Transcript

The Future of Startup Finance: A Symposium on *Investment Crowdfunding*

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Opening Remarks

https://youtu.be/JtWJevlj0dY

[00:00:00.89] So it's my pleasure today to introduce Professor Andrew Schwartz by way of background. He is the proud of Brown University where I didn't know that you studied civil engineering as an undergrad. He did his JD at Columbia University where, among other things, he served on the Columbia Law Review.

[00:00:21.08] After Columbia Law, he clerked for Judge William Fletcher of the US Court of Appeals for the Ninth Circuit, and judge Naomi Reice Buchwald of the US District Court for the Southern District of New York. Following his clerkships, Professor Schwartz practiced corporate law in New York at Wachtell where a sometime co-professor of mine, Jason Lynch, who's a general counsel at Foundry group, was a colleague alongside Professor Schwartz.

[00:00:51.77] And since 2008, he's been teaching at Colorado Law School. He teaches and publishes in the areas of corporate securities and contract law. Among other duties, he has been a visiting professor for seven years at the University of Auckland, which sounds more like a privilege than a duty, doesn't it?

[00:01:09.69] He's a Fulbright research scholar, and his scholarship has been published in a number of leading law reviews, including UCLA, Minnesota, Notre Dame, as well as the top specialty journals including the Yale Journal of Regulation and the Harvard Business Law Review. That scholarship has been not surprisingly recognized through several awards, including the WOAS Scholarly Paper Competition, and the Federalist Society Young Legal Scholar Paper Competition.

[00:01:39.54] At Colorado Law, he's also garnered several awards, including the provost's award for Faculty Achievement, and the Gilbert Goldstein Faculty Fellowship, which goes to a professor who's doing really interesting work and gives some research-- teaching relief for research.

[00:01:56.65] Additionally, more personal to me on top of all these things, he's really a leader in the field not just in terms of the scholarship that Andrew has produced, but in terms of supporting really generations of legal scholars who have come alongside him as well as those who have come after him. He launched the Junior Business-- Junior Scholar-- I've been screwing this thing up for 10 years.

[00:02:24.48] I ran the thing for a few years. The Junior Business Law Scholars Conference, which was just a genius format. Andrew early on thought, wouldn't it be cool if we'd bring 12 or so junior scholars, pre-tenure scholars out to boulder during the summer, workshop papers together in a really nonthreatening, nurturing environment, which became a great way to build a network.

[00:02:47.91] And then as other scholars came along, including me, those scholars who are just the right amount of more senior than us brought us along. You handed that baton off to me. It was such a great event, and I'm very grateful for that. He is the author of a book, Investment Crowdfunding, which is the anchor of today's discussion, published by Oxford University press.

[00:03:14.94] This is a topic that hits near and dear to my heart. I teach and write in the areas of venture capital and start up activity. And obviously, this is right on point. By way of framing comments, entrepreneurship, including investment into startup and emerging companies, has traditionally been very tied to location.

[00:03:37.74] And as between a view that the world is flat, that is, it doesn't matter where you start a company or it doesn't matter where you invest in a company from, or alternatively, a view of the world that the world is spiky, that location is of outsized importance in terms of where you start a company, location and geography are of outsized importance in terms of where you invest from, crowdfunding is a really interesting case study insofar as it presents the tantalizing promise to help democratize the world of entrepreneurship and make it less spiky and ideally more flat.

[00:04:20.58] Thereby empowering a generation of entrepreneurs and investors to participate in entrepreneurship in a way that was very limited and marginalized before. But, there are some real challenges to this as well, including the traditional way that investors and entrepreneurs interact is a function of living in the same proximity to one another.

[00:04:48.10] And as we separate out that relationship, there's a series of challenges around that. That as well as other issues are going to be very interested to hear in today's discussions. A heads up, after of the event, there's going to be a book signing outside the courtroom at the panel tables. And with that, please help me give a warm welcome to Professor Andrew Schwartz. Andrew.

[00:05:10.11] [APPLAUSE]

[00:05:21.52] Thank you so much, Brad, and thank you everyone for being here. He's already mentioned, but let me reiterate a tremendous thanks to the whole Silicon Flatirons team-- Nate, and Shannon, and Sarah, and Christine, and Brad, of course. And the Tech Law Journal, especially Sydney and Nick and Marlena.

[00:05:43.21] Thanks to all of our visiting scholars who are here today and our panelists who have come from all across the country. I really appreciate you taking the time to discuss this subject that's near and dear to my heart. You heard there were a couple of New Yorkers in the house. And one of them I just met, but the others are my parents, Lesley and Ken, who are visiting from New York. So thank you.

[00:06:07.42] [APPLAUSE]

[00:06:15.13] Let me begin what I want to say today with an orientation into our subject. What is investment crowdfunding, and then I'll move on to explaining why are we doing this? What's the purpose? What are we trying to achieve. I'll talk some about international comparisons, looking at other countries where I've where I've studied this subject as well, and then I'll spend the last part giving essentially what is the thesis of the book and discussing some of the specific applications of that idea.

[00:06:49.78] So just let me begin at the beginning, what is investment crowdfunding? Well, it's like Kickstarter, except you get a share of stock instead of a product or a tangible reward. Entrepreneurs post their business models and their ideas or information about their companies on a specialized website like Kickstarter-- these are called platforms, and anyone across the country is invited to participate, to peruse the various offerings, and to invest in ones that seem interesting to them.

[00:07:28.40] Now, this would be totally illegal about 10 years ago because the securities laws say, it's one thing to offer t-shirts, and apps, and your name in the credits as Kickstarter does. You can do that to the public, and that's fine. But if you want to offer investment opportunities, you come within the federal securities laws that are almost 100 years old, most importantly, the Securities Act of 1933.

[00:08:00.14] And the basic rule of the Securities Act of 1933 is, before you sell securities, you must register them with the SEC, the Securities and Exchange Commission. To register securities means to provide a thick amount of disclosure about the company and what investors might want to know when they're getting into it. If you don't register the Securities and offer them to the public, that's against the law and the SEC will bring a lawsuit against you.

[00:08:35.75] But the law can be changed at any time, and so it was. In 2012, a huge bipartisan Congress passed a law called the JOBS Act-- J-O-B-S, standing for Jumpstart Our Business Startups Act. And in the JOBS Act, which was signed by President Obama in April of 2012, it created a new exception called formerly an exemption.

[00:09:06.08] A new exemption to this rule that you must register securities before offering them, and this new exempt option is-- I call it investment crowdfunding. And this new exemption has a whole set of rules of its own. If you want to raise money in this way for your company, you must go through an independent third party platform. You can't just sell securities straight to the people, which makes it by the way very different than initial coin offerings, NFTs, all sorts of other things that are sold directly.

[00:09:45.89] These platforms are themselves licensed by the SEC or analogous foreign regulators like the FMA in the UK. There is a limit called an issuer limit. You may only raise a company-- an issuer of the securities may only raise $5 million annually in this fashion. If you want to do more, you can go do a traditional IPO like we see on Wall Street all the time.

[00:10:23.51] As for disclosure, you don't need to register the Securities and file the normal S-1 full IPO disclosures. But under the US-- under the JOBS Act, there is a set of mandatory disclosures that must be provided. Much simpler than a traditional IPO, but there are certain items that must be included like financial statements and other things.

[00:10:55.99] I'm going to talk later on about international comparisons, and several other countries like the UK and New Zealand do not require any mandatory disclosure in this way. They just let companies decide what to disclose. But coming back to the US and elsewhere, one of the other rules of investment crowdfunding is that not only are the issuers limited in how much they can sell, but the investors are also capped in how much each investor may invest.

[00:11:30.41] And in the US law and the JOBS Act, it's a complicated formula, based on a percentage of your net worth. In other countries, it's something simpler. Like in Australia, $10,000 per company. You're not allowed to invest more than that. That's a rule. And the idea is that these are unregistered securities of startups, and they're speculative, and it's OK to invest in them, but we don't want anybody to put their life savings into one of these sorts of things.

[00:12:01.80] And then the final basic rule of investment crowdfunding is-- I call it-- it's not just me, I call it all or nothing. And this comes from Kickstarter. This comes from the-- as crowdfunding has been practiced for a long time, the entrepreneur, the startup company has to announce at the outset a certain minimum funding target. We need to raise $200,000. And a time frame to do it, over the next three months.

[00:12:30.32] If investors don't pledge up to the target amount, it's not popular. If the time comes and goes, the whole thing is called off, nobody hands over their money, no securities are issued. But if the crowd likes the plan and invests up to or over the minimum, then the deal goes through. And this is trying to harness the wisdom of the crowd to figure out which companies should be funded and which should not.

[00:13:01.23] So those are the basic rules, and let's take a look, if we can, at what is the state of the market? I have a couple of slides that are mostly graphs-- one chart, I'll confess. So what I've got here is, the JOBS Act passed in 2012. But in the statute, a variety of items were assigned to the SEC to determine by regulation.

[00:13:29.87] And it took the SEC several years. They had other things to do at the time like Dodd-Frank, but the SEC only finally put out the regulations I think in maybe the late 2015 or 2016. So the first year of investment crowdfunding in the US was 2016. And so in that first year, there weren't even 200 offerings. But as you can see, it's grown very rapidly. By 2019, there were about 700.

[00:14:01.04] And in the most recent year that I have data for in the book, 2021, about 1,500 companies tried to raise money in this way. And as an aside, overwhelmingly probably 70% or 80% hit their funding target and were funded. So almost all of them succeed. Here's just another chart showing similarly the growth over the last few years. This is, how much money was raised each year by crowdfunding companies all across the country.

[00:14:38.26] And as you can see, in millions of dollars. In the first year or two or three, it wasn't even $100 million in the whole country for all companies and all investments. But more recently, it really jumped up to in the 400s-- $400 million a year, and this has-- I feel that as a matter of fair disclosure, I should tell you, this chart looks like it's zooming to the moon.

[00:15:05.68] In fact, what's happened over '22 and '23 is that it stayed pretty high I think at about this level, roughly 500 a year. Which, given that venture capital and other sources of funding dropped tremendously is a very nice showing, but I don't want to give you the wrong idea here.

[00:15:27.49] And just of the 1,000 or 1,500 companies that sought to raise money, more than 100-- each year, more than 100 companies raised more than $1 million each year. So there's a good bunch of larger raises here. And so that's the state of the market and the basics of how it all works. What's the point? Why did the US Congress pass the JOBS Act to amend the Securities Act and allow this sort of market.

[00:16:06.22] And there's, in my view-- and I talk about this in the book, there's really three primary goals that Congress was seeking. And goal number one was simply to provide a new source of capital for startup companies. Startup companies are really valuable to the economy. They create new jobs, they develop new products. Plenty of them don't make it, but those that do really have an outsized impact on our economy.

[00:16:38.90] And so the first goal is just, let's just get some more money to startups. And as you can see, it really grew very quickly, and we're at $500 million a year. To give another a bit of perspective, that is less than 1% of VC funding in the US per year. So it's growing very fast and we'll see what happens. But it still is quite small.

[00:17:06.47] I keep talking and mentioning other countries because I've spent the last 10 years traveling around the world and talking to people in the industry, talking to lawyers, talking to professors. And in other countries with a little bit more experience like the UK where crowdfunding started earlier, it's actually grown to be larger than angel investing in the UK and is hot on the heels of VC.

[00:17:36.73] So we'll see what happens. The UK started their market in 2010, so have at least a five year head start on us. So let's see what happens in the future. So the first goal is to provide funding for startups, but the second is-- excuse me, and let me move to my next slide. This is similar chart showing the number of investors. How many people are participating in this?

[00:18:05.78] And in the early years, not even 100,000 people in the whole country were. These days, it's more like a half a million and growing. But the idea here really was, the policy goal is-- and we talked about venture capitalists. We talk about angel investors. Why do startup companies sell stock to venture capitalists, angel investors, friends and family? It really goes back to the law.

[00:18:31.43] Remember, if you want to sell securities, you must first register those securities with the SEC, unless there's an exception, an exemption. And there's two very important exemptions that have been used for a long time. One of them is for so-called private placements. If you only sell securities to the entrepreneur's friends and family, you don't have to register them. Another one, another key exemption is for accredited investors.

[00:18:58.44] Accredited means either a professional investor like a college endowment or something, or a wealthy individual who has more than $1 million to spend. But if you sell-- if a startup were to offer securities to people of modest means or who aren't connected with the company, they would have to register the securities, don't want to do that. The effect is that for several decades, startup companies have studiously excluded the broad public from investing.

[00:19:28.86] And maybe there's some wisdom to that, but as President Obama thought and I agree, the American people should be given at least some chance to invest in this asset class. And so investment crowdfunding, one of the key, in fact, defining features of the form is that it's open to all investors, not only accredited investors. So it's designed to be a more inclusive market on that side. The third policy goal of investment crowdfunding is also about inclusivity, but it's from the other side, the entrepreneurs.

[00:20:06.66] The statistics and anecdotes of women and minorities and rural entrepreneurs trying to get funded by venture capitalists is not very good. People that are out of the loop, if you don't have a rich uncle and you live far from Silicon Valley, it's going to be hard to get your company funded. And so the third goal of investment crowdfunding is to create a more inclusive and equal opportunity market for entrepreneurs who might have a good idea but need funding. And so this gives them a chance to pitch to the whole country.

[00:20:49.42] And so what we've seen in this area-- at least just taking statistics here. And again, to be fair, these statistics are maybe a little bit making the venture capital numbers look a little bit worse than they might be. But in broad strokes, this is roughly right. We've gotten the blue side is the percent of on one side female founders who were funded by or the percentage of venture capital companies with a female founder, and it's not even 10%.

[00:21:24.15] In investment crowdfunding, we've seen at least of the larger-- what I've charted here is the million dollar plus the largest-- because I think they're more comparable, the largest raises on investment crowdfunding in a given year to 2021, nearly half of the founders of the companies that raised money were women. And if you move over to minorities, in the VC world, it's maybe 20 something percent, and maybe it's 40 something percent in investment crowdfunding.

[00:21:53.73] If we were to look specifically at African-American founders, the numbers that I've seen-- and it's a little bit anecdotal, are somewhere in the range of maybe 1% of the funding of VCs goes to African-American founders, and maybe it's 4% for investment crowdfunding, which is a huge rise. And beyond just isn't it the right thing to do that everyone should have a chance to get their company funded, it's really, there's huge social benefits from this.

[00:22:25.78] Because think about it. On the up side, these 1,500 companies a year that get funded, some of them are really going to do great things. Hire people and develop new products, and improve our standard of living. On the downside, worst case scenario is that some company goes out of business and $5 million is lost. And the individuals who invested, the most-- they were capped on how much they could lose by, let's say, $10,000 in that investment.

[00:22:58.13] So what we're dealing with is basically, unlimited upside, capt downside, and there's really a great opportunity, I think, for pro-social benefits here. Let me move on. So I've defined for you what is the topic and what is the policy goals-- raise more money for startups, inclusivity for investors and entrepreneurs, and let me move on to an international report.

[00:23:27.72] What I have here on the chart here is for each year, various countries-- the US, the UK, New Zealand, and Australia-- I guess, I should have given Australia green. I'm sorry. But what I'm charting here is on a per capita basis-- it's not fair to compare New Zealand with a population of 5 million to the US with our 330 million. But on a per capita basis, how much money is being raised?

[00:23:58.34] As you can see from-- just maybe take a look at the Green for a second. New Zealand started out five and six years ago really strong and has stayed quite high. The US in blue on the left is just almost catching up. Australia on the far right, I guess in purple, has really done nicely.

[00:24:21.14] Australia started really late, in maybe 2018 2019. Which was a little bit embarrassing when they were talking to the New Zealanders, but it turned out to be really useful because Australia had the benefit of looking around the world, which is what I do in the book and see what's worked, what hasn't. And Australia put together really a quite good set of regulations, and they've immediately almost jumped out. But then as you can see, big red here.

[00:24:48.75] The lobster backs of the UK are on a different playing field than everybody else. And what is going on in the UK and in New Zealand, these two leaders, this is something that I really wanted to find out. And so among other things, I went to New Zealand on a Fulbright, and I've talked to various people around the world.

[00:25:10.81] And what I've come up with is-- this is going to be a little bit hard to see, and I apologize. But I've analyzed the different legal regimes around the world, and what I've got here is a chart of some of the key regulations in place. So as you can see, licensed platforms. Every country requires licensed platforms.

[00:25:32.37] There's an issuer limit, roughly about the same across the world, but there are a couple of differences here. And the biggest difference is, mandatory disclosure. New Zealand and the UK, I call them the liberal jurisdictions. They really rely on what I'm going to call private ordering, and that's going to be the focus of the last part of my talk.

[00:25:58.30] The New Zealand and the UK really rely-- instead of relying on a whole lot of regulations and laws as we traditionally have in securities, the New Zealand and the UK really leaves it very much to the market and market forces to govern and police the market to make sure there's no fraud, to make sure that when a company raises the money, they don't just go fritter it all away on company jet or something.

[00:26:28.98] Most jurisdictions, the US, led by the US, follow what I call the standard model of investment crowdfunding regulation. And I call it standard first because the US was the first one to have crowdfunding regulation, and so set the standard, but it also uses the standard tools of securities regulation, which is mandatory disclosure. File that form with the SEC.

[00:26:58.43] And what I've seen is that these other markets that have really moved away from that, the more liberal jurisdictions, have really much significantly larger markets than the standard jurisdictions, and with no greater levels of fraud or problems or anything like that. Basically, in each jurisdiction, whether it's the US, or the UK, or New Zealand, over the last five or eight years, in each jurisdiction, there's been one case of fraud.

[00:27:34.79] After thousands, at least, in our case, thousands of companies have raised money, there's bad apples in every field. But what we've seen is that even in the liberal jurisdictions, without all of these additional regulations, similarly very low levels of fraud. So this brings me really to my thesis of the book, and I'll expand on it with the time that I have remaining. So my thesis is basically this. Dramatic.

[00:28:12.72] [LAUGHTER]

[00:28:16.32] Because investment crowdfunding by the law and its nature in every jurisdiction is capped for the issuers-- it can only raise $5 million, or in New Zealand, 2 million New Zealand dollars, whatever it is, the only workable legal regime is one that keeps the regulatory compliance costs to an absolute minimum.

[00:28:44.64] If you can raise an unlimited amount of funds as you can on a traditional IPO on the New York Stock Exchange and you're seeking to raise $800 million, your A&D, it's a reasonable thing to have extensive regulations that end up costing several million dollars to comply with. OK. You got to raise $800 million. It's going to cost you $3 million to do it. OK.

[00:29:08.97] But you can't spend $3 million in compliance costs to raise $4 million. So just as a matter of math, the regulations and the legal structure has to or people just won't use it. And there have been instances of this. Ontario put out a-- maybe in 2016, an investment crowdfunding regulation that was onerous in its regulations, and had a very low amount that you can raise. 0.0 companies ever tried.

[00:29:41.32] The only way that you can have this regime-- we already have the highly regulated public offering that exists. This is for a different purpose. And so because it's only $5 million-- it used to be, by the way, $1 million. SEC raised it in 2020 when it made a few other moves in the liberalizing direction. Because the limit is only $5 million, compliance costs just need to be kept to a minimum, or it just won't really work.

[00:30:15.34] So that means-- and this is what I'm going to talk about just in my last few minutes. What that means is that-- and this is what I spend the bulk of the book on, is that policymakers and regulators need to think carefully and put in as spare and light a regime as possible. They need to think carefully about which aspects will be addressed through private ordering market forces, and--

[00:30:43.18] But there are some places where we do need law and regulation, but we just need to really be very efficient and only use it in a very targeted way to facilitate and assist the private ordering method. Now, I've used this term private ordering a whole bunch of times. What do I mean by it? What I mean is market forces, economic incentives, everything but the law. Everything but the law.

[00:31:11.82] And in the book, I talk about a whole variety of powerful private ordering methods in investment crowdfunding. I only have a few minutes left here, so let me just give you a flavor with a few of the highlights of some of the nonlegal private ordering methods that the law can look to bolster and rely on as opposed to replace. So number one, I call it gatekeeping. Gatekeeping.

[00:31:40.29] Remember, to sell securities in investment crowdfunding, the entrepreneur must get listed on one platform or another. These platforms are themselves private companies that are trying to make money. They make money when people come and buy stock. They get a little bit of a transaction fee. These platforms, if they were to allow a fraudulent company onto their platform and investors buy in and then lose their money, those investors are not coming back, and those investors will go to some other platform.

[00:32:21.04] So the platforms have a very powerful economic incentive to be pretty strict with which companies they let list. And in fact, talking to platforms across the world, the leading platforms in various countries reject 90% and 95% of the companies that request to participate and only present this slice. And this really acts to protect the investors by giving them a curated set of investments.

[00:32:55.50] Just one or two other examples of the private ordering that I'm talking about. One other one that I would say is syndication-- I call it syndication, and the idea is this. Crowdfunding companies under the law may simultaneously or one after the other, but simultaneously has become the norm in the more mature economies in the UK and New Zealand, can simultaneously raise money from a venture capital fund, for example, and run an investment crowdfunding offering.

[00:33:34.94] So this works really well for all concerned because a venture capital company-- a venture capital fund that has done careful research and is putting hundreds of thousands or millions of dollars into the company, they act as a lead investor, and the whole crowd can say, well, if this investment-- excuse me, if this VC fund has done so much work and knows this company so well and is willing to invest that much and I'm being invited to invest on the same exact terms, I'd join that syndicate. Let me do it.

[00:34:08.60] So this way, it allows investors to invest $250, $500 in a company that has been vetted and reviewed by some experts out there and can come along. So that's another private non-- it's not ordered by the law, but that's another way that investors are protected and the market works without legal compulsion.

[00:34:33.58] So in the book, I discuss a number of other private ordering methods, but my basic conclusion is that investment crowdfunding has huge potential for upside, totally unlimited, and very modest and cabined downside. To make the system work, the legal framework needs to be what I call liberal, very spare, and low cost.

[00:35:01.00] And the US is moving in that direction. As more and more countries get this message and reform their laws to be more liberal like the UK and New Zealand, I think that investment crowdfunding is really going to be a significant force across the world. So thank you very much for your time, and I look forward to the rest of the day. Thank you.

[00:35:22.82] [APPLAUSE]

Law Panel

https://youtu.be/CXuRfiE1XMg

[00:00:00.29] So we have three panelists as your program indicates, and I won't read or give you much on their biography since it's all set forth in your program and beautifully said, too. Abe Cable, Doug Cumming, and Mirit Eyal-Cohen. And they will speak in that order for about 15 minutes, and then we'll have a period of comments and then questions. And with that, I call on the first person alphabetically, Abe.

[00:00:35.85] [INTERPOSING VOICES]

[00:00:40.89] OK. Well, it's wonderful to be here, and I really couldn't think more of Andrew's book in terms of it being a comprehensive, evenhanded account of crowdfunding, full of sensible proposals. So I was a little stumped on what I was supposed to say about it given all that. So what I'm going to do is I'm going to try to get at the topic from a slightly different angle, which is I'm going to compare this phenomenon of crowdfunding to Robinhood, online trading app, which is another area where we've heard a lot about democratized stock markets. And I think through the comparing and contrasting, we can end up with some interesting insights.

[00:01:33.58] So to me, when you think about Robinhood, it is somewhat useful to, for a moment, put aside some of the controversy of herding episodes with GameStop or payment for order flow, or a lot of the things that you may read about, and to just think about it first as a triumph in product design, marketing, and branding. And the reason I say that is that it is not a new idea to decide that everyone should be able to own stock. And I would say that whole areas of securities law could be explained by trying to make securities markets hospitable to everyday retail investors.

[00:02:25.53] And the industry itself has tried throughout time to try to make owning stock more accessible. So what's up on the screen right now is a story about a New York Stock Exchange campaign in the early

20th century called the Own Your Share campaign, whose goal was mass stock ownership. And the idea was that everybody ought to own a little bit of corporate America. And the fact of the matter is it's slow going.

[00:02:57.52] I would say there was something of a modest start to it with the pioneering discount brokers like Charles Schwab that arose, in part, from probably easing some anticompetitive pricing by the Wall Street firms. So there was something of a regulatory impetus to being able to trade for $5 instead of $60. And there were, of course, online portals for Charles Schwab, and E-Trade, and Ameritrade, and all those for a while. But they were really different, I think, in scope and character from what we saw with Robinhood.

[00:03:36.97] And to put a fine point on it, this is just a snapshot from Robinhood's IPO prospectus. And by the time of their IPO, they had almost 18 million active users, and they claimed that over half of them were owning stock for the first time in their lives, right? So this one product brought 8, 9 million people into the stock market, and it wasn't a result of some sort of regulatory easing or change or anything like that. What I would say it was was, at least in part, just a really snappy app. And it's easy to downplay that aspect of it, but the Robinhood mobile app, really, is different from what was available even at discount brokerages at the time and now.

[00:04:36.53] The app came about in an age when the field of user design or UX design had really come of age. And there are noticeable principles of design at work in the app like reducing the amount of information, information minimalism. So you could get 150 different charts and graphs on your Charles Schwab account, you can get like five on Robinhood. And that doesn't sound good, but the fact of the matter is it makes it viable to use on an app, which is helpful for people using it more, and it also just avoids various types of information overload.

[00:05:15.67] Famously, the app incorporated all sorts of different gamification techniques. So you got the very controversial burst of confetti when you traded your first stock that induced people to want to use the app more and more and more. It's populated with all sorts of lists of our top movers for the day that people seem to have a real interest in following.

[00:05:38.96] And so all of these things just made it, in the words of UX design, delightful to use. And that word is UX design jargon, and it shows up a million times in the IPO prospectus for Robinhood. So in part, I think what we have is a technological breakthrough, not in a high-tech way, but in a application of state of the art design principles to an old application. And people loved it.

[00:06:07.40] I also think it is worth taking seriously that there is a kind of ideology behind Robinhood, right? That name is not a thoughtless moniker. The idea is that there was something that was supposed to fix capitalism and take from the rich and empower everyday people. And this comes through in the origin story of Robinhood, where the founders claim that they were in their big skyscraper at their soulless finance job, and they looked down on the street, and they saw the Occupy Wall Street protests, and they decided that they wanted to bring Wall Street to those people.

[00:06:46.70] And people seem to find this energizing. I mean, when you look on the Reddit boards that caused some of the controversies in the GameStop run up, you see very much this ethos at work. I mean, it's why people are investing to some extent. OK. So to this, we could, of course, add that they dropped their commissions down to zero through somewhat controversial economic arrangements. But honestly, everybody did that, and still IPO-- and still Robinhood was the app that everyone wanted to use.

[00:07:22.91] OK. So what do I think of Robinhood? I'll give you the quick version of it from some prior work. And I do think that there is something worthwhile in having people own stock. My grandmother bought me shares of stock when I was 12 years old, and I still have the actual share certificates. And we looked in the newspaper at what the stock was doing, and that was learning through doing, and that was extremely valuable. And I think there's absolutely something important there with people owning stock.

[00:07:54.44] I also think people just like it. And you know what, that matters. They enjoy using the app, and we live in a world where literal gambling is legal in most states. And there is some point at which we ought to just consider the fact that this seems to be an enjoyable experience to some people, and perhaps we shouldn't stamp it out altogether.

[00:08:22.73] On the other hand, I have serious reservations, really, about Robinhood itself. When you look at the investing activity there, there are some signs of, let's just call it some suboptimal investment techniques from conventional financial planning perspectives. People tend to chase particular stocks because they're on the top mover list. There's demonstrated history of people herding into stocks, and that's associated with lower returns.

[00:08:53.87] We also shouldn't just think about people buying a couple of shares of GE stock and watching it grow over the years. A lot of what's going on is trading in complex options, things called the iron condor, and they have all sorts of crazy names. And they're complex, and they're hard to understand, and they're available right on the app. There's also a pretty major segment of Robinhood where people are trading crypto assets that I would venture they don't fully understand.

[00:09:25.43] Robinhood, also, just was a move fast and break it-- break things kind of start up, and had some really fairly egregious compliance violations early in its history that are, I think, troubling. And then this is a point that I want to emphasize a little bit here, which is that if you actually look at what most people are doing on Robinhood, it is a few hundred bucks of stock, and it's not so much buying and selling. So if you look at just the median Robinhood user, they're doing something that is not of major concern.

[00:10:03.73] But it's clear that you couldn't make an IPO-worthy business out of those users. And so where they make their money is on crypto, and complex option trades, and on a group of-- I would just characterize them as compulsive super users who are trading all the time. And when Massachusetts security regulators brought an action against Robinhood, they had examples of Massachusetts residents who had made trades at alarming frequency. So in a way, we have these beneficial aspects of Robinhood, and I think that's worth keeping in mind that there's something good going on.

[00:10:46.56] But in a sense, it's financed on the back of the compulsive super users trading crypto and complex options. And I think we ought to pause on that for a minute. In my prior research on Robinhood, I had some ideas about how we could try to preserve what's good and limit what's bad. And that's not especially relevant for today, so I'll spare you those details. And I'll move on to now comparing that picture of democratized stock ownership to crowdfunding and see what pops up from the comparison.

[00:11:19.61] OK. The first thing I'd like to say is I also think that you can view the current success of crowdfunding as being a technological breakthrough. And I say that, in part, because there were efforts to use the internet to match buyers and sellers of startup stock for a long time. So what's relevant for this law review citation is that the article is written in 1998.

[00:11:40.02] And at that time, the SEC on an ad hoc basis had actually been quite accommodating to different economic development groups that wanted to create electronic bulletin boards where people could post plans for startups and people could be matched with local investors. And they were also accommodating to registered broker dealers starting websites that would vet investors for accredited investor status, and then would match offer them startup investments.

[00:12:08.10] So the SEC was dipping its toes in this area on a limited basis for a long time, and it just didn't take off. And I think you can appreciate that if you think about what your computer screen looked like in 1995, it just wasn't a very compelling experience. And I think if you turn today-- so this is a snapshot from Wefunder-- you see something that's really quite engaging. And so across the top, you can click on different affinity groups that might interest you, and they'll serve you up with lots of offerings in those areas.

[00:12:43.26] It's very social. People tend to have their little pictures, and their names, and their profiles, and you interact with people in that way. There's also a healthy little bit of drama and FoMO with the, oh my gosh, the future of coffee is almost sold out so I better click on it right now. And also, when you do click on a company, it's great. You have a video that you watch. There's an early bird special for early investors. You can comment and ask questions. And the whole thing would have been, I think, hard to even imagine in 1995 looking at your electronic bulletin board, right? So this is a really great experience.

[00:13:25.59] And if people would rather, I don't know, put off their new car for a year and instead sit in their living room and put on their Patagonia vest and play VC for the day, more power to them. That sounds actually fun to me. So I think there's definitely something here that's worthwhile. I would also say there is this ideological branding part. This actually comes from the Wefunder website.

[00:13:54.02] So you see the crowd all wanting to crowdfund, but there's these bad laws in the way, and it's so sad for the entrepreneurs. And Wefunder associates itself with crowdfunding as a movement, right? You do this, and you're part of all those people. You're part of something that's changing society. They say in various places that their goal is to fix capitalism. They're a benefit corporation and all those things.

[00:14:18.15] And so if you doubt me that there's similarities to Robinhood, here's my gotcha slide. We're building the Robinhood for pre-IPO startups, and everyone should angel invest $100. That comes right from Wefunder. So there's certainly-- we're in a similar atmosphere, and I think you can think of these as all being a part of a similar development or movement or breakthrough or whatever you want to call it.

[00:14:43.71] I would say I feel better, a lot better about crowdfunding than Robinhood, and I'll give you the reasons why. I think the same pros basically apply. But the one that I would add that is significant is the inclusiveness from the standpoint of, who can raise money? The company's side inclusiveness.

[00:15:06.06] Because Silicon Valley is just famously, demonstrably clubby. And this is a far more open system geographically, racially, in terms of gender, whatever way you want to slice and dice it. This is really available to people even in a world where the top sites are doing some screening and gatekeeping. So I think there's something more here, even better.

[00:15:36.13] I will say, I would first say, what you won't see on my pro side is we are sharing the benefits of the entrepreneurial economy with everybody. Because my personal opinion is that if you have a couple thousand dollars to spare, you should buy index funds or I-bonds from the US Treasury, and that none of this really has, I think, a serious role in any kind of financial future of any person.

[00:16:03.15] Not to say that you couldn't hit, but everything we're learning about venture capital, at least, and we can assume somewhat similar dynamics here, is the power law, and is the idea that very few companies create most of the returns in this sector, and that the smart way to invest is to be a limited partner investing in a bunch of different venture capital funds that invest in a bunch of different companies, and you get massive amounts of diversification that way, or significant amounts, I should say. That's not present here.

[00:16:34.53] So I think we need to be cautious about it, and I also think that there is a question in my mind about exactly how the business models are working, and exactly what the users are doing, and whether the averages and medians, which make it sound like small potatoes, are true, or whether there's some group of people who are compulsively hitting the button and investing in everything. And I honestly don't know the answer, but I feel different about the whole thing if it resembles Robinhood in some respect.

[00:17:04.93] So in my mind, the most important feature of any regulatory system here would be the investor cap. And it can take different forms, but to just cut right to the heart of the matter and to limit the amount that a person can invest through crowdfunding to contain the damage if there is any. And to just put a cap on individual losses would seem, to me, a good cornerstone of any regulatory system. And from there, I'm fairly comfortable letting the people on the ground figure out what works and what's compelling. But I would recommend that that one feature be prominent.

[00:17:44.62] And I think Professor Schwartz has endorsed in a qualified sense that aspect of the regulatory feature, and has also pointed out some fairly significant flaws in the way that it works right now in Regulation CF. Which I don't think is-- I think is a bit clumsily done. So the bottom line is crowdfunding, better than Robinhood. Keep the investor caps. All right.

[00:18:13.13] [APPLAUSE]

[00:18:15.19] I could do an hour [INAUDIBLE].

[00:18:18.40] If there are any questions-- I think we'll do questions after each speaker. If you have any, now would be the time. OK. We'll have a mic come up.

[00:18:28.87] Yes.

[00:18:30.19] Thank you. I don't know if I should stand or not. But my name is Seth, I'm a former student here. You mentioned towards the end that one of the wise ways to go about investing is to be an LP with the VC or whoever. Is that possible for people to just become an LP in various different funds now, just opening new doors here by allowing direct investment, or? Just curious about that.

[00:18:57.03] So, I mean, I think I could give a cute answer, which is there are some investment vehicles that are publicly traded that invest in venture capital funds, but they're a fairly minor part of the landscape, and I'm not sure they're that great either. So the spirit in which I meant that was that if you have the luxury of being an institutional investor, then startup investing is the way to go. And if you don't, you should view it as an enjoyable experience rather than part of a financial plan. Yeah.

[00:19:33.36] Thank you. So my question is, are there any additional actions beyond investor caps that can be taken so that crowdfunding apps avoid the exploitations of super users like Robinhood, while holding true to democratizing access to investing in startups and the liberalization of these markets in general?

[00:19:56.46] Yeah. I mean, I have to say that the policy, the shorts policy prescription all sounds pretty good to me. The idea of focusing on the mechanics of the offering. So when does a funding go through? What's the minimum funding amount? Those types of actions, issuer limits, et cetera, I think all combine to contain the damage.

[00:20:32.19] And I share the impulse as well that the instinct of securities law is to try to make the investments safe in some way. And that's either through separating who's sophisticated or not, which we do very clumsily through accredited investor status, but it's some effort at that, or through disclosure, right? So if there's information gaps, let's fill the information gaps.

[00:20:56.99] And I'm just highly skeptical that that stuff matters. And particularly when it comes to what I see on Wefunder, I don't think that the pros are valuing those types of opportunities on the basis of historical financial information, and that tends to be the biggest pain point in the mandated disclosure. So I just don't think that they are-- I don't think the mandatory disclosure currently is providing the types of information that actually matter. And so I would focus on things like issuer limits, regulating the terms of the offering, making sure offerings don't go through when they've only raised $5,000.

[00:21:39.99] But investor caps would really, to me, be the centerpiece. So I'll just say, my solution to Robinhood was also that we ought to create a open space for apps like this for small accounts. So if you have an account under $1,000, then all sorts of regulatory concerns that Robinhood might have around whether it's making recommendations, and whether it's accurately screening people for sophistication so they can trade options, all sorts of regulatory questions that loom over Robinhood, I would personally say, well, let's just give them a pass on all of that and a clear path to doing what they do that people seem to enjoy, but let's only give them that safe harbor for small accounts so that people aren't harmed in major ways. And so I really think the caps are a nice place to focus investor protection.

[00:22:32.39] We have a question over here.

[00:22:33.74] Yeah.

[00:22:35.24] So I want to follow up on that question regarding information asymmetries. And Andrew was talking about it in his book. Perhaps when you were comparing Robinhood and crowdfunding, some of what Andrew was saying is that the benefits of crowdfunding is that we have those forums where people can talk about the companies, they can share some information. How is that compared to Robinhood and how inside information is being monitored there whereas in crowdfunding it's almost welcomed and people are providing information, or asking questions, getting their information asymmetries more balanced?

[00:23:20.81] I mean, I would plead ignorance on what types of message board chat features there are on Robinhood, I just don't recall. But I can tell you where that is going on is on Reddit and other external discussion forums. And lots of it's going on, and, I don't know, my suspicion is that it's not super great information. But it's information I suppose. Yeah.

[00:23:47.07] We have one more question.

[00:23:49.05] OK. Thank you so much for this. I really appreciate your analysis of Robinhood. You mentioned Occupy Wall Street, I wrote a book on Occupy Wall Street. So people used to ask me during the GameStop thing, isn't this just like Occupy Wall Street? But, of course, they weren't feeding people in the streets and things like that. And the kind of behaviors that it fed, I think, are really interesting to look at. One question I have about this is about the possibility of tying investment to participation, which is the root of an earlier form of securities exemption, the cooperative business form that enabled a form of crowdfunding but in the context of participation.

[00:24:34.56] And one thing I'm tracking a little bit right now is some new apps that are trying to tie equity holding to a consumer rewards model saying, we'll treat you as a special consumer if you can verify that you own stock in our company. And I'm curious about whether that might be something that we should look for in the context of equity crowdfunding.

[00:25:03.71] A lot of companies I've worked with that have explored this. They're seeing it as a marketing opportunity to try to align potential users as investors. And it also provides investors with more direct interactions with the company, ways of validating and checking, and just making the market less of a matter of pure speculation but something that's grounded in direct economic relationships and also maybe direct personal relationships.

[00:25:42.97] Yeah. I mean, I think Professor Schwartz gets at this in a number of different ways in the concept of the crowdfunders being brand ambassadors who are sometimes also enthusiastic users of the company's product. And also, something that was in the book, new to me, was the fact that there is a certain amount of ongoing interaction with the company through video conferencing, and shareholder meetings, and things like that.

[00:26:13.94] And I do think that that type of practical knowledge about companies is probably more useful than, say, financial statements, and maybe more useful than financial projections or promises or all the other things that you tend to find in regular disclosure. So I think to the extent that people have an affinity and an involvement in the product and with the company, that that is a reason to view that as a kind of expertise that warrants some recognition in securities law. Yeah.

[00:26:49.81] OK. Thank you.

[00:26:51.10] All right.

[00:26:51.61] [APPLAUSE]

[00:26:56.95] Our next speaker is Professor Doug Cumming.

[00:27:02.39] Great. OK. Well, thanks very much for the chance to join you. I am in Florida, but I'm Canadian originally. Lived in Florida the last five years. I'm very much indebted to Sofia and Robert, my two co-authors on this paper. Robert is a PhD student at FAU. Great student to work with. And Sofia, I've done many projects together with her. In fact, I found her to be such a good co-author I felt I needed to marry her. So that's how that turned out. It's been a very successful partnership.

[00:27:41.24] I really enjoyed this book and chance to join the forum. There's many great quotes out of the book. I picked a few in order to motivate the particular paper here. So in particular, the book starts out like, wow, why would you ever do this? Information asymmetries are huge. The investments are very illiquid. It's right at the start of a company. So why would you ever do this? And we know that the crowd really wants this.

[00:28:15.30] So you think of some famous examples like Oculus Rift being financed through rewards crowdfunding on Kickstarter and sold to Facebook for over a billion. And, of course, the crowd gets very angry that you can go to Vegas and bet $5,000 on slot machines, but you can't put money in a startup. So that's how it all got started. And with the rigorous analysis in the book, we come to this conclusion that there's potential great gains, lots of things that could be done right, but we need the right regulatory standards to make sure that it's successful.

[00:28:52.26] And over the years-- so I've been writing papers on crowdfunding over the years, actually for over a decade now. And normally, we've been using data from places like Australia or Europe because they've had crowdfunding for way longer than we've had in the US. But now there's data available from the US, so that's what our goal is in this particular paper to see exactly how effective are things going in the US.

[00:29:21.96] Does the market work in the way in which we would expect with the presumption that here we have information asymmetries, entrepreneurs are signaling information through their disclosures, and those signals work in ways that we think are effective? And are there some limits to the regulation that's being put in place that inhibit the way it's done? And perhaps there's some regulatory requirements imposed on entrepreneurs irrelevant to the crowd.

[00:29:55.47] And I'm going to show you some things that we believe the data are telling us, and I'll show you the evidence that we have to date. And this is a work in progress going through an R&R to journal. So very much welcome any comments or feedback. What we have in the paper are some interesting governance mechanisms based on the data that we can obtain from the SEC web page, over 4,000 campaigns. We believe we have 100% of the population from May 2016 to December 2021. So we started doing this in early 2022, and that's where we're at with the paper. It takes a while to go through the data.

[00:30:37.72] Now, when we examine the data, the interesting things that come up that we wanted to know about was, firstly, Delaware. So this is not a difficult sell to law students. But over the years, how the literature has progressed with Roberto Romano's original work in 1985 showing the great benefits of a Delaware corporation, when you reincorporate a Delaware publicly traded company, their share value increases tremendously, to work more in the 2000s that said, this Delaware effect has disappeared. Publicly traded firms have other ways to govern themselves, and the marginal benefit of Delaware is essentially zero.

[00:31:28.73] And so what's interesting in the crowdfunding context is that we don't really have many other good governance mechanisms or things that we can use to signal to the crowd, and so maybe this is relevant. So there are a lot of papers that show Delaware corporations are less subject to managerial entrenchment. It's easier to sue Delaware corporations. The judiciary is way more sophisticated in Delaware than other jurisdictions. And there's legal familiarity so that everybody, even in Florida or Colorado is taught Delaware law.

[00:32:04.82] Now, as I say this, I say this with a bit of trepidation because I was just on a road trip from Canada back to Florida, a very long drive, so I started listening to Freakonomics podcasts. One of the podcasts said, Delaware is where all the evil corporations go, and you don't need to disclose your identity. So I'm a bit on the fence as to the way I'm interpreting this, and I'd very much welcome your thought on that particular point.

[00:32:30.26] Secondly, we have these mandatory disclosures, two years of financials. So there's tremendous amount of data in the US that does not exist in other jurisdictions with respect to income, assets, liabilities, and so we're going to see if that matters. In the US, you don't only need to use common equity, you can use other things like SAFEs, simple agreements for future equity. Which is better? Common, or SAFEs, or maybe debt, or convertible debt, convertible preferred, you have all these different options. And we have a prediction in the paper that common equity is best, and that's something that we could take a look at in the data.

[00:33:12.20] And then finally, there is a weird thing that's in the US which allows platforms to take an ownership stake in the companies in which they invest and-- sorry, not invest, an ownership stake in the companies in which they list. And you can imagine there's all sorts of potential conflicts of interest that they overpromote those companies at the expense of others. And so for me, that was a bit of a weird one, and we wanted to see if that was potentially relevant as well. So that's where we really focus on. We have many other variables in the data, but I have just a very short amount of time. In a different forum, I'd give you another 10 slides on each of these points, but let's go to the data.

[00:33:56.64] So the data, as I told you, from the SEC. We even created a page with Robert, he's good at doing these kind of things. We have a crowdfunding tracker on the FAU web page that's of interest. I could just show you a few of the slides. We saw some similar ones today.

[00:34:15.74] So on a quarterly basis, the amounts raised a number of campaigns. So it's a market that's growing large and arguably could grow larger if it enjoyed the freedoms of, say, New Zealand, which is always a very big puzzle because it's one place where there's more sheep than people yet it has this very successful, one of the more successful crowdfunding markets in the world on a per capita basis. So there's certainly room to grow.

[00:34:43.93] The evidence of the room to grow is very much highlighted by the May 2021 change that restricted campaigns to raising only a million dollars, which as a Canadian, I found that very puzzling. The land of the free, but no, you can only raise a million dollars. And so they changed it to $5 million in May of 2021, it's just massive increase in capital raises. So arguably, $5 million is also pretty small, but I guess securities regulators are risk averse. And if there's a major crisis that happens, then people lose jobs, and that's how things go, but that's notable.

[00:35:32.52] I like this map because it shows some regional differences. And some fun things happened during COVID. One of which I noticed in Florida is that everybody moved to Florida, and crowdfunding took off like crazy, which I appreciate a lot because my house price doubled in value over a couple of months.

[00:35:53.54] And then other places like Idaho benefited tremendously by the population shifts. If you want to see this on this graph, the Florida one is the turquoise color became second for a little while when COVID hit. And COVID has been showing the real great benefits of crowdfunding, that crowdfunding, that's way more resilient in a crisis than traditional bank loans, for example.

[00:36:23.45] And then here's the Delaware slide. So Delaware has an enormous bump up in success chances. So just on each of these quarters. And two of them, they're equal. And then the very first one, there's a difference. But the dark blue is the Delaware incorporated ones compared to the others.

[00:36:43.17] Now, someone asked me about this this morning-- actually, last night at dinner. Do you have data on platforms? And yeah, Wefunder is the most successful with the largest amounts raised, but there's some differences in success rate. The US goes by an all or nothing rule. So if you set your campaign goal, if you don't meet it, then you don't get the money that you raised.

[00:37:06.38] Now, we do a few things in the data-- and I know I'm out of time in about ten seconds. So I will just say, there's a lot of statistics in the data. I'm not going to trouble you with the small font in general, but perhaps one thing that I could just do is tell you a few things. So Delaware companies raised about $66,000 more on average, controlling for other things being equal in a regression setup. Common equity raises are roughly $60,000 to $109,000 more on average.

[00:37:47.26] But the interesting part of this is we require all these financial disclosures for two years. It does not matter which way you cut the data, it appears that nobody cares. So literally, there's no predictive ability from financial statement disclosures. By contrast, market conditions matter a lot. Delaware corporations matter a lot. Firm age also matters. The type of security that you put in matters. And that post-SEC regulatory change matters. And I give some statistics there.

[00:38:27.11] But let me just focus on this last one. So those two significant events that are interesting. This regulatory change May 2021, it bumped up just for that rest of 2021 because our data ended at the end of 2021. So it raises capital by an increase on a percentage basis of 260%.

[00:38:51.98] And then the other is that, hey, we like things, new solutions that help us out in a crisis. And we published this in a different paper, but you look at bank loans that just died in the crisis. And then fintech solutions did extremely well in the crisis. So probability of success even went higher during the crisis period.

[00:39:14.91] So that's all I have to say. Thank you very much. Excellent book. Congratulations. Thank you.

[00:39:21.86] [APPLAUSE]

[00:39:22.72] Going to take some questions? We got a couple of minutes.

[00:39:25.10] Yeah, yeah. Absolutely. Yeah. And if anyone has thoughts on Delaware-- I don't know if you've seen the Freakonomics podcast, but now I'm like wondering if I got it all wrong, is Delaware evil or is it good? And maybe the Delaware thing is a bit of a red herring, I don't know. So I'd love to collect-- I'd love to crowdsource the ideas for that. So thank you.

[00:39:47.30] Thank you. Do you have any data on other firm performance? Maybe this is a longitudinal effort, but I'm thinking that their future fundraising efforts from institutional investors all the way to their ultimate success.

[00:40:03.17] Yeah. I'd love to come back 10 years from now and have more information on these companies, what did they do? And so our measures of success are extremely short term just with the campaign success. So we'd like to know, did they get follow-on venture capital? Did they get an IPO perhaps? And so not with the US data because the history is so short, and the runway is so long. We can't say much about that with US data.

[00:40:36.05] We say a little bit about that with other country data. So one of the better crowdfunding platforms in the world is one from Israel called OurCrowd. And they've had some great successes, like my favorite one that-- I do this in the classes, I have a class on crowdfunding, in fact. And I always bring up ReWalk.

[00:40:55.49] So if you're bored tonight, just google ReWalk Crowdfunding, and you see people with an exoskeleton that are quadriplegic or paraplegic, and they can now walk a marathon. And so it almost brings tears to your eyes, and that's a crowdfunding company that went public on NASDAQ about 18 months after crowdfunding. And many other good examples like that.

[00:41:20.82] So the international data while small, because even 10 years of history is not really enough, but it suggests that people that say only bad companies use crowdfunding are really quite mistaken. There are some great examples from different places around the world. The largest market in the world is the one in the UK, Crowdcube is the biggest platform in the world. And they, too, have some good success stories. But yeah, it's-- so I would say, more data, more time. Someone might come here 50 years from now and say, wow, those guys are crazy. But I think all signs are pointing to the fact that it's going to be great things with this market moving forward.

[00:42:10.38] Actually, maybe just one last final thing on that is that fraud rates-- so we published last year a paper on crowdfunding fraud. Fraud as a percentage of publicly traded companies, the fraud rates detected are about 3% to 5%. Undetected, possibly as high as 15% depending on which paper you look at. And then in crowdfunding, the detected fraud rates appear to be way lower even with rewards crowdfunding. So, again, maybe more time is needed to flush that out, but so far, it appears that the wisdom of the crowd is quite savvy and not funding bad campaigns.

[00:42:48.01] Is there one?

[00:42:54.56] I apologize if you're the wrong person to be asking this question. But I'm wondering if anybody on the panel or the audience has thought about the use of nonfungible tokens as a medium to transact the democratization of finance.

[00:43:18.48] I could say very briefly that I know a little bit about it, and that in some contexts, that those are very successful new financial tools with the caveat that the volatility in that area is so large that that's problematic. And so for the regular person, that's not exactly the best way to go. Perhaps others would like to comment on that.

[00:43:52.09] I'm going to talk about the tax consequences in a bit.

[00:44:01.69] Thanks. Really interesting information. I am actually on the board of a company that's about to do a crowdfunding raise, and I don't actually know yet what are the basic transactional costs to the company. Like, how much do they end up having to pay? And it looks like you would know that. And then I'm also interested-- I feel bad saying. I think there's a Wefunder person here. But the CEO texted me the other day and said we're switching from Wefunder to StartEngine. Are there significant differences between the platforms and advantages of the different platforms?

[00:44:40.22] So different platforms do different amounts of due diligence. If you wanted a quick and dirty synopsis, Wefunder has raised a bit more in total than StartEngine. The success rates on the two places are quite similar, 65% and 72% is not going to be a statistically significant difference. As between the two, I would encourage you to go and check that out more carefully.

[00:45:16.28] Now, I forget, precisely, the fees on these two particular platforms, but often in the US, they have a 5% rule. So 5% of the amount raised goes to the platform. And you might go, oh, that's bad, but when you think of, say, taking a company public, there's a common thing that the largest capital raisers, the investment banks, they're charging 7%. And then for smaller IPOs, that's even a much higher percentage of the capital raised.

[00:45:46.64] So 5% isn't so bad. It's not that everybody charges 5%. There's a lot of variability. And we have, actually, all the percentages charged and the details in the data. So if you ever needed that information, you can fire me an email and I could let you know. But yeah, all this information is publicly available, so I'm happy to share it with you if you want to ask me anything further.

[00:46:15.47] OK. With that, we're going to move to the next speaker. And thank you very much, Doug.

[00:46:18.92] Thank you.

[00:46:19.49] [APPLAUSE]

[00:46:24.12] Our final speaker is Professor Eyal-Cohen.

[00:46:28.38] OK. Thank you for inviting me, Mr. Schwartz. And so, really, online crowdfunding campaigns have become more common, and the question arises is, how does tax relate to this phenomenon? And in his book, Professor Schwartz is saying that when he compares the investment crowdfunding activity in the US and other countries like Australia, he theorizes that perhaps the fact that the UK has special tax benefits that are not specific to crowdfunding could be the reason for the discrepancy of why the numbers in other countries are higher than when compared to the US.

[00:47:14.16] So having that claim in mind, I delved into this comparison and looked at the UK and the US tax treatment of investment crowdfunding. So at the entity level, funds that are raised in the UK from crowdfunding are usually not taxable if they're exchanged solely for equity in the company. There are also some R&D credits and incentives. For example, if the company invests in qualifying research expenditures, they can get up to 33% of that amount as a write-off.

[00:47:59.28] But, really, what I wanted to focus on are tax incentives for investors. So the UK has four schemes to help small and medium companies grow by attracting investments through offering tax reliefs to individuals. The Enterprise Investment Scheme, the EIS, the Seed Enterprise Investment Scheme, the SEIS, the Social Investment Tax Relief, which became ineffective this year, and the Venture Capital Trust. And, really, I'm going to focus on the top two. But just so you know there are four, or more like three main schemes.

[00:48:40.71] So starting with that, the incentives have a lot of limitations for exactly on industry. So legal or financial services is not qualified, property development, running a hotel, banking, insurance, debt, or financing services, these are not eligible for these benefits.

There are limits on the investment amounts. So the maximum amount that you can raise in a lifetime in a company for EIS and Venture Capital Trust, the VCT investments, 12 million pounds. And for the SEIS, 250,000 pounds. So these are the limits.

[00:49:21.10] And if you look at the EIS program launched in 1994, it makes investing in shares in early stage businesses more attractive through tax relief. And, again, there are limitations and qualifications that you have to abide by. So, for example, there could be-- company qualification could be no more than 50 pounds million in gross assets, less than 250 employees, and have active sales of not more than seven years for the EIS and the VCT programs.

[00:50:00.04] But really, what they're offering are four types of tax relief. The first one is income tax reliefs. Investors can claim up to 30% of their qualifying investments to reduce their taxes. So if you put in a million dollars, you can get up to 300 million-- sorry, pounds. If you put a million pounds, you can get up to 300,000 pounds as a deduction against your income. It's a tax-free growth platform, so when investors sell their EIS shares, the growth in value from the investment is usually tax-free. And this is quite significant because, usually, small and medium firms have a high potential of growth.

[00:50:46.02] The capital gains can be deferred. So when you have a gain made from sales of other assets, not EIS sales, you can reinvest them in EIS shares and defer them over the life of the investment, and there's no upper limit for that. And there's also loss relief. So loss is deductible against ordinary income, and that reduces the impact of the losses when you have EIS companies that are not successful.

[00:51:15.75] The SEIS program, the Seed Enterprise Investment Scheme, is very similar. But it qualifies for firms that are active less than two years, and they have no more than 350,000 pounds in gross assets, less than 25 employees, and haven't been-- previously carried any other trade. And if you invest in SEIS, you can claim up to 50% of the investments and exempt on any capital gain tax. Just to note that to be able to claim these tax benefits, the UK tax authorities need to send a letter of authorization, a unique reference number, and a compliance certificate. So it has to be done with a lot of collaboration with the company and the investors.

[00:52:07.87] So let's explore what's going on in the US. With the entity taxation, again, funds raised are not considered income. There was a question about cryptocurrency. So property, including cryptocurrency, exchanged solely for equity could be tax-free capital contributions under Section 351 and 1032 under specific requirements. But if there are rewards involved, the code explicitly states that if investors receives reward throughout crowdfunding whatsoever aside from the equity, these are taxable gains.

[00:52:54.33] So at the entity level, there are also federal and state R&D tax credits. For example, Section 41 provide a dollar-for-dollar tax incentive for the companies against their taxable income-- I'm sorry. Yeah, against their tax bill. It's a credit, so it's dollar for dollar at the end of the process. And at the state level, we have 38 states that provide R&D tax credits similar to the federal level. And there's really interesting stuff at the state level.

[00:53:27.37] For example, I found that Pennsylvania had the innovation zone tax credit that provides credits for companies that are less than eight years old that specifically invest in Keystone areas around universities and nonprofit organizations, trying to mimic Silicon Valley. You can get really generous-- there's a $15-million pool of a tax credit that you can use to claim up to 50% of the increase in your portfolio companies. What other tax incentives, though, do they provide in the US to investors? Because that's really the gist of maybe the reason why the UK crowdfunding and the US crowdfunding is so different.

[00:54:20.81] So here, as I emailed Professor Schwartz when he pitched this idea to me, I thought, well, we do have tax incentives in the US for small businesses, and I wonder how that would apply to crowdfunding. So, for example, for small business stock defined as a C corporation with assets of less than $50 million-- and you heard correctly, $50 million doesn't sound very small. And I've written about how small is not really small and why.

[00:54:56.41] We have three main vehicles that are very much like the UK tax incentives. We have Section 1244 that provides reporting capital losses for small business stock as ordinary losses. Up to $50 million if you're a single filer, $100,000 if you're a joint filer. Section 1202 provides 50% to 100% exclusion depending on what year we're talking about, who's the president at the time from gain and small business stock held for five years or more, and provides you that exclusion like the tax-free growth in the UK. And when you sell the stock, stock sales could be eligible for Section 1045 rollover of gain if you invest within 60 days in another small business stock. So very similar to what we have in the UK.

[00:55:55.99] In looking at the state tax benefits, we do have angel tax credits. Over 31 states provide angel tax credits that attract investors. They are mostly refundable tax credits against your income, and then some. And there are available to accredited investors to use against their business or corporate income tax liability. But, again, it requires a lot of collaborations. It needs to be certified by the state ex-ante, but needs to be done after the deal is complete. And that's something I'm going to talk about in terms of, what can we do better?

[00:56:37.19] There's something really cool that I noticed in Colorado, for example. We used to have a-- we, you guys used to have in 2010 the Colorado Innovation Investment Tax Credit that actually sunsetted the year afterwards that provided a specific percentage of the investment against state income tax liability. It permitted equity investment in, specifically, qualified small business in aerospace, bioscience, clean energy, and information technology industry to get that dollar-for-dollar reduction. But that sunset in 2011, and was replaced with the Advanced Industry Investment Tax Credit that really limited to areas of enterprise zone in Colorado. So more geographical rather than industry-wise.

[00:57:30.28] The only thing that I found that specifically relates to crowdfunding is in Virginia. And Virginia has Qualified Equity and Subordinated Debt Investment Tax Credit. This is a long way to say that, really, it provides crowdfunding companies, and it specifically mentions crowdfunding. In 2013, it was enacted. It provides up to $50,000 of income tax credit equal to 50% of the qualified investments in transactions via online general solicitation, online broker, or funding portal, i.e. crowdfunding platforms.

[00:58:17.30] What is a qualified business? Has gross revenues of no more than $3 million, principal business in Virginia, also established, primarily, production in Virginia, and so on and so forth. It's a grant-like credit, meaning you have to apply. There is a cap. And if there are more applicants than what is available, they reduce it, and they allocate it. And you can carry it over for the next 15 years if you're not using it at that year.

[00:58:48.12] So just to summarize, what are the issues with what I've seen so far? First of all, complexity. Because it could be that we're offering the same thing in the US and the UK, but somehow the way that we administer it here makes it more challenging. So investors need to establish that the corporate level requirements are satisfied mostly when you look at gross assets test, qualified trade or business, and redemption rules.

[00:59:16.29] And so, for example, to qualify for any tax write-offs, all three Section, 1202, 1045, and 1244, you have to hold actual equity investments common stock. So Professor Cumming's note about the type of equity, it cannot be SAFEs, for example. So any type of convertible shares are not qualified. It has to be common or preferred. What happens if you have convertible to common and preferred? Then only when you convert it you can claim that benefit.

[00:59:49.65] There's a lot of uncertainty. So tax rates require both firm and investor to collaborate and to get, sometimes, certification from states as eligible for the credit. But, again, only when the deal is complete, and it requires a lot of collaboration. There's tax salience and everything. But specifically here, there are a lot of significant challenges that even when you have a VC-backed startup, people don't really pay attention to tax until it's after the fact, and they have to go back, and their accountants are looking at numbers and agreements and try to make sense of how to get those benefits.

[01:00:32.13] And there are agency problems that Professor Schwartz wrote in his book, and I reiterate here. When you have small investors that do not really have a lot of influence on crowdfunding companies, to oblige them and to nudge them to satisfy the necessary requirements to get them to benefit from the rules.

[01:00:51.40] So I'll finish with some recommendations of what I think we can do to improve the situation. I think the IRS should adopt clear guidance regarding crowdfunding tax incentives because right now, as I said, it's general small business qualifying stock. It's not crowdfunding specifically. Legislated, like, Congress should enact safe harbor rules for investors and crowdfunding. So taxpayers can follow basic instructions, rest easy knowing that their crowdfunding investments will qualify for the tax benefits.

[01:01:25.89] And to save on agency and administrative costs, both investors and the IRS could look into crowdfunding companies and platforms to issue advance tax assurances like representations, tax statements that reflect the company's fulfillment of qualifications for various tax positions to clarify for potential investors, and even draw them by saying, hey, these are the tax consequences of these specific crowdfunding rounds, and that is before you make the investment and you come more knowledgeable to that investment.

[01:02:06.64] So, again, I want to reiterate my appreciation to Professor Schwartz, to Brad, to Christine, to all the organizers for making this event successful, and for the opportunity to work on this interesting project. And I welcome your comments and thoughts.

[01:02:25.53] [APPLAUSE]

[01:02:36.13] We have one up here. Yeah. So I feel like I read somewhere along the way that one criticism of the various state schemes to provide tax credits to angel investors is that there's a strong sense that those investors don't really optimize for tax. So the tax credits aren't really pivotal in the decision whether to invest or not, they're just a freebie on the back end. And I wonder whether you think that same concern could apply to the crowd.

[01:03:14.68] I actually think that the crowd is different. And I'm writing a paper now on R&D credits generally. And I think you basically reward the rewardee because they're going to do the R&D credit-- the R&D investment to begin with. And I've worked with accountants that specifically fix the numbers or present them so that they would get the R&D credits. And you're right, it's just a lollipop you get at the end of the year for doing what you're doing anyway.

[01:03:47.35] I think in crowdfunding, though, because you put it out there and you make this salient and you're thinking, huh, I may have a positive income liability, tax liability this year, I might be able to claim this, or this is a sweet portion of the deal that I haven't thought of, that could actually be-- if you put in ex-ante, that could actually be different from the R&D credits and the angel investor credits.

[01:04:19.88] Yeah. Parallel question. As a US resident, can I invest in UK crowdfunding? And the parallel question is, as a company, a US company, can I seek crowdfunding in the UK?

[01:04:35.78] You could. But if you're asking about your tax credits, it's usually for domestic-- certainly, for the state tax credits. And for the US, it needs to be a domestic company.

[01:04:46.83] [INAUDIBLE]

[01:04:54.40] Yeah. So from the entity perspective, they can still benefit from the entity tax level incentives, and then the foreign investor cannot-- well, let's put it this way. It's complicated because you have to file coordination tax-- reports that coordinate between the foreign tax credit and the credits that are offered federally. It is doable, but very complex if the company is domestic, and we have a foreign investor that has positive tax liability in the US.

[01:05:39.21] More questions? Well, thank you very much. That's a terrific presentation.

[01:05:42.73] [APPLAUSE]

[01:05:47.09] And can we have one more round of applause for all of our speakers? Thank you.

[01:05:51.43] [APPLAUSE]

Finance Panel

https://youtu.be/6VCqOQiOyC0

[00:00:00.59] My name is Rabea Benhalim, and I'm going to be serving as your moderator for our second panel of the day, which will be focusing on regulatory and business aspects of investment crowdfunding. I'm going to start by just doing some quick introductions. You'll find the longer bio for each of our panelists in the program, but I do want to just give a quick intro for each.

[00:00:24.51] So first up is Todd Zywicki. Todd Zywicki is a George Mason University Foundation Professor of Law at Scalia Law School at George Mason University and research fellow at George Mason Law and Economics Center. During the fall of 2023, he is serving as a visiting scholar in conservative thought and policy for the Bruce Benson Center for the Study of Western Civilization at the University of Colorado, Boulder.

[00:00:47.87] From 2020 to 2021, he was chair of the Consumer Financial Protection Bureau task force on federal consumer financial law. In 2021, he was inducted to the American College of Consumer Financial Services Lawyers. He is also a senior fellow of the F.A Hayek Program for the Advanced Study of Politics, Philosophy, and Economics at George Mason University and a former senior fellow of the Cato Institute.

[00:01:12.22] Next up, we have Allison Herren Lee. She is the former SEC acting chair and commissioner and served as commissioner from June 2019 through July 2022. She served as acting chair of the commission also from January 2021 to April 17, 2021. During her tenure, Commissioner Lee focused on bringing transparency and accountability to markets on issues related to climate change and other ESG-related information.

[00:01:38.08] Prior to government service, Commissioner Lee was a partner at Shearman & Howard LLC, focusing on securities, antitrust, and commercial litigation. A member of the Colorado Bar, she holds a bachelor's degree in business from the University of Colorado and a JD from the University of Denver College of Law, where she was salutatorian, a chancellor's scholar, and served on the law review.

[00:01:57.01] Next up, we have Sanjai Bhagat, who has spent over two decades in senior finance positions in venture capital, private for profit companies, and public nonprofits. He has advised the US Securities and Exchange Commission and US Department of Treasury on corporate finance and corporate governance. He is an expert on venture investing, ESG, executive compensation, and cybersecurity governance.

[00:02:17.51] Throughout his more than 20-year teaching career, Professor Bhagat has been recognized for excellence in teaching. He was the graduate professor of the year and winner of the Frascona Undergraduate Teaching Excellence Award and Educator of Distinction Award finalist. Dr. Bhagat has served as chair of the university's Benefits Advisory Board that advises the president of the University of Colorado on strategic compensation and health benefit issues.

[00:02:38.55] Finally, we have Jonny Price. Jonny leads the fundraising team at Wefunder, which has been discussed several times today, a platform that helps funders raise capital from their community and allows anyone, not just rich people, to invest in startups they love.

[00:02:51.44] Originally from the UK, Jonny started his career in strategic consulting at Oliver Wyman before founding the US team at kiva.org where he led for seven years. Jonny has a degree in history from the University of Cambridge and has served on the Federal Reserve Board's community advisory council. Take a moment to welcome them all please.

[00:03:08.18] [APPLAUSE]

[00:03:14.16] So I should go first?

[00:03:14.96] Yeah, so the way we're going to format this is each of our panelists will present for about 5 to 10 minutes. And then we're hoping to really have an open dialogue and open it up for audience questions. So Todd, you'll kick us off.

[00:03:25.28] Well, sounds great since so much about this is about egalitarianism and that sort of thing. I think this is the first time I've ever been able to go first with the last name like Zywicki. So that's why I was clarifying, right? It's a different world we live in now apparently.

[00:03:42.71] So it's a thrill for me to be here, and it's a thrill to be on this distinguished panel as well. I'm really looking forward to what these guys have to say. My background is in consumer protection. So I'm going to let these guys talk about a lot of the corporate finance stuff and that sort of thing. But as you heard, I've worked at the Federal Trade Commission. I worked at the CFPB. And so that's what I'm going to talk about in my lens here.

[00:04:08.59] And this is a great book. This is a really powerful, great book. I just want to make that really clear, and I mean that from somebody coming at it from a consumer protection perspective. This is not just a book about investment crowdfunding.

[00:04:25.02] This is maybe the best book I've read so far on just how to think about consumer protection in the internet age because the way he does this, the way Andrew does this with the focus on private ordering, on the focus on different ways of transmitting information and that sort of thing, it doesn't just have an applicability here. It's a model for thinking about the whole economy and consumer protection regulation from occupational licensing to you name it. It really is very powerful.

[00:05:00.37] The other reason this is a great book is what I love about it is he doesn't wimp out. He doesn't flinch. He takes the argument, and he takes the argument to where it goes. He's not starting to-- does a wimp out like the traditional law professor will obviously. We can't go too far with private ordering, right?

[00:05:19.32] He draws the lines and says this is the logic, this is the argument, this is right, this is wrong. I think the distinction, the discussion he has in the book between information disclosure and primary versus secondary markets is itself worth the price of admission to go through that distinction about information asymmetries and that sort of thing and primary versus secondary markets. So it's a great book.

[00:05:48.15] And I say that also that as a result of reading this book, I'm now a new participant in Wefunder. I am basically the poster child for the book, which I'm sitting there reading. It's like, I've heard about this. I should see what one of these things are.

[00:06:04.74] So I google up, top crowdfunding sites, and Forbes or some other credible source comes up and says-- I think it said something like easiest to use. I was like, that looks like the one for me. And it was Wefunder, right? And I looked and I saw in the book it was in here. It's like, all right, he vouches for it also.

[00:06:22.59] Landed on the page and now I'm the newest investor and brand ambassador for Oak & Eden Whiskey. It is exactly as Andrew said--

[00:06:32.82] It's working.

[00:06:33.36] It's working. They're going to raise-- so they started on September 1st. They're going to try to raise $10.6 million in December 1. They've raised $9.5 million, $9.5 million on this crowdfunding site from this. And it's got everything he says. It's got a pitch deck. It's got a video from the guys.

[00:06:53.88] I put it on Facebook. I'm an investor, all of a sudden, I start getting into my Facebook feed. I asked the guy a question on Facebook and like five minutes later he responds. I always like getting specialized bottles or personalized bottles, so I'm going to solidify my role as a son-in-law of the year by getting my father-in-law a bottle of Oak & Eden Whiskey with his name on the label.

[00:07:19.13] So the whole thing is just fun. It's interesting, and I think I'm going to make some money off of it also. So it really is a great smooth sort of thing.

[00:07:30.30] So let me just make three points substantively beyond urging all of you to go out and buy Oak & Eden Whiskey, which it turns out the next thing I did was googled up, where can I buy Oak & Eden Whiskey in Boulder? And I found the place and now I have it here because my perk does invest until the-- I don't get my perk until it makes its numbers. Yeah, so I couldn't wait that long.

[00:07:53.81] So I want to make three points about why I think this is such a profound book about consumer protection and consumer financial protection and why it deserves to be read by anybody who's thinking about consumer protection, not just this. The first is that we've, for a long time, the basis for most consumer protection regulation has been asymmetric information.

[00:08:17.65] And it's clear that-- an occupational licensing being the good example, right? It's clear that is a very poor way of regulating things. Disclosure, sort of, mandated disclosure is also a poor way of doing things. It's the worst way of doing it except for every other way we could think of in the past, right? Now we have a much better way, and he lays it out right.

[00:08:42.70] The internet, the information economy, the reputation economy, all these sorts of things, we're getting increasing evidence that this is much more powerful and more useful to consumers. We've always understood that when the market drives disclosure, it generally drives disclosure towards the things that consumers care about not the things that bureaucrats think consumers should care about.

[00:09:05.26] And that's what we see here is it's providing information in a useful way to consumers, and it's just something that consumer protection attorneys simply have not and thinkers have not really internalized. And what we see here is a new market, and it's really quite remarkable that the regulators haven't screwed this up already, that they have done a pretty good job of letting this market exist and thrive.

[00:09:35.39] And so I think this point about-- and there's some studies on occupational licensing, for example, that show that consumers don't really care about government licenses. What they care about is your rating on Yelp and that sort of thing. So consumers are using this information already. And this really explains the logic of it and explains why the internet can be such a powerful tool in this area.

[00:09:58.37] The second thing I like about this is something I've been talking about a long time is we can think about consumer protection regulation as a three-legged stool, which is we've got markets, common law, and then regulation. Regulation is the luckiest and most ineffective way of dealing with most things because it's one-size-fits-all, it takes forever to do it, it's subject to all kinds of public choice pressures and the biases of regulators.

[00:10:29.08] But that has become the default, right? That's become the default way that we think about solving problems, consumer protection problems and the like rather than and it should be the last resort not the first resort, right? The market itself is the most effective way of protecting consumers, which is advertising, reputation, repeat dealing, all these sorts of things. And the internet now makes us much more powerful starting with markets.

[00:10:56.32] But the other thing that's very prominent and it tends to get lost, I think, in the discussion, and Andrew mentions it-- he doesn't go to a lot of detail, but the simple old rules about fraud, contract, tort, right? The common law is another way of providing consumer protection, warranties, anti-fraud, that sort of thing.

[00:11:16.77] And he keeps reminding you for the whole thing. It's like, dude, there are anti-fraud laws out there that are still available to consumers in that sort of thing in addition to the other private ordering mechanisms here. And so I think he's very calibrated about start with the market, figure out how far the market takes us.

[00:11:35.48] Think about what the market failure is. Think about whether the common law solves that, right, through contract and that sort of thing. And then what's left over at the end for regulation? And I think he makes a very compelling case for where regulation can come in, how it can be useful in the like while allowing those other sorts of more flexible ways to flourish.

[00:11:57.44] The last thing he says, and I'll close on this point, which is, again, just a great point, and I applaud him for not flinching when it comes to the implications of his argument, which is there's two ways you can think about this from a law and economics perspective. You can think about loss prevention, right, or loss mitigation, right?

[00:12:16.75] And a point he makes that I think is a really powerful point that I've thought a lot about is he says, one of the ways of dealing with this is to simply limit rather than trying to prevent every idiot from losing money, right, if they do something stupid. Another way is just limit the amount that people might end up losing, right, which is that there is a cost to all this regulation. And we just pile these regulations on consumers, trying to keep them from ever making a mistake.

[00:12:46.63] And sometimes it may just be, we know, for example, one of the ways that-- one of the way consumers learn about bank accounts and that sort of thing is by making mistakes, right? We make mistakes early in our life, but they're small mistakes and we learn from them, right?

[00:12:59.95] And so there's a dynamic process there. And so I think the idea, he says, one of the points he makes is just limit the amount that people's exposure is, right? And people will learn from it, markets will learn from it and that sort of thing. And don't treat people like children thinking that we can always keep them from losing money, right?

[00:13:26.26] You can go out and you can buy a $1,000 pair of loafers, but you can't go out and make a $1,000 investment in Oak & Eden, right, which you actually get something for it, at least I hope, at the end of the day right. But we have these worlds in which we just ignore the reality, right, that people can spend their money on a lot of different things and there's nothing fundamentally different here.

[00:13:51.46] And we don't limit how much people can spend on a handbag or a car or something like that, right? And so here we've even got more protections in place from that, and you might actually make some money off of this. So anyway, it's a great book and I'll close there.

[00:14:05.56] I would just like to acknowledge that was perfectly at 10 minutes.

[00:14:08.29] Oh, well, thank you.

[00:14:09.82] Allison, please.

[00:14:10.54] Sure. And I'll probably give back some of my time because I want to be brief and get to the Q&A and the discussion, which I think is always more interesting. So I'm a former regulator, and I view these things slightly differently from Todd, although I will say that the last point, I'm 100% in agreement with. And it is the single, in my view, most important protection that we have in the regulation crowdfunding space, and that is that investors are required-- are prevented from investing over a certain amount. There's a cap on what they can invest.

[00:14:44.61] And I think that is what gives me comfort in this space. I think it's important at some level, and we can have this discussion. But there are some fundamental differences between consumers and investors. That's why we have the Securities and Exchange Commission. Investors are expecting something, and they need something. It's important.

[00:15:02.03] They're building savings, they're building for retirement, for their kids' college and the like. They're not buying an expensive purse, which they might do. But what they're engaging in, the conduct they're engaging in is fundamentally different when they are investing and looking to get returns on their hard earned money. So I think we have to-- there are certainly some important parallels, and then there are some places where I think that the analogy doesn't work as well.

[00:15:28.56] Here's what I'll say. So I am a big fan, believe it or not, with that intro of crowdfunding. I think it's a very important-- it came in the Jobs Act in 2010. I was supportive of it then, and I was supportive of it when the commission first came out with the regulations in 2015.

[00:15:45.32] Why? Because it is one of the very few-- first of all, it capitalizes on the internet, which is just profoundly important and very difficult in many ways to do in other areas of finance. And then secondly, it really does help those micro businesses get started and helps people understand how can they possibly think about raising money. And there are very few other spaces where some of these really small operators can have a chance to raise money. So I think it's an important regulation.

[00:16:19.64] That said, it is a regime that allows what we call retail investors to invest. You were saying can't spend $1,000. Actually, you can. You can spend $1,000 on an investment through regulation crowdfunding and more depending on your income.

[00:16:38.39] So I think it's a profoundly important regulation, but I think you have to also think about Markets don't-- So there is no such thing, frankly, as an investment market that is completely free of that's just market-driven. If there are no rules, there's no market. There have to be rules.

[00:16:56.13] So the question is what rules? And how do you weigh them? And reasonable people can and do differ on how to strike the balance between how much regulation you need and how much investor protection you need. That's not easy.

[00:17:11.22] There is no one single answer to that question, but it's one that is constantly worth thinking about and engaging in and one that I spent many, many years thinking about as a commissioner at the SEC and before that as an enforcement lawyer when I see firsthand what happens to some of these investors who do get bamboozled out of their life savings literally at 80 years old and have to try to go find a job at Burger King. I've spoken to those people.

[00:17:36.57] And so I think it's important to keep both of those sides in mind. Every time you're adding something that is there to protect investors, there's a cost. But every time you take it away, there is also a cost that is less visible to many but very visible to folks like me who spent over a decade doing enforcement work.

[00:17:56.40] So all of that said, here's what I'll say. I think it's an extremely important regulation. I think it's something that the SEC should pay more attention to rather than less. They have not done a lot of data analysis in this space. That's why, and I should have led with this, I do just think Andrew's book is fabulous, and I highly, highly recommend it.

[00:18:17.97] It's an in-depth data analysis, in-depth ideas. And I agree, I really appreciate it when academics will just say, here's what I think should happen as opposed to oh, maybe on one hand this, on the other hand that. I think it's quite useful and quite helpful. So congratulations to you Andrew on that. And I think I'll stop there and just look forward to the discussion and any comments or questions. Thank you.

[00:18:46.37] Thank you. So I think you've heard two perspectives or at least two sets of ideas. And I they are both excellent. I think both Todd and Allison gave a very excellent exposition of what they think are critical issues with regard to crowdfunding or investing and more broadly.

[00:19:14.57] So I'll take a somewhat different slant, more of a finance investor slant. The issue is what kinds of crowdfunding funding efforts are likely to be more successful? And Jonny may actually have some real data or experience, but I'm relying on the data that we have so far analyzed.

[00:19:41.29] So what we see is that in those crowdfunding efforts where the founder or founders retain a larger fraction of the equity, they are more likely to succeed. Now, crowdfunding is not-- like I think as has already been highlighted, not the only way investors can invest.

Here, the dollar amounts are small, the overall dollars are small, but it's an interesting market.

[00:20:17.68] We then move on one step higher to the IPO market. If you want to understand which IPO will get valued more highly given the same-- if you look at two IPOs in the same industry with roughly, let's say, the same asset size, one IPO may have a much higher valuation than the other.

[00:20:40.60] And again, the reason is if the insiders, meaning the CEO of the company, the VC, if it's VC-backed, the directors and other large investors in the company, if they retain a larger proportion of the overall size of the equity of that IPO company, that IPO will have a higher valuation.

[00:21:06.58] We've shown that with US data. It also applies internationally and applies over time. So if any of you are fortunate enough to get close to an IPO, your company is getting closed and you're wondering what you can do, don't sell your equity. And recommend that to your other CEOs and board members also to not sell. Investors will value that more.

[00:21:31.90] Now let's go a level higher. Publicly held companies, very large publicly held companies, if you are looking for one variable that will explain how well a company is governed with respect to investor interest, that one variable is going to be the equity ownership of the median director or the average director's equity ownership.

[00:22:04.34] How invested are the directors of the company in the stock of their own company? If they have a higher level of equity ownership, those companies perform better over time. So that's the broad landscape to understand. It's the whole thing. If you have more skin in the game, you pay more attention, you pay more attention, usually good things happen.

[00:22:32.87] And nobody was expecting to hear about Silicon Valley Bank today, like crowdfunding, these are worlds apart but not really. So Silicon Valley Bank, of course, funded many, many startups and tech companies, so there's one connection. But what I wanted to highlight with this equity ownership and how it might help you predict which companies will do better is the same story with Silicon Valley Bank, First Republic, Signature.

[00:23:04.47] You hear a lot of media stories as to what went wrong, and some of that is superficial. These companies, the duration of their investments were misaligned with regard to their assets and liabilities. Essentially, they were getting overnight deposits, investing it in longer term treasury bonds, mortgage bonds. So they were misalignment. But that's superficial.

[00:23:26.46] Now, why did that happen? Look at what the CEO was doing for each of these companies three or four months before. They were selling tons of equity. They knew there was a problem with their banks. They were bringing down their equity ownership in their banks.

[00:23:45.79] Now, of course, everything they did, the CEOs are allowed legally to sell stock at certain time periods. But every time I see a CEO selling a large amount of stock, usually something bad happens. I've seen this movie before.

[00:24:02.33] Let's go back to 2008. Look at two or three years before that at all the CEOs of all the big banks that were too big to fail, same behavior. You find them selling-- back then, of course, those were CEOs of much bigger banks. They were selling equity on average worth $60 million each.

[00:24:20.81] Jesus.

[00:24:21.82] Here the equity amount got less, but you compare these three banks with other banks of similar size, they sold significantly more. So that's one thing that always predicts when you see a problem. We can talk more about-- I can talk some other aspects of equity crowdfunding, but I think Jonny may get you some more insights, better insights perhaps.

[00:24:48.89] I don't know about better but yeah, hello, everyone. Jonny Price here. I am from England originally as you can probably tell. These days I live in Nashville. We lived there a few years ago from San Francisco, where Wefunder is based and where I live for 10 years or so.

[00:25:05.75] I wanted to start by just talking a little bit about Wefunder's mission. So we're a public benefit corporation. You guys may know you can incorporate as a C corp, or an LLC, or an S corp, or a PBC. And a public benefit corporation is not obligated to maximize shareholder value like a C corp is, but it's obligated to uphold its charter. And if you get to wefunder.com/charter, you can read our PBC charter.

[00:25:31.19] For me, what our charter is all about is three things. The first is getting more capital flowing to startup founders. And our founders we funded back in 2012. They're actually pretty influential in getting the Jobs Act through congress, and we're in the Rose Garden with Obama, and he signed it into law then took a few years to be rolled out. And as we've heard and you guys probably know, May 2016 was when the Reg CF rules were rolled out.

[00:25:58.74] So since then, Wefunder has been the largest Reg CF platform in the country. But a big part-- I think our CEO Nick's probably the biggest driver of him of why he started Wefunder and what our PBC charter is about is getting more capital flowing to startups and entrepreneurs in America.

[00:26:16.85] And it's interesting that the context, the historical context of the Jobs Act is post-2008, the crash, the recovery was slow. We needed to get more capital flowing to entrepreneurs. And one way to do that was to unlock the power of unaccredited investors, retail investors to invest in entrepreneurs.

[00:26:33.56] So for us at Wefunder, we think entrepreneurs are cool. We think more people starting companies, being able to get the capital they need to launch grow companies is a good thing for the vibrancy of our economy and society and for the communities we live in. We do main street businesses, and we fund-- we do bars, and restaurants, and breweries, and distilleries like Oak & Eden as well as tech startups, and biotechs, and movies, and soccer teams. It's really cool the diversity of companies on there.

[00:27:04.10] But so getting more capital flow into founders is a huge part of why we exist as a company. And if you look at the trends around entrepreneurship in America, I think COVID has actually bucked these trends because maybe people are at home and decided to start businesses. I think for the first time in decades, there's been an uptick in entrepreneurial startup activity. But over decades it's been a big decline in the number of people starting companies in America.

[00:27:27.23] And so for us, what we're doing with Reg CF, and we fund our investment crowdfunding, is about trying to change those macro trends and not just the aggregate amount of capital flowing to startup founders. But also if you disaggregate, I think 1% of venture capital today in America goes to Black founders. I think 1%, similar percent, goes to Latino founders.

[00:27:49.67] I saw a stat that 2.2% of venture capital goes to female-only founder teams. You want to guess what that is for male-only founder teams? 80%. If you look at it geographically, I think 80% roughly of VC is concentrated in three states-- California, New York, and Massachusetts.

[00:28:08.82] And so a part of what we're trying to do as well is to say if all of the people deploying venture capital dollars are white men that look like me and Silicon Valley, then maybe that's part of the reason why-- not all of the reason, but maybe part of the reason why white men in Silicon Valley are getting a very high share of VC funding today.

[00:28:30.81] So if you can empower women of color in Nashville, or Colorado, or Columbus, Ohio or wherever to be angel investors, and it's not just VCs. If you look the profile of angel investors in countries like overwhelmingly men, overwhelmingly white and also similar geographic concentrations, it's really hard to raise capital if you're a woman of color in Louisville, Kentucky.

[00:28:55.44] And so we actually we have a partnership with a VC in Louisville. They're really excited about what we're doing. And if you look at the number of angel investors investing in startups in Louisville, they're really excited about Wefunder's model is massively increasing that number, which then hopefully can get more capital flowing to startup founders outside of those three states that I mentioned. So that's on the founder's side.

[00:29:18.81] And then on the investor side, as has already been discussed and really enjoyed the discussion actually, I look forward to diving into that more. But on the investor side, I joked about this in the intro that Rabea read, but why should only rich people get to invest in startups? There's very, very valid arguments on the consumer protection side the other side.

[00:29:43.27] I also love that the SEC has a limit on how much investors can invest. So any of you guys irrespective of income and wealth can invest $2,500 per year in startups through Wefunder or a Reg CF platform. And then depending on your income and wealth that goes up but it's capped. And I think that cap is a really good thing.

[00:30:04.19] But yeah, a lot of wealth creation over the last few decades has come from Uber's IPO or Google's IPO. And no retail investors, no middle class Americans got to participate in that, maybe indirectly because pension funds or LPs and VC firms. But for the most part, the people benefiting from that wealth explosive wealth creation are accredited investors.

[00:30:27.88] And I wonder if, to some small extent, if a lot of wealth creation, probably more wealth creation in the last two or three decades has come from companies in private pre-IPO in companies used to IPO earlier, so more of the wealth creation was post-IPO. So retail investors did get to participate. But if more of that wealth creation is coming pre-IPO, if the only people that can get to play in that are rich people, is that one small contributing factor to worsening inequality that we've seen in this country over the last few decades.

[00:31:03.71] So that's the second point around investor access and letting ordinary people invest in startups they love, founders they believe in. And then the third one is just around some of the stuff that Todd was talking about where they can eat. And actually we think it's cool, especially for consumer-facing businesses. And as Sanjai was mentioning, I think the best fit, the sweet spot for Reg CF and community rounds is consumer-facing companies.

[00:31:29.98] But for those consumer-facing companies, if you can turn your customers into owners and investors, then they'll become your brand ambassadors on a panel at a university law school in Boulder and tell all the audience to go and buy Oak & Eden Whiskey because it's a great brand. So literally, that was like beautiful poster child moment for the whole idea of what we're getting at here.

[00:31:53.74] So more people getting to participate, not just in the economic upside, but also just in the journey, like more people participate because angel investors investing in their community, not parking their money on Wall Street, not parking their money in Starbucks but investing in the local coffee shop. And we think that's a good thing on the investor side more people are participating in startup journeys and investing in their local communities. We think that's a good thing.

[00:32:21.32] So that's what our PBC mission is about. How am I doing on time?

[00:32:26.14] You've got two and 1/2 minutes.

[00:32:29.71] I was going to say something else, but I don't think I'll have time, maybe at the end. The last thing I'll abbreviate it. Looking forward, we're pretty excited about this way of raising money because if you look at the trends in a number of different industries, there's this word democratization, right?

[00:32:46.77] So Uber is the democratization of taxis, Twitter is the democratization of journalism, Airbnb is the democratization of hotels. And you see a lot of industries moving this direction with the internet. And it's pretty anachronistic to me that the way that technology startups raise capital today is one, you can only from rich people and two, only in private.

[00:33:12.03] And again, there's very good reasons for this. The consumer protection, it's really important to keep in mind. But it does seem anachronistic to me. It seems like a future where everyone can participate democratically, and we're using the internet to be able to share the investment opportunity widely. Just seems like a trend that we're on the right side.

[00:33:33.96] I tongue-in-cheek posted I think on LinkedIn a while back that venture capital investors gleefully disrupted the hotel industry. And some people said, Hilton said, well, not anyone can be a hotel owner. We have to be the hotel and no one's going to go and stay in an Airbnb. But the VC gleefully invested in Airbnb said, no, anyone can be a hotel owner.

[00:34:04.48] And then Uber came along and people said, oh, not anyone can be a taxi driver. You have to be a trained professional to be a taxi driver. And Uber came along and said, no, anyone can be-- and the VCs gleefully invested in Uber and said, no, anyone can be a taxi driver. And you can run it Robinhood in the public markets, right? VCs gleefully invested in Robinhood.

[00:34:25.33] When it comes to Wefunder now, sometimes there's skepticism from VCs like, only we can make these investments. But our perspective is no, let's open it up. Let's Let everyone invest in startups they love. And yeah, that's what we're about as a PBC.

[00:34:43.19] OK, thank you. Before we jump into questions, I also want to give my plug for the book. As someone who writes law review articles virtually for my living, I am sympathetic to those who might be wary of something written by a law professor.

[00:34:59.52] And I just wanted to say that it was with great joy when reading this book and also inspiration that the sheer accessibility of the way it is and the way in which it is laid out. And so for those of you that have said like, yeah, this seems interesting, but also I'm not sure I want to read a law review article. It's not a law review article of writing.

[00:35:18.48] It's very, very accessible, and it really lays out things in a way that I found even if someone knew nothing about this and obviously walking away from today, you'll know quite a bit and really, really builds the ideas in a lovely way. So I just want to put in my own pitch.

[00:35:32.70] Todd, I want to start us out with questions. So as you told us, you have recently become a crowdfunding investor. And I was hoping you could share a specific part of that experience, which is the book talks through this idea of private ordering, maybe not versus government regulation, but at least as an aspect of government regulation in terms of building trust and protection.

[00:35:54.13] And what we mean for those who did not read the book yet in terms of private ordering is the ways in which those on the internet get information and also send different signals as to the potential reliability of an investment. I personally was delighted at the idea that Google stalking-- I don't know if you're familiar but you could go on and try and find out as much that Google stalking could have a real upside and benefit to the world.

[00:36:18.08] So I was just hoping you might share your own experience as someone trying to make these determinations as to the impact of private ordering and government regulation on the decision making where you're at.

[00:36:29.94] Yeah, well, the first thing which is one of the things I've thought about and Jonny mentioned Louisville, people in Louisville. The first thing I thought when I was reading the book is like, oh, I've heard of crowdfunding before. That's what they did with Muhammad Ali, right?

[00:36:43.76] Those businessmen in Louisville got together and basically did crowdfunding of Muhammad Ali's career. But they just happened to be a bunch of local businessmen. This is just Muhammad Ali writ large, right?

[00:36:53.24] I don't know if you know the history yet. It's like, Muhammad Ali after the Olympics didn't have any money. And so businessmen got together and pooled their money so he could train and get a trainer and all this sort of stuff. And then they got a share of his earnings.

[00:37:04.85] But yeah, so it was a funny story, which is I was reading the book, and I was a couple chapters in. And I thought to myself, well, I just had to see what this thing is, right? And so what ended up happening was in doing it, as I was reading the book, and what I discovered as I got deeper into the book was everything that then Andrew diagnoses is the things that work for me is actually what worked for me, right?

[00:37:29.09] So I go in there and what you see is it's a product I like, right? I understood the logic. I like whisky, right? It seemed like fun.

[00:37:39.91] There was a lead investor who right up front said he had previously invested, I don't know, $300,000 or something. And he was investing like $75,000 or something in this round. And then his mom and dad chimed in and said where his mom and dad and they really believe in this, right? And so we're investing, right?

[00:37:56.61] So it's the lead investor that he talks about. They had a slide deck that explained it. They showed everything that they were doing. And it was just one of these things, it's like, I get it, right?

[00:38:05.94] They had a storefront down in Fort Worth. Here's their plans to expand. They said that makes sense. People will like that, right? I would go to that kind of thing. I know there's a market for this sort of stuff.

[00:38:16.54] So it's one of these things where it just made sense to me. Interestingly enough while I was goofing around, I thought, well, it'd be fun to own a part of a soccer team, right? So I looked around and I came across frankly, a pretty amateurish presentation for a soccer team that seemed a little bit dicey. And I was like, I'll wait before I invest in the soccer team.

[00:38:40.27] But these guys had their act together, right? And it just gave me confidence, and there were a lot of people. There was the lead investor, there was the website. I interacted with them on Facebook, right?

[00:38:54.36] It's one of these things where it's like, this gives me confidence, and it's a product that'll be fun. And it's one of these things that I'll be both the consumer and the investor kind of thing. But you have to use some judgment, right? But it felt very easy to me so.

[00:39:16.11] OK, thank you. Allison, the next question is for you, which is you talked about the importance of some of these regulations. And I was just curious, and you talked a little bit about which regulations you think are the most important. I was curious if you have any perspective or opinion on what direction you would like to see regulations take in the future.

[00:39:34.50] Sure. Specifically with respect to Reg CF, which again, the commission voted on that initially in 2015. I think it didn't become effective until 2016. And then there was a revisit of that in 2020, where they made some additional changes raised the ceiling on how much issuers can raise in a year and a few other of those things.

[00:39:57.79] There were some missed opportunities, I thought, at that time. And a couple of them were the commission did not at that time do a deep dive on the data that was out there. They didn't scrape data from crowdfunding portals like Wefunder, which is just a wealth of, I'm sure, great information. I too went on to Wefunder and signed up. I haven't invested yet, but I probably will.

[00:40:20.26] We'll work on that.

[00:40:20.98] Yeah, no, no, it's only because I didn't have time to go through. It was a really great experience, and I'm sure I will invest something there. But what we didn't do at the commission in 2020 when we made changes was really, in my view, a thorough enough economic analysis to understand how well the system is working.

[00:40:43.13] But we don't-- it's not as though we have an abundance of evidence to suggest that it's not, but we do have. And Andrew, I noticed in your book you pointed out that there was only one SEC enforcement case thus far, which I think was in 2021 when I was still on the commission. And I remember noticing it as well because it was unusual.

[00:41:06.91] I don't think it's because of full compliance by everyone in that space. I think it's more because the staff, these are very small in general very small cases, and the staff has to triage its time. And so they have not focused as perhaps they might in other spaces where the losses are a little higher.

[00:41:27.97] Now, let me back up and say, what do I think should happen in the space? I think it's in a pretty good place. I do think we should have done a better analysis at the time of the changes in the rules. And I take great comfort from the investment cap.

[00:41:45.01] To me, that was almost all I need to know. I'm like, that's fine. Let's experiment, let's see what happens. And for the most part, what we know is that retail investors, their losses will be limited.

[00:41:59.02] The problem too, though, is it's not just their losses that are limited. Oftentimes, it's their upside as well. That is a place where I think we should have looked. And that's the one area that I think deserves some more attention. The problem is you don't get the regulatory gears in action over one little issue.

[00:42:17.20] There needs to be-- I think maybe the smarter thing to do would be to wait a few years, really gather some data and figure out whether some additional changes need to be made. But one thing I think we should have looked at the time in 2020 was these safe, simple agreement for future equity. And I don't know if you all are familiar with this in general, but it's a form and it sounds like perhaps that's what you might have invested in.

[00:42:42.22] And I'm not saying it's bad. I'm saying it's complicated, and not everyone understands it. And what can happen there, of course, is that-- and it's a very common feature of some of these crowdfunding offerings. And it can prevent-- so when you say like, oh, Uber, everyone made all their money before the IPO, and if only they could have gotten in earlier and held on, that's not the way these cap tables actually work, right? They don't.

[00:43:14.69] You will get taken out. You will get diluted into non-existence practically or taken out before those huge returns are-- in general, that's almost always what happens and the safe actually facilitates that. So I think we should have looked at whether to preclude those or maybe put some additional guardrails around it, something to make sure people understand when they're buying in to an investment, they're not actually getting equity in that moment. They're not shareholders. They don't have a vote.

[00:43:45.13] And so that piece I think is one piece where we should look at it. But I'd also like to see the commission do a deeper dive to understand maybe some of the regulations could and should be loosened, maybe some should be strengthened. We haven't done the kind of data analysis that I think would warrant that type of work.

[00:44:02.92] Can I just chime in?

[00:44:04.14] Sure.

[00:44:04.84] I agree with that. That's what I found to be the most complicated or difficult part of figuring out what I was doing, which is how does the back end on this work? It's still pretty opaque to me.

[00:44:18.34] Can I come back on that actually? So on the safe, the safe doesn't actually preclude you from-- you can't get pulled out in future rounds. The safe is a good example for me of a really interesting trade-off I think that I wanted to actually get your take on, Allison around investor protection versus the more regulations or burdens that you put in, burdensome regulations.

[00:44:51.46] It can lead to a problem of maybe adverse selection, you might say. A safe is a really good example, partly the reason I came back because we lobbied the SEC. Our CEO wrote a letter to say, please don't take away the safe.

[00:45:05.15] I read your letter.

[00:45:05.80] Yeah, so Nick, I see you read the letter. I think our competitors were pushing for a safe to be not allowed with Reg CF. Every company coming out of Y Combinator, which is the best accelerator in the world-- apologies to Bradfield if he's in the audience, but YC, a great accelerator. Everyone's coming out of YC and raising on safe.

[00:45:29.69] And so our CEO's and I think our position with the safe is if you ban the safe for Reg CF, every company coming out of YC you're precluding them from going on Wefunder if that's the instrument that they're raising. And this is-- VCs are investing in safe, angels are investing in safe. This is the go-to industry standard for seed rounds, early stage rounds before a VC comes in and runs a price round and sets a price. And it's very quick, cheap legal document, saves the founder a ton of money on legal fees.

[00:46:00.44] So the trade-off I think is a really good one, right? It's like, do the retail investors really understand that this safe doesn't convert to equity unless there's an exit or a follow on financing rounds? And yes, they're not getting equity, but it's de facto equity. Like when a VC invests in a safe, it's like they're seeing it as an equity investment. So there is that kind of investor protection concern but against the adverse selection thing of if you ban a safe, then all these really awesome companies, the best startup companies might then not want to open up a community round.

[00:46:34.40] And the other example I think of with this is carried interest. And so I believe that the reason why lead investors-- Todd, you mentioned the lead investor in the Oak & Eden deal. I really love this product feature that we came up with at Wefunder where every deal now on Wefunder requires a lead investor who's investing a meaningful amount of money, typically 5% or more of the round, and the amount they're investing is public, like you saw $75k this round, $300k previously.

[00:47:00.29] And I love this because one thing we've learned over the years at Wefunder, you can't only rely on the wisdom of the crowd. That needs to be complemented with the wisdom of experts because if everyone is doing five minutes of due diligence, no one's kicking the tires. And so having a lead investor who's really going deep and investing a large sum of money and is an expert and helping to set the terms of the investment, they complement each other really well.

[00:47:26.96] But we would love for lead investors in Reg CF deals to be able to earn carried interest on the full amount. This is how it works on angel lists. If you run an angel syndicate in Reg D, the syndicate lead can basically earn, I think usually 10% of investor profits.

[00:47:46.05] So if the investors invest $1 million in the syndicate and the company 10x's, so everyone makes $10 million of profit, the lead investor for bringing that deal on to angel list and giving the investors this investment opportunity can get 10% of that $10 million, $1 million of carried interest upside.

[00:48:03.06] And I think the SEC rationale, which is, again, very fair investor protection, not wanting to tax retail investors with this kind of rather complex carried interest that then if the exit comes down the line, like, oh, there's a tax on my profits, what is this carry interest thing? I think it was motivated by investor protection.

[00:48:25.58] But our position is if lead investors could earn carried interest, then rather than right now, lead investors are really economically incentivized to put those deals up on Reg D, where only accredited investors can participate like on a platform like angel list. If the lead investors get on carried interest, they would be much, much more economically incentivized to bring these awesome, high quality deals to a platform like Wefunder.

[00:48:49.49] And so the quality of the deals on the site then boom. And so there's a real interesting tension between protecting investors versus adverse selection or attracting quality deals. And the other example there is the financial reporting requirements, which I actually am a fan of, right?

[00:49:07.82] So if you raise more than $124k, you need a CPA review of two years of GAAP financials. If you raise more than $1.235 million, you need a CPA audit of two years of financials. And again, it's great because retail investors, they can see this information. It's been signed off on by CPA. So you know these financials are real and you can't have the wool pulled over your eyes by a nefarious entrepreneur raising capital.

[00:49:33.85] But again, the biggest impediment right now to world-class venture-backed founders that don't need the money, they have people throwing money at them, the biggest reason they don't do Reg CF is because they need to publicly share financials. And if you raise through Reg D and accredited investors only, you don't need to show your financials.

[00:49:51.34] And so again, I'm not advocating for the removal of those requirements, but I think it's just a really interesting trade-off between investor protection and founder have that selection.

[00:50:01.40] I do. I'll tell you, though, I think some of the concepts in the VC and angel investing space don't translate as well to retail investors. So lead investor is another good example of that. These are not really fiduciaries. They're not people whose job is to look out for the other people who come into that deal.

[00:50:19.70] And the same thing with safes. Of course, it's true that that's a vehicle that works quite well in Silicon Valley. It doesn't translate as directly to retail investors. And let me just say when we say retail investors, we're talking about a defined term. I'm not. That's not a term of art. But that's usually the term people use. But what they mean is non-accredited investors.

[00:50:42.98] And non-accredited investors, this notion that if you're accredited, it's only rich people that are accredited. That's actually not right. You know that, right? Because you can be-- so $200,000 in income, that's a sizable chunk. But the other way to get in is $1 million net--

[00:51:01.84] Household wealth.

[00:51:02.78] Equity, yeah. And people who have spent their entire life saving have those. That's a very common amount. You could be a postal worker and have spent your entire life putting your money away. So I just don't think those concepts translate as cleanly.

[00:51:18.11] I take the point that if they were to prohibit safes, you might see some change. I don't think you're saying we therefore ban anyone from coming out of that. They will have to make their own decision, do I want retail investors or not, right? It's not as though it operates as a direct ban.

[00:51:36.50] But I just think it's important to think about some of the Silicon Valley concepts that work quite well for the sophisticated folks in venture capital and even angel investors who can also be quite sophisticated as you know don't necessarily translate as well to everyday retail non-accredited investors.

[00:51:56.90] And I had to spend, myself, I've been a securities lawyer for 25-plus years just trying to understand what a safe was and reading through one of those contracts. It took me a week to really understand, OK, I think I know what's happening here now. I think--

[00:52:15.95] A safe is three pages, right? And a typical price round contract is about 60 pages.

[00:52:20.77] A typical what?

[00:52:21.99] A typical equity price round contract is 60 pages. So it sounds the legal contract that the investors signing a safe is a lot shorter.

[00:52:29.84] I want to ask a follow-up question which I think is related, which is-- and I don't know that any of you will have the answer to this. But one of the curiosities I had when reading the book and also listening to the conversation is how much is investment crowdfunding an emotionally related decision?

[00:52:45.21] So is it emotionally related decision and that the emotional feedback is actually what you're getting out of it? And so far as there's this idea that you could have the dream of, I don't know, becoming a billionaire, right, or extremely wealthy in the United States.

I think there's been a lot of conversation in the larger political and social sphere around this shift of the American dream to maybe just the dream of being ultra wealthy.

[00:53:08.36] And so how much is investment crowdfunding just allowing investors to have this emotional fulfillment of the possibility of this dream versus is it actually being a sincere investment, something that investors can expect to get a significant ROI on? And I was wondering if anybody knows in aggregate how it compares to, say, just going to the stock market and investing in stocks.

[00:53:33.86] Can I ask, and maybe this is a question for Jonny versus versus-versus. When I look at the website, what I see is a lot of people basically giving money to things and they don't care whether they make money, right, with like a lot of these environmental products.

[00:53:48.65] Like there's this one that I'm not going to invest in, where you can compost your body when you die, right?

[00:53:56.48] Is that [INAUDIBLE] burial?

[00:53:58.13] I don't know what it's called, but they're raising a lot of money for it, right? And when you look at all the comments on the board, it's basically, these people who are giving money, they start giving it because they think they're going to like-- it's going to be part of their estate when they die, put it another way. But a lot of these things just seem to be not emotional, but they don't-- but they're not really doing it to make money. It's a way of essentially giving charity. Do you know how many people are animated by that?

[00:54:27.55] Yeah.

[00:54:28.90] Please, Sanjai.

[00:54:29.86] Yeah, so I'll give a more, what I'd say, broader perspective on this and your question. So in finance investments we talk about individuals making two types of decisions, investment decisions as in investing in fixed income, treasuries, stock market, real estate so the investment efficiency.

[00:54:54.49] Then they have what they call consumption decisions. So somebody wants to go to Las Vegas, somebody wants to go watch a Bronco game or maybe not. Somebody wants to fund some charitable cause or a nonprofit cause that they feel strongly about with no expectation of any financial return.

[00:55:17.81] So finance really is about investment decisions. And crowdfunding the financial aspect of it is about investment decisions. And it is fine for individuals to engage in consumption, like I think you heard that people feel good about looking at various kinds of investment opportunities. It's exciting know, it's a small amount of money.

[00:55:43.65] That's all good. But that's not what serious investment is really about, and that's what the commissioner guess was referring to that we have to not let people lose too much of their real investment wealth. So you have to-- if you're looking at some crowdfunding opportunities in Jonny's website or other websites and they look fun and interesting, that's fine. That's a consumption opportunity.

[00:56:14.37] Somebody wants to go skiing here-- well, maybe it's too early to go skiing, maybe not too early if you go to a basin. But somebody wants to go there. The decision about what you like to do for fun, that's fine. But finance had nothing really to say about that. What we have to say is how do you make your investment decision?

[00:56:37.44] And on that note, there was earlier talks about people missing out on big opportunities, and we should get the common man to share in these upsides, and it all sounds good. And we normally think about, say, the IPO of Google or Microsoft did the IPO way back when and some of these more recent IPOs. These IPOs have gone up in value so much, thousands of times.

[00:57:05.25] And if only the common person could have gotten into the IPO early on and now the earlier version of IPO may be crowdfunding earlier on, we could have more less inequality. And I'll get to what can really solve inequality or the evidentials can.

[00:57:23.76] So if you're looking at investors out there, they have many choices of where to invest. They can invest in fixed income treasuries, mortgage bonds. They can invest in real estate directly. They can invest in corporate bonds. They can invest in corporate stocks, IPO, like a whole gamut of investments.

[00:57:47.65] Now, it has to be the case that if they looked at all this across many investors and over many years, the risk adjusted return from all of these investments have to be the same. So the only way you'll get those really high returns or high expected returns is if you're willing to bear an exceptionally high amount of risk.

[00:58:12.53] And there's a lot of evidence in finance to back up what I'm saying, and I won't get into the details of that. Maybe my friend can educate you more out there, Doug. He also does this for a living.

[00:58:26.54] So you have to look at what I'd say the vast amount of data out there in finance that really the only way to get higher return on average is if you're willing to bear more risk. So crowdfunding one, may not be quite investments that we think of it. It's more consumption, and that's fine. No problem with that, but that's how you should treat that.

[00:58:50.91] Now, the other-- I'll just take two minutes because this issue has come up directly and indirectly about income inequality. It's a serious issue, but it's not going to get solved by some making crowdfunding easier for investors or I think it sounds good.

[00:59:10.58] The only things that have solved, at least according to the economic evidence on income inequality, so we looked at 200 of the largest US cities. We got measures of rule of law in a law school. It's good to talk about rule of law though I teach in the business school.

[00:59:28.91] So cities that have better rule of law have more job growth two, three, four years later. Cities that have better rule of law have less income inequality two, three, four years later. So that's what the evidence suggests. It's not very flashy. It's not very-- something you can really-- the media wants to talk about too much. It's focused on things that we know matter.

[00:59:59.33] Now, this is obviously data on 200 US cities. We also looked at the 100--

[01:00:06.43] Sanjai, I'm going to pause you quickly just for timing purposes. I'm supposed to have opened it up to the audience. So I want to open it up to the audience for questions now. I think we have a microphone going around. And I want to give the prerogative first to a student. So do I have any students?

[01:00:20.60] Can I say one more thing very quickly?

[01:00:22.79] Maybe I can see get hands going first.

[01:00:24.71] I've loved this panel. This discussion has been so good, and I really-- you've done an awesome job moderating it. And I've really appreciated the discussion because it's actually brilliant for everyone of you guys to know because there's real debate, and tension, and discussion here. And I've actually-- I really like-- I think there's kind of good arguments on both sides. And so thanks. Sorry for being a little combative maybe, but it's much more fun

[01:00:55.85] You're in a law school. That's the name of the game.

[01:00:57.23] Yeah, I'm probably used to this. As an Englishman, I feel, kind of, uncomfortable in this debate here.

[01:01:04.97] You just have to spend more time in office.

[01:01:06.29] Yeah, I hope to continue the discussion.

[01:01:08.21] Sure. All right, we'll give you the first question.

[01:01:10.04] Great. Thank you, all. Based on one of the comments from Professor Cable this morning and then lots of elements of the panel tonight, it seems like just funds in general have a solution to a lot of what's talking about, the diligence challenges, the documentation challenges, the portfolio challenges are in creating portfolios.

[01:01:33.27] And as retail investors, choosing individual stocks, individual businesses, especially individual early stage startups seems like a bad approach despite the five minutes of diligence that you can do or hours spent watching videos or whatever. I just wonder if equity crowdfunding has thought about creating, whether it's a portfolio approach where you can invest into a wide swath of these opportunities, and whether that's something that from the regulatory standpoint has been discussed, and whether you think that's a good idea or not.

[01:02:12.87] Like a crowdfunding mutual fund.

[01:02:14.92] Yeah.

[01:02:15.19] Yeah, that's a great question. Regulation crowdfunding doesn't allow for that. So you have to invest in individual deals and pick investments one by one. You should google Sweater VC. So they're doing some interesting things around trying to create a VC, and it's kind of complex from a regulatory perspective. But really love the idea of retail investors being able to invest as LPs and VC funds and invest in index and a portfolio as well as individual.

[01:02:46.83] And yeah, the analogy for me is like Wefunder, our tagline is literally angel investing for everyone. So we think angel investing is cool. And some of it is obviously, to be what Todd did, which is like browse through the companies, choose one you like and invest.

[01:03:02.23] But it might also be that your friends that you've known for 10 years that you would really, really believe in, and he's starting a company, and you know that this guy would run through walls, and you really, really believe in him. You know the passion he has for this company that he's been thinking about for years and he's finally taking a run at it, that might be the investment.

[01:03:23.49] And actually, the vast majority of investment volume on Wefunder is coming from people that have found the company brings either people in their first degree network, personal connections, or customers of the business. Actually, a pretty small percentage is people like Todd that find the company on Wefunder and then invest through the platform.

[01:03:43.71] So it may be years and years of due diligence from personal relationships. It's not always the five minutes that you mentioned. But yeah, the analogy for me is like Reg CF is angel investing. But there is some cool stuff going on with retail investors, unaccredited investors in VC funding.

[01:04:02.40] How much do you guys vet the companies before you list them? Is it a purely process or do you look--

[01:04:07.85] Very little.

[01:04:08.68] OK.

[01:04:09.01] Very little. So our philosophy is we're pretty open platform. And so there's a lot of required checks that we go through from fraud and compliance perspective. But in terms of is this a good investment opportunity? And this is actually like the biggest--

[01:04:28.63] Numeric review.

[01:04:29.98] Exactly. And this is the biggest kind of question for me. And I've argued with a couple of lawyers in the space because they will be looking at this issue I didn't file the annual report. And the technical compliance with the laws for me is actually not the biggest kind of concern.

[01:04:48.85] And you were leading to this, Allison. The biggest concern here is like investor returns, and is this a good investment? Does this valuation makes sense? And that for me is a bigger concern more so than technically have they checked the compliance boxes?

[01:05:05.77] I saw a hand over here.

[01:05:06.94] Can I just-- I want to say one thing about the funding. First of all, compliance is a really good red flag for actual bad returns.

[01:05:16.21] We have to do that.

[01:05:17.41] Yeah, so it is important. But I want to just say one thing about the fund, the question about whether there should be funds in the space. And this goes back to my concern about data and not knowing. We don't even know what the average return. So what you would want to be capturing is some sort of index across crowdfunding. And we don't even know what those-- we don't even know if we want that or not because we don't know what those returns are.

[01:05:41.86] In the stock market you can buy an index fund. You can look at decades of history, and you can say to yourself, this is pretty much what I can expect over the next 6, 10, 15, 20 years. You can't do that. Doesn't mean you shouldn't, but I am saying hard to answer that question without knowing what the average returns are.

[01:05:58.03] And then to Sanjai's point, the only way to-- in general, just market forces. The only way to increase those returns is to increase the risk, period.

[01:06:09.07] Just to touch on-- to distinguish, I think this is an important point. So I think you're talking there about an index fund in Reg CF. That's actually not what I was referring to. I was referring to a VC fund that has unaccredited investors as LPs, where the VC would be choosing who to invest in.

[01:06:28.98] so like a hedge fund for--

[01:06:30.68] I want to make sure that we get our audience questions. Yeah.

[01:06:33.97] Two comments, Mr. Price, as an investor over 40 years, it's the rider not the horse. I agree with you. Secondly, I think that David Hume confronted some of this when he suggested, and I paraphrase, in the 18th century. There is no rational action without prior emotional involvement, emotion and human activity. And your professor of finance will bear this out. Always, always rational action, always follows emotional engagement.

[01:07:08.89] And then did I see a hand here for a question? Yes, please.

[01:07:13.46] So I'm here thinking, should I crowd fund? Oh, so happy to be here. I think this is absolutely fascinating. So I have two questions, and I don't know if there's data for the first.

[01:07:27.73] But I've known that historically female founders are more successful than male founders. And I saw that in the UK, at least you guys have more data on this crowdfunding arena. I wonder if businesses that are crowd funded are, if there's any data around them, being more successful than traditionally backed VC businesses.

[01:07:46.09] And then my other question is, does places like yours work with potential people wanting to be put on the platform and say, hey, you're a good fit. Is there any data around the areas where you think that-- you said the democratization of things. Is it like products that are tangible, crazy ideas, soccer teams. Is there any data that would suggest like these types of things are much more successful on this platform than others?

[01:08:16.50] Yeah, so on the first question, if you get a wefunder.com/PBC, we have some stats, and actually, Andrew references in the book. But there's some encouraging data that some of the stats I gave earlier percentage of dollars going to Black founders, female founders, states outside of California, New York, Massachusetts, like a higher on our platform. I don't know about other platforms.

[01:08:41.89] It's not 50% of dollars on Wefunder going to female founders. Oh, yeah, sorry. From memory, it's 20%. So if the current status quo is maybe 2%, we're at 20%. And it's actually the same on the investor side.

[01:08:58.96] So I googled gender breakdown of angel investors, and I found 85% of angel investors were men. On Wefunder, a high 60% of our investors are men. So it still skews towards men but certainly much more balanced than conventional angel investing.

[01:09:18.13] On the second question, the simplest answer I could wax lyrical for hours about this. But in terms of which founders are the best fit, which companies are the best fit, the simplest answer, consumer-facing. One, because your customers then are potential investors. So you can go to your customers invest.

[01:09:35.77] And then secondly, Oak & Eden probably gets more value from Todd being the brand ambassador on this panel than an enterprise SaaS company. So B2C companies get a little more value from recruiting an army of brand ambassadors. But we've done many B2B companies, biotech companies, all industry sectors, but in a one sentence answer, consumer-facing.

[01:09:58.82] Thank you. Brad, I think I saw your hand.

[01:10:00.76] Yeah. Thanks. So there's one of my favorite lines of a friend of Silicon Flatirons was he said, I don't always understand what's being said on those panels, but I always understand a good fight. So no need to be apologetic. That made for a terrific conversation.

[01:10:21.90] So I've got three comments/questions. I welcome reaction if any of these things catch your attention. The first is-- one is to the point about the difficulty of tracking outcomes in crowdfunding. I just note that comparatively, angel investing is notoriously difficult to get accurate data about returns of this asset sector. And yeah, there's guesstimation but it's really hard.

[01:10:47.07] And it occurs to me that while there's conflict of interest challenges with, say, Wefunder or a platform taking an investment in this, it might be a way to representatively track outcomes over time in a pretty interesting way. Second is that traditionally, the outside investment, whether it's an angel or a venture capitalist bundles expertise with the capital.

[01:11:14.20] And I think an interesting trend in the world of entrepreneurship really over the last 10 to 15 years has been the rise of networks that help that unbundling to a certain extent. So whether it's accelerators, which yes, take some investment but at least allow for a lot of outside expertise, formalized mentorship programs, whether it's as part of a university or a community. How does that inform your thoughts about the possibilities around crowdfunding and the possible unbundling of the expertise from the capital?

[01:11:49.75] And then the last piece is-- and I'll come back to your point about a safe being like a three-page agreement. Startup investment contracts are really pretty thin little documents from a legal perspective that tend to be augmented by all sorts of reputational and social norms. And that tends to work really well in some communities, especially something like Boulder, where if an entrepreneur acts opportunistically and badly, that gets around.

[01:12:16.36] The same thing in terms of an investor. If she acts that badly, that gets around too. What are you seeing in terms of reputational work in the crowdfunding world?

[01:12:29.80] Yeah, I can maybe speak. I think my answer to your second and third points are maybe similar. One thing I will highlight is that it's usually not an either/or thing. And we are really, really pushing it hard for it not to be an either/or thing. By either I mean, accredited and institutional investors or unaccredited investors.

[01:12:57.27] So I think there can be a misconception like, oh, I'm not going to go the institutional route. I'm going to go the crab route instead. Some of the best companies on Wefunder are actually like Oak & Eden that Todd invested in. Substack is an example, Mercury Bank is an example, REPL is an example. Mercury is a $120 million series B from VCs and then opened up $5 million to let their customers invest. And that's awesome to have both, right, both the VCs and the customers and community and non-accredited investors.

[01:13:29.36] And to your second point on the value add, right? Yeah, I don't think that-- I mean, you may. A founder can send an update to their Wefunder investors and say, hey, does anyone have any ideas about this or we would love some product feedback if you guys are into this product. So there can be some advice.

[01:13:50.27] But at the end of the day, average investment on Wefunder is $1,000, median is $250. So if someone's investing $250, they just don't have the time. They're not going to take a board seat, right?

[01:14:03.03] So for me, if a VC invests, yeah, maybe they've trodden the path before, they have some great advice, they take a board seat. They invest their time in giving that advice. That's less of the value prop of community round funding, Reg CF funding. The value prop for me for the founder like for Oak & Eden is you recruit an army of brand ambassadors and thousands of loyal customers.

[01:14:26.94] I'm going to pause you because we've run out of time. I want to make sure, Todd--

[01:14:29.40] Yeah, just 30 seconds. One thing I thought was interesting is a lot of these, I just know the consumer-facing ones, they have these perks that you can get. And almost always one of the perks if you invest enough is you get to have dinner with the founders or dinner with the management, right, which is interesting.

[01:14:45.34] I think it was out of my price range, like $25,000 or something for Oak & Eden, but you get to go there and have dinner with these guys, right. So there's a sense that I think they're obviously tapping into some sort of reputational aspect of it.

[01:14:57.82] The second thing I would just say is the last thought, which we've talked a lot about the returns. And I understand this is about investment. I do want to make the point that my perception is that people are not investing in a lot of these companies purely for the economic returns, right? People invest in the New York Stock Exchange for the economic returns.

[01:15:16.11] A lot of these companies, I get the sense people are investing because they think they're doing good, and they're not investing purely for the economic returns. And in some sense, they don't really care how much money they make off it. So as our empiricists are going forward, and I'm not an empiricist, the empiricists are going forward, I would just ask that people keep that in mind, which is I don't think the financial returns measures everything that these guys are doing as a public benefit corporation, for example.

[01:15:45.39] They're meeting a need for people that isn't quite consumption. It's not quite investment. It's backing a project that they think is good for the world in a different way from just making a charitable contribution. And the financial return on that I think doesn't measure everything. That's my sense.

[01:16:01.52] Thank you. Well, we are at time. I had hoped we could jump into more about the future of investment crowdfunding. I personally am hoping there will be an entertainment value. I hope we can see one day to have Shark Tank crowdfunding edition. Well, we'll see what happens. But y'all can give a quick round of applause, please, for this fabulous book and this fabulous panel.

[01:16:19.14] [APPLAUSE]

Closing Remarks and Q&A

https://youtu.be/odRrNQyM478

[00:00:00.00] [APPLAUSE]

[00:00:04.91] [SIDE CONVERSATION]

[00:00:24.90] Well, thank you, everybody, and thank you to our-- excuse me, thank you to our last panel. This has been an absolutely incredible day. As somebody that is thought so carefully about these issues and researched them for so long by myself, it's really a lot of fun to have other people give me some feedback and get these different perspectives.

[00:00:50.04] And I think that throughout the course of the day, we really have had a whole variety of perspectives, and I really appreciate the good humor and the collegiality that we've had all day even when on substantive matters, I think there's some significant disagreement.

[00:01:07.85] So with the last maybe just about 15 minutes here before Brad concludes for us, I thought let me just make a couple of comments about what I've heard today, and then open it up for comments or questions from the audience and I'll see what I can do to answer those of what you're still interested in learning more about. So just a couple of comments in response to what we've heard today from our panelists.

[00:01:37.64] I think what maybe most overarching comment is, there's been a lot of consistency, I think. I think a lot of the things that one panelist said is backed up by another panelist and by theoretical ideas and by data and by experience. And so I think that we are circling towards what's really going on out there and what is effective.

[00:02:03.15] One question that-- a suite of questions have been asked and raised about, what are the financial returns in this field? And Eve was asking earlier in the day, are there super users or who's investing in these sorts of things? And as we've said, I mean, when you have the New York Stock Exchange with an active trading, you could figure out what companies are worth on any given day.

[00:02:34.33] But these sorts of companies, investment crowdfunding and private companies, are not traded on a daily basis. There's no secondary market. So it's incredibly difficult to figure out what returns you've generated over time, and it'll just take years and years to really get a sense of that. But I do think that it might be the case that investment crowdfunding-- where does it play a role in the real financial planning of an individual?

[00:03:13.56] I think that really, as the industry gets a little bit more mature and we get higher quality companies listing, I think that over time, this could be like the Holy Grail for investing a noncorrelated asset class where you can invest in the stock market, you can invest in bonds, you can invest in foreign stocks, or small stocks, or value.

[00:03:36.57] And what are the main things as a theoretical matter people are trying to do is to invest in noncorrelated assets. They don't want everything to go up at the same time or down at the same time. And I think that with the really long time that it takes to generate the returns in these sorts of businesses-- and they're very different than public companies, I think that this might be actually useful as a financial matter as a small component of a retirement plan as a noncorrelated asset.

[00:04:09.81] There was a point-- Allison made the point that the lead investors who were saying I invested this much and I'm really behind this, that these lead investors are not a fiduciary of the crowd that's maybe relying on them, and that's true. That is true. But I do think that the term reputation has been brought up a couple of times today, and I talk a lot about it in the book.

[00:04:34.32] The online reputation or the maybe global reputation of the lead investor who's putting their name out there and saying, this is something I really believe in, they're not a fiduciary, but there's a tremendous pressure to be honest and forthright in that. Because if you're not, it could really come back to haunt you.

[00:04:55.30] And as we've seen maybe to a greater degree than we wish we could, the internet never forgets and can be very harsh on people who have said something that turns out to not be true or something like that. So with those comments, let me, if can-- we still have the microphones out there. Let me see if there are some questions still remaining here at the end of the day that I can try to address and talk about some of the things that are still interesting to you all. Please.

[00:05:33.53] So I appreciate the comments on the investor side. Now, I'm with you. I'm a founder and CEO considering whether to do crowdfunding. And I'm here trying to-- trying to evaluate what are the considerations that I need to take into account when deciding to crowdfund? And what are the costs associated with crowdfunding?

[00:05:59.32] What are the-- I'm trying to create these criteria for pros and cons, and not just in the vacuum of I am just going to crowdfund or I'm only going to go for VC or only go for nondilutive funding. But when creating my funding strategy, how do I incorporate crowdfunding into that?

[00:06:18.45] So if you can talk about it, or maybe Johnny can talk about it, or Sanjay, you can talk about it. And I think one of the things that I learned today that I hadn't really thought about was the tax consideration. How can we think about those things when we are putting together that strategy, that funding strategy?

[00:06:42.35] Yeah. OK. It's a good question. I think the costs are coming down every year. There's an industry that's developing of the platforms that are getting better at guiding the entrepreneurs through things. There are specialized lawyers and consultants that are getting very good at efficiently filing the form C that has to be filed and other items like that.

[00:07:14.55] And so I think that it's becoming increasingly efficient, but I also think-- and Johnny said this and I think you were hinting at this as well, that it's definitely not an either/or proposition. And that far and away, the most successful model that I've seen around the world is really cooperative between the VCs and angel investors on the one hand, and the crowdfunding on the other.

[00:07:39.72] And it really is just super synergistic in that the entrepreneur can get money from the venture capitalist and advice, can get money from the crowd and brand ambassadors and a marketing boost, and the VC also can get a whole lot more capital from the crowd to a portfolio company that it wants to support, and the crowd can get the comfort that there's a VC that is look carefully at this.

[00:08:12.03] And so really, the most effective way going forward for all concerned I think is really-- and this is really what's going on in the UK, especially, is the VCs and the angels and the crowd are all working together and finding opportunities that they find interesting.

[00:08:32.24] Can I add to that? I think your question, if I interpreted that, it depends on the kind of business you're running and what your product is. If your product is likely to appeal to many consumers out there and you're trying to find out if they like what you have, whether it's a piece of art or some music or some consumer like whiskey thing, that's appropriate for crowdfunding.

[00:08:58.82] On the other hand, if you are writing or if you're developing, say, an inventory management software, that doesn't sound like a crowdfunding opportunity. I mean, how many people would-- maybe like a half a dozen people in the world of big companies might have an interest in that. So a lot of that would depend on what is it that you're doing. And that's why crowdfunding, you hear a lot about because it mostly is a B2C and mostly attracts consumers or is directed towards them. Sorry.

[00:09:30.23] Andrew, it sounds like you're saying the lawyers are probably in there somewhere. You probably have to hire a lawyer somewhere in there to get all this paperwork.

[00:09:37.58] You do, but they are getting their systems really in place and they're getting quite efficient at it. And let me just make one point on this last one, and Sandra is definitely right. The type of company it is makes a huge difference, but-- and it was a platform founder in Australia that really emphasized this for me. He said, but it's not only consumer products.

[00:10:01.48] There are a lot of-- as long as there's a story and it's interesting and it's something that people might want to support-- like for example, in Australia, there was this company called Sea Bin, B-I-N, and that's what they call like a rubbish bin. And so it's this device that goes out and-- you put it out into the beach, and it collects the rubbish that's been floating out there. That's not a consumer product, but that's the sort of thing that can capture the imagination and people would want to support.

[00:10:33.78] First of all, thank you so much for being here. This has been a fantastic conversation. I've learned a lot. My question is, there's been an ongoing narrative about crowdfunding being or helping circumvent a lot of innovation outside the traditional innovation centers such as San Francisco. And I was wondering, from your perspective, what is the next step that crowdfunding needs to take in order to help stand up these competing centers of innovation across the country?

[00:11:06.18] it's an excellent question. I think that-- and we're trying to ameliorate it right here. I think that the number one issue is just people don't know about it. Entrepreneurs haven't heard about this. Investors don't know about it. More have learned each year. But I think that as investors or as regular people that I talk to, I discuss this with them. A lot of people say, wow, that's really interesting. I'm very interested, like Todd. And entrepreneurs likewise.

[00:11:37.95] There are a lot of entrepreneurs who would like at least the option of including their customers or in their journey and that sort of, thing and also having more ability to name their own valuation and other terms as opposed to being negotiated down to nothingness by some experienced VC.

[00:12:07.22] [INAUDIBLE] behind you.

[00:12:13.05] May I? One thought that I had about what Professor [INAUDIBLE] comment was I think that maybe the market can be segmented between people who are trying to make money or people who are trying to have a sense of agency. And perhaps a panel like this should include some people who understand the dynamics of crowds and social psychology because I think there are a lot of trends in the culture, including the transfer of wealth between generations, that probably has a lot of bearing on the course things could take.

[00:13:00.37] Good point. Well, let me say-- and I think Abe said this and Todd was hinting at it as well maybe some others, that if a person enjoys it and gets value from it, then that's worth something unto itself. And the agency of being able to send a text message to the founder of the company that you just invested in and they write right back to you, people like that. That's valuable in and of itself.

[00:13:30.50] But I do think that in the end, there is a financial motivation here, and that it is not just charity, and is not just supporting a cause. That's a part of it. But I think-- and this is-- I mean, Johnny years ago worked at Kiva, and Kiva is a sort of organization where-- let me just say it most simply, people lend money to businesses is for 0% return.

[00:14:01.58] I think that could get you somewhere, but I think that you get so much more money and so much more just capital flow if there's even a chance a promise of some financial return. But let's just get to one or two more questions, and then I'll turn things over to our MC, Brad Bernthal.

[00:14:20.71] Awesome. Thank you all for being here. This is fascinating. I'm learning so much today. One, first, just a quick PSA. If you don't know what a safe is or how it works, Carta has really awesome videos, and I encourage you to watch especially their cap table 101 series. Question how are people managing the cap table to make sure there aren't hundreds of people with tiny slivers of the company?

[00:14:47.23] That's a softball. It's a great question. Because it used to be a huge issue that when the statute and the Reg CF was initially put in place, if a company raised money and sold shares to 1,000 investors, it now had 1,000 shareholders on its cap table, and a next round VC might say, I don't want to be the first investor. No, thank you. So that was a huge issue that would deter companies from even trying this in the first place.

[00:15:23.42] Looking to other areas of the law and what other countries have done, in 2020, the SEC changed the regulations to allow special purpose vehicles, SPVs. Which means that instead of there being 1,000 people on the cap table, there's just one, the SPV. And then the SPV has 1,000 shareholders, and that was-- is my understanding from the industry, absolutely vital and it's really solved a big problem there. All right. Last question of the day, my friend. Thank you.

[00:15:53.87] You guys have talked very much about getting investors in, nothing about getting them out. And Alison is very well aware, of the previous investment things required liquidity for the investor downstream. Is Johnny going to come out with an exit system that allows that investor to recover money on an illiquid investment?

[00:16:18.58] There are the beginnings of secondary trading here and in other countries too. It's sometimes done like one week per quarter so that you get all the traders there for one time. It's not the New York Stock Exchange. There's just not enough shares out there at one time. And just one other point on an exit, there's certainly anecdotal stories of companies being bought or going public and other things.

[00:16:49.78] But also, because at least in the US, the securities that are being offered can be of any type, sometimes the company will include a term that says something like, and these shares can be repurchased by the company at a fair price or something. And that happened, for example, with Meow Wolf, this art exhibit. The company raised 1 million or two maybe more through investment crowdfunding, but one of the terms said, these can be repurchased.

[00:17:20.51] And they were. The shares were sold for maybe $20 and were repurchased a year or two later for $80. Some people thought that was great. Some people thought-- some of the shows were really upset, they didn't want to be bought out. But so with that, let me please turn it over to Brad to conclude us for the day. Thank you.

[00:17:41.11] [APPLAUSE]

[00:17:47.97] All right. So there's a line, which is often associated with faculty meetings, that everything has been said, but I haven't had a chance yet to say it.

[00:17:58.50] [LAUGHTER]

[00:17:59.52] I'll try to avoid that here. First is, boy, this was an intellectually nourishing day. I've got at least six pages that suggest that I learned a ton myself. I hope that many of you did, which really gets to the essence of I think public University interacting with the community and convening a group that is really, really cool to be a part of.

[00:18:27.57] I encourage you to come see us again at Silicon Flatirons soon. On Tuesday night, we've got the startup variety show here in the courtroom. And then looking out to October 6, I mentioned before, is our next conference, which will be about generative AI and copyright. That should be really terrific. I know what many of you are thinking right now, which is, how could I support Silicon Flatirons?

[00:18:50.80] [LAUGHTER]

[00:18:56.59] Johnny, let's talk. If you'd like to, I'd be happy to. In terms of substance, this has been such a great discussion. I just wanted to say, we've had some founders who have been here who are thinking about crowdfunding, including I know that invisible ink. Rather than me distilling any of the substance, is there a question that's pending yet that we could get out on the table that you're like, oh, this is pressing. Before I leave, I want to know this. And I'll give the prerogative to our friend from New York first.

[00:19:25.99] Yeah. If [INAUDIBLE] fairly revolutionary [INAUDIBLE]

[00:19:47.71] Johnny, you want to take the first swing at that?

[00:19:50.50] Yeah. So our general-- this is hopefully one thing we and Allison can agree on. Our general perspective at Wefunder is if Wefunder didn't exist, what would you do? So if Wefunder didn't exist, what valuation would you be raising on? And I would say, would you do a safe or a convertible note or a price round or would you do a revenue based financing deal? And if Wefunder didn't exist and you were raising from sophisticated accredited institutional investors, would they invest in a subsidiary?

[00:20:20.86] And if not, then we don't like doing-- we don't like doing things differently because it's unaccredited investors because it's [INAUDIBLE]. So usually, I pass the buck and I say, I don't know your business. I don't know your industry. I'm on investing. The only person whose opinion counts on valuation in terms is someone writing a check. So who's going to write the anchor checks into your weekend campaign or have you already raised from larger investors and what terms are they investing in and start there. And then take those terms and put that up on Wefunder. That's our paradigm.

[00:20:58.34] That's great. All right. A couple thank yous as we conclude the day. First, thanks again to all of our out of town guests and speakers in addition to our moderators, Mark and [INAUDIBLE], super skillfully done. It was really terrific. Also to the tech journal for being a fantastic partner and pulling together a really intellectually rich day.

[00:21:24.98] Silicon Flatirons, our team, including two people that I was remiss not to identify. One is Matthew here, who's our newest team member. Talked to him about space law. And not a fully fledged member of the team in terms of our payroll, but Lisa here, you'll see some terrific photos coming out of this.

[00:21:45.54] And by the way, if you to see some fantastic rock and roll photos, talk to Lisa about her collection as well. She did a show this summer that was really a treat. And finally, and I think most appropriately to end with this note, please join me in a hearty congratulations to Professor Schwartz on a terrific book, and thank you for sparking really a terrific day for us here. Andrew Schwartz.

[00:22:09.74] [APPLAUSE]