurship that would emerge from these exchanges, is one of the single most important actions that policy leaders can take to reignite the American Dream and restore America’s position as the “Capital market envied by capital markets throughout the world.”

Appendix

The Small IPO Collapse Coincided With The Policy-Driven Shift To Low-Cost Electronic Trading. Venture Exchanges, Properly Structured, Could Lead A Recovery.



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About Weild & Co.

Weild & Co. is the brainchild of noted Wall Street executives, including David Weild and Ed Kim, whose work is credited with having led to The JOBS Act. Weild & Co. uses technology, data and people to improve the marketing and distribution of new issues for corporate issuers and investment banks. This leads to a better aftermarket and performance for public companies and their investors. The mission of Weild & Co. is improve capital formation. We are pioneering equity distribution and marketing platforms to complement traditional investment banks. Our clients include both corporate issuers and investment banks.

About Weild Capital

Weild Capital is the investment banking arm of Weild & Co. Weild Capital represents companies and investment banks with a securities distribution approach that allows managements and investment banks to reach longer-term and smaller institutional investors. Weild Capital also provides advisory and placement services but does not accept commissions from investors.

About the Authors

David Weild is Chairman and CEO of Weild & Co. He is a Former Vice Chairman of The NASDAQ Stock Market who ran its listings businesses in the U.S., Europe, Asia and Latin America. The studies that David co-authored with Ed Kim documented the long-term decline in equity capital formation in the United States and provided the core arguments that gave rise to the JOBS Act and many of the specific provisions contained in the JOBS Act. For these reasons, he has been called "The father of the JOBS Act" (Forbes). David has worked on over 1,000 public equity offerings during the course of his career in senior management at a major Wall Street firm where he oversaw equity capital markets, corporate finance, online brokerage and technology investment banking. He has a BA in Biology from Wesleyan University and an MBA from the Stern School of Business.

Edward Kim is COO of Weild & Co. Ed has over 25 years of capital markets, finance, product development, and operations experience. Prior to helping form Weild & Co., he ran financial communications at Stern And Company, a strategic communications and public relations firm. Ed was formerly head of new products for the corporate client group at The NASDAQ Stock Market. Ed has worked in investment banking, trading, research and equity capital markets at firms including Lehman Brothers, Prudential Securities, and Robertson Stephens. He has a BS in Materials Science and Engineering from the Massachusetts Institute of Technology.