Written Testimony of

Vincent R. Molinari
Chief Executive Officer, GATE Technologies, LLC

Before the Subcommittee on Capital Markets and Government Sponsored Enterprises
U.S. House of Representatives Committee on Financial Services

Legislative Proposals to Facilitate Small Business Capital Formation and Job Creation
September 21, 2011

Chairman Garrett, Ranking Member Waters, and members of the Subcommittee on Capital Markets and Government Sponsored Enterprises (the "Subcommittee"), my name is Vincent Molinari. I am the Chief Executive Officer and co-founder of Gate Technologies, LLC ("Gate"). I commend the Chairman, the Ranking Member and the Members of the Subcommittee for holding this hearing on proposals to facilitate small business capital formation and job creation. I also want to acknowledge Chairman Bachus and Ranking Member Frank and thank them for bringing this issue before the public today I offer my opinions as a businessman, an entrepreneur and the chief executive of a firm committed to the creation of new jobs through innovative capital formation.

In my invitation to testify, the Subcommittee asked me to: (i) provide specific recommendations on initiatives the U.S. Securities and Exchange Commission (the "SEC" or the "Commission") should pursue to facilitate capital formation; (ii) discuss the potential impact of President Obama's proposals to (a) establish a "crowd funding" exemption from SEC registration requirements for firms raising less than $1 million (with individual investments limited to less than $10,000 or 10% of investors' annual income); (b) increase the cap on "mini-offerings" (Regulation A) from $5 million to $50 million which will make it easier for entrepreneurs to raise capital and create jobs; (iii) provide my views on the following legislative proposals H.R. 1965, H.R. 2167 - the Private Company Capital Flexibility Act - H.R. 2930, the Entrepreneur Access to Capital Act, H.R. 2940 – the Access to Capital for Job Creators Act, and the draft Small Company Job Growth and Regulatory Relief Act of 2011.

Background

GATE is an innovative, global financial services and technology company which I co-founded in 2009. We provide technology solutions and develop platforms that facilitate the trading of illiquid securities and promote pre trade and post trade transparency. Currently, GATE operates in the United States through its wholly owned subsidiary, GATE U.S. LLC ("GATE U.S."), a broker-dealer registered with the SEC and the Financial Industry Regulatory Authority ("FINRA"). GATE U.S. operates as an agency broker and an alternative trading system ("ATS"). In addition to operation of its business through an ATS, GATE U.S. also relies on SEC no-

action letters that provide flexibility for the use of Internet and other modern communication technologies in private offerings without running afoul of the general solicitation ban under federal securities laws.[1]

GATE U.S. facilitates transactions in the following asset classes: unregistered securities of private companies, restricted securities of publicly traded companies, and warrants. GATE U.S. is also working with other firms to facilitate the trading of state and federal tax credits, asset-backed securities, and limited partnership interests. Additionally, GATE has partnered with one of the largest financial services foundations to adopt platform technology for impact investing. GATE believes in creating value through trading in a structured, regulated venue where buyers and sellers meet for price discovery and to transact, settle, and transfer securities. GATE's business is fully regulated, archivable, and auditable. While the core of our business model is creating value for private companies and market participants, GATE Technologies is also an innovative, privately held, emerging company. As a result, we encounter the same capital formation and startup company issues that are encountered by other early stage companies.

We understand the SEC is monitoring the secondary trading activity on a variety of online trading platforms which are facilitating the trading of securities of private companies. The SEC has acknowledged that the trading that develops on online trading platforms such as the GATE ATS can be beneficial in that they can provide much desired liquidity to investors, which can assist in attracting investors to smaller private companies. We also appreciate the SEC's concerns that such benefits must be measured against the Commission's statutory responsibility to protect investors.

GATE believes the trading of unregistered securities is accomplished most effectively through a broker-dealer, an ATS or an exchange registered with the SEC because such transactions provide the books and records and an audit trail that can be used for surveillance purposes. In the absence of such information, an infinite allocation of resources to the SEC, will be unable to properly monitor such trading.

The Engine of Job Creation - Small Private Companies

Historically, small private companies have spurred economic growth and job creation. Many of the most prominent companies in the World, Apple, Microsoft, and Google, started as small private companies. These companies and countless other small companies are the engine of economic growth and job creation. Today, we focus on one of the major challenges of our

[1] *See, e.g.*, IPONET (July 26, 1996) (general solicitation is not present when previously unknown investors are invited to complete a web-based generic questionnaire and are provided access to private offerings via a password-protected website only if a broker-dealer makes a determination that the investor is accredited under Regulation D); Lamp Technologies, Inc. (May 29, 1998) (posting of information on a password-protected website about offerings by private investment pools, when access to the website is restricted to accredited investors, would not involve general solicitation or general advertising under Regulation D).

current economy: job creation in sufficient numbers to return unemployed and underemployed Americans to the workforce in positions that make use of their considerable talents.

The importance of small companies is evident in light of the following statistics:

- Small businesses represent 99.7 percent of all U.S. employers and employ half of the private sector workforce.
- Small business are responsible for creating 9.3 million net new jobs between 1993 and 2009, 54 percent of the total.
- Over 50 percent of U.S. private, non-farm GDP is generated by small businesses every year.

Historically, small businesses drive innovation, producing 13 times as many patents as large firms. These innovations set us apart internationally; give us the ability to lead in newly created industries; and allow us to take advantage of exchange rates that are adjusting in favor of U.S. exports.

The Causes of the Broken Engine

Private companies are critical to the U.S. economy and their ability to access capital is an important driver for growth, job creation and government tax revenues. However, the high costs of regulatory compliance associated with the Sarbanes-Oxley Act ("Sarbanes-Oxley") and the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") are limiting the ability and benefits to smaller private companies of going public. These smaller companies are seeking new methods of capital formation, and looking increasingly to private market funding alternatives, while the public market's appetite for new listings has waned. Initial public offerings ("IPOs") have decreased significantly while average deal sizes have increased, which may indicate that smaller companies appear to face increasing challenges in going public. For example:

- IPOs raising less than $50 million have dropped from approximately 80% of offerings in the 1990s to approximately 20% of offerings since 20003; and

- The 1990s saw more than 500 IPOs annually on average (during and before the internet bubble), while 2008, 2009, and 2010 combined have seen a total of 248 IPOs.

Mitigating against the above trends, new trading platforms, such as the one operated by GATE U.S., offer small private companies and investors an increasingly transparent model to access capital. As these platforms become more broadly accepted, they will also become increasingly robust and transparent through technological advances.

Recently, the spotlight has fallen on the private equity market due to investor demand for private companies such as Facebook, Zynga, and Twitter which operate in the public

sphere due to their size and commercial presence. Smaller private companies, however, are looking to emulate the private financing model employed by these companies while

attempting to manage the growth of their investor base to comply with applicable state and federal securities laws.

Unfortunately, the flow of capital to these potentially dynamic job creators is anemic. The current capital formation process is painfully broken, and it is operating under policies that do not support efficient allocation and the best use of available funds. We need to increase the system's capacity and get capital moving through it. Over the past fifteen years, the standard business model for a successful company---startup to a relatively quick public offering---- has been has been dramatically changed, in large part due to the bursting of the technology bubble, the rise of China as a global economic power, the unintended consequences of the adoption of Sarbanes-Oxley Act, the financial crisis of 2008, and the unintended consequences of the adoption of Dodd-Frank Act.

Initial public offerings today generally are already large, established companies. The banking industry has adjusted according to the changes in the economy: investment banks no longer provide services required to bring small- and mid-market companies to the public markets. Taken together, all of these factors have put the public capital markets out of reach for a vast swath of the private sector.

Angel investors and venture capitalists no longer see an exit sign for their capital in the foreseeable future and, as a result, become more reluctant to commit funds and to assume risk. The average hold time for a venture capitalist's investment was 4.7 years, and that hold time has now increased to ten years. Professional investors seeking to invest, profit, and then redeploy their capital elsewhere simply do not want to be in a private company for a decade or more. Due to the extended time frame, companies are forced to raise additional capital in order to offset the return on investment, thus making the climb steeper. As a result of these conditions, the flow of capital has been greatly diminished.

This situation has also created a new space in the economy that is no longer about initial public offerings and investment banks. It is about small and private companies that many never be brought to the public markets or may take a decade or more to reach the offering stage. The marketplace is telling us that there is an appetite for investment in private companies much earlier in the business growth cycle. We have an opportunity to create a system and a marketplace in which private companies can now access capital and liquidity from investors in a safe and transparent manner.

When companies have adequate capital, they can reinvest, expand, and hire. These small and private companies offer the economy tremendous growth potential and job creation, and they deserve to be supported with federal policies that make capital more available and foster their success. They have the ability to become the engine of economic recovery which is so sorely needed in the United States today.

Reform of Regulation D

Turning to the specific proposals being considered today, the proposed reform of Regulation D, as part of Representative David Schweikert's Private Company Flexibility and Growth Act,

would be a welcome change in the capital formation process that would promote economic expansion and job creation. I commend Representative Schweikert on the bill's introduction, which would increase the total asset threshold for registration to $10 million and raise the shareholder of record limitation from 500 to 1,000 persons.

In 1964, the total asset threshold for companies not required to register was set at $1 million, and the threshold was increased to $10 million in 1996. Regrettably, the 500 shareholder limitation of Section 12(g) has not been revised since it was established in 1964. Since then, the numbers of public companies and the numbers of investors have increased dramatically, and changes in technology have enabled innovative trading platforms, such as the one developed by GATE, that provide transparency and all of the investor protection offered by a broker-dealer. These technological advancements not only provide more transparency for investors, they also enable effective monitoring of private market transactions.

Section 12(g)

Section 12(g) of the Exchange Act requires a company to register its securities with the SEC, within 120 days after the last day of its fiscal year, if, at the end of the fiscal year, the securities are "held of record" by 500 or more persons and the company has "total assets" exceeding $10 million.[2] Shortly after Congress adopted Section 12(g), the Commission adopted rules defining the terms "held of record" and "total assets."[3] The definition of "held of record" counts as holders of record only persons identified as owners on records of security holders maintained by the company in accordance with accepted practice. The Commission used this definition to simplify the process of determining the applicability of Section 12(g) by allowing a company to look to the holders of its securities as shown on records maintained by it or on its behalf, such as records maintained by the company's transfer agent.[4]

When Section 12(g) was established in 1964, the Commission could not have anticipated the technological changes that have transpired since that time. These advances not only allow small companies to grow rapidly, but also bring more transparency and confidence to the financial markets. The rise of secondary private equity trading, driven by new bulletin boards and platforms that allow accredited investors and institutions to buy and sell private equity, has opened the private market to a wider potential investor base than was imagined

---

[2] *See* Exchange Act § 12(g)(1); Exchange Act Rule 12g-1. When Section 12(g) was enacted, the asset threshold was set at $1 million. The asset threshold was most recently increased to $10 million in 1996.

[3] Release No. 34-7492, *Adoption of Rules 12g5-1 and 12g5-2 Under the Securities Exchange Act of 1934* (January 5, 1965).

[4] *See* Release No. 34-7492, *Adoption of Rules 12g5-1 and 12g5-2 Under the Securities Exchange Act of 1934* (January 5, 1965).

when Section 12(g) was adopted. The result is a significant, unforeseen shift in the private equity landscape that has produced:

- Easier access to high-growth investments for smaller investors;
- Increased challenges for private companies to maintain a shareholder base of fewer than 500 owners, regardless of the desire or need to go public; and
- Private equity valuations that are driven by real transactions in the secondary market.

We believe that the evolution of the private equity market is unlikely to stop and more issuers will inevitably be impaired in their ability to raise capital in compliance with Section 12(g). However, Congress granted the SEC the authority to liberalize the application of Section 12(g). We encourage the SEC to exercise such authority and ask Congress to supervise the exercise of that authority.

The SEC Has the Authority to Amend the 500 Shareholder Limit

While we support the proposed legislation, we believe the SEC has broad authority under Section 12(h) to exempt issuers from the registration requirements of Section 12(g) so long as the Commission finds that the action is not inconsistent with the public interest or protection of investors. Additionally, Congress has granted the SEC broad exemptive authority in Section 36 of the Exchange Act.[5] The Commission has previously established exemptions from the Section 12(g) requirement,[6] and Section 12(g) provides the Commission with authority to define the terms "held of record" and "total assets."[7] We believe the SEC has the requisite authority to revise the 500 shareholder threshold of Section 12(g) if it concludes that doing so is not inconsistent with the public interest or protection of investors.

While believe amending Section 12(g) is consistent with the public interest and the protection of investors for several reasons. Currently, the 500 shareholder requirement of Section 12(g) is making it very difficult for small companies to raise capital. Moreover, due to the pronounced economic recession the United States has experienced and the massive capital contraction, small private companies are facing considerable difficulty raising the capital required to promote the research and product development that will encourage job creation.

---

[5] The Commission "may conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of this title or of any rule or regulation thereunder, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors." Exchange Act § 36.

[6] *See* Exchange Act Rule 12g3-2.

[7] "The Commission may for the purpose of this subsection define by rules and regulations the terms 'total assets' and 'held of record' as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent circumvention of the provisions of this subsection." Exchange Act § 12(g)(5).

Congress and the Commission could not have foreseen in 1964 the current state of our economy or the deleterious impact that the 500 shareholder limit of Section 12(g) would have on private companies. We believe the exigent circumstances coupled with the technological advances, including the development of ATSs, support the amendment of the 500 shareholder limit of Section 12(g).

Reform of Regulation A

Congress authorized the SEC to create the Regulation A exemption in 1933 because it recognized the economic benefit of helping small businesses secure capital through public offerings of securities. Regulation A was adopted by the SEC to enable small companies to offer their securities publicly in accordance with streamlined offering and disclosure requirements. However, the Regulation A exemption is rarely used because the $5 million threshold is too low to warrant companies incurring the time and expense to satisfy the offering and disclosure requirements. Indexing the threshold for inflation and re-visiting what the level should be on a timely basis will ensure that Congress's original intent is satisfied.

Currently, entrepreneurs and small businesses cannot access the capital they need to grow and create jobs. A record 41 percent of small business owners cannot get adequate financing, according to the National Small Business Association – up from 22 percent in 2008. A critical source of funding – the public capital markets – has been largely closed off to America's proven job creators.

Increasing the SEC's Regulation A exemption from $5 million to $50 million will improve the ability of small companies to access desperately needed capital. By reducing the regulatory burden and expense of raising capital from the investing public, Congress can boost the flow of capital to small businesses and fuel America's most vigorous job-creation machine. Regulation A can also help entrepreneurial businesses attract private capital by providing liquidity opportunities at a lower level than might be feasible for an IPO using full registration.

I commend Representative Schweikert, as well as the Financial Services Committee for considering and passing this legislation in June. I look forward to House floor action on the legislation, and I also commend the authors of Senate companion legislation that was recently introduced, Senator Jon Tester and Senator Pat Toomey. The amendment of Regulation A will Provide another powerful tool to promote capital formation and job creation.

Crowdfunding

The term "crowdfunding" generally refers to capital formation by means of a mechanism by which a group of people pool money to support a specific effort or goal. Crowdfunding typically involves small individual contributions. This strategy has been used to support the funding of books, films, music recordings and charitable causes. The use of crowdfunding as a capital formation tool has become increasingly popular.

However, the potential of crowdfunding as a capital formation tool for early stage for profit companies has been impeded by uncertainty with respect to whether such transaction are

subject to the registration requirements of the federal securities laws. The SEC has been examining the permissible use of crowdfunding and possible exemptions from registration under the Securities Act to encourage the use of crowdfunding as a capital formation strategy.

We believe the use of crowdfunding as a capital formation strategy would be enhanced if the SEC were to exempt such activities from registration under the Securities Act. Such an exemption is not without precedent. The envisioned exemption would be similar to the exemption previously included in Rule 504 which allowed a public offering to investors (including non-accredited investors) for securities offerings of up to $1 million, with no prescribed disclosures and no limitations on re-sales of the securities sold.

Any concerns regarding the protection of investors would be addressed by the fact that crowdfuding would still be subject to state blue sky regulation and the anti-fraud and other civil liability provisions of the federal securities laws. Additional protections could be garnered through a requirement that crowdfunding be conducted through a regulated entity such as a broker-dealer or an ATS that must archive all transaction records in a format that is subject to applicable SEC rules with respect to preservation of auditable books and records.

GATE believes crowdfunding has tremendous potential for supporting small and private companies. Given the changes in the marketplace, increases in investor participation, and the advancement of technology, the general solicitation ban is becoming increasingly hard to defend. In the future, it is likely to become exponentially more difficult to enforce.

While information could be widely disseminated if there was an exemption to the general solicitation ban, there could still be full validation of the individual coming through the brokerage account. Those who choose to click through to the trading platform would go through the regular process to become accredited investors.

We have the ability to bridge the two worlds of social networking and investing while remaining true to investor protection and this is a powerful new paradigm. This is the sort of new thinking that will be required if we are to adequately capitalize small and private companies.

When you consider the numbers and the growth potential of social networking, I believe that eventually, the regulatory community will embrace it, even though it may seem to be a radical idea today. It is important to stress the protocol that would be in place to manage the process of accrediting investors. There is an entire layer of compliance process that would have to occur between an electronic communication and an actual investment.

Investors want to capture the beginning stages of a company's growth in order to maximize their investment. And we can use the Internet and social networking to make these distributions more broadly---and make them much fairer---than they have been in the past.

I commend Representative Kevin McCarthy and Representative Patrick McHenry for their foresight in addressing this issue. People are communicating about investments continually, and it will become increasingly difficult to identify exactly what a solicitation is and to enforce the

general ban. I support progress on this issue, including two pieces of legislation that have been recently introduced, H.R. 2940, the Access to Capital for Job Creators Act, and H.R. 2930, the Entrepreneur Access to Capital Act.

Changes to Sarbanes-Oxley For Small Companies

GATE Technologies' business model is based on the belief that promoting liquidity in illiquid markets enhances economic efficiency. By promoting liquidity and transparency in a venue that is regulated as a broker-dealer and an ATS, GATE plans to attract investors that want to more efficiently manage their capital.

At the same time, accessing the public capital markets is part of the natural growth cycle for successful companies. At a certain point, companies require more capital than what is found in the private markets. The numbers and market capitalization totals of companies matriculating to the public markets are a commonly used indicator of economic health in the small company sector.

The area of accounting and corporate governance practices in publicly traded companies covered by Sarbanes-Oxley is outside my expertise. However, I support eliminating regulatory costs that are unnecessary for these companies in the interest of bolstering small company growth.

The discussion draft offered by Representative Stephen Fincher, the Small Company Job Growth and Regulatory Relief Act of 2011, offers reasonable relief from Sarbanes-Oxley Section 404 for many companies in the Russell 2000 Index. The draft is a thoughtful approach that would ease the transition for small public companies as they adjust to their new listing status and as they continue to mature. A policy change such as that being offered by Representative Fincher would be welcome news in the small company sector.

We believe that exempting issuers with less than $500 million in market capitalization from the auditor attestation requirement of Sarbanes-Oxley Section 404 will promote market efficiency, while still retaining basic internal controls and management assessment of the effectiveness of those controls.

Newly listed companies with market capitalization between $500 million and $1 billion would have five years before they would be required to step up to full Section 404 compliance, which strikes me as a reasonable and balanced approach.

Considering current economic conditions and the need to fuel growth in this sector, I would respectfully suggest that the funds that very small publicly traded companies expend to attain auditor attestation could be put to a more productive use. If Representative Fincher's legislation were to be enacted, covered companies would immediately have healthier balance sheets and greater ability to grow and to hire.

Conclusion

I am encouraged by this hearing, by the recent progress that has been made on this issue, and by the sense of cooperation displayed by the members of the Subcommittee in bringing a number of creative pieces of legislation that is meant to spur the capital formation process. I commend President Obama and Speaker Boehner for their leadership on this issue.

President Obama recently noted that his "[a]dministration will pursue efforts to reduce the regulatory burdens on small business capital formation in ways that are consistent with investor protection." Speaker Boehner noted that In his remarks to the Economic Club of Washington, D.C. last week, "[i]f we want job growth, we need to recognize who really creates jobs in America. It's the private-sector."

I commend the authors and cosponsors of the pending pieces of legislation, as well as the leadership of the relevant committees on both sides of the aisle for moving forward with continuing discussions, hearings, and markups.

We have a rare opportunity to enact policies that will further the goals of the investors and small and private company entrepreneurs, while assisting our battered economy and our unemployed workers. Taken together, these policies will have a powerful and positive economic effect that will become apparent very quickly. These changes are the best and most effective actions than could be taken right now to invigorate the economy.

On behalf of GATE Technologies, I urge continued action on these pieces of legislation and look forward to their enactment. Thank you for the opportunity to present these views in support of reforming capital formation policies.

Vincent R Molinari
Chairman and CEO
GATE Technologies

GATE
TECHNOLOGIES

United States House of Representatives
Committee on Financial Services

"TRUTH IN TESTIMONY" DISCLOSURE FORM

Clause 2(g) of rule XI of the Rules of the House of Representatives and the Rules of the Committee on Financial Services require the disclosure of the following information. A copy of this form should be attached to your written testimony.

1. Name:	2. Organization or organizations you are representing:
Vincent R Molinari	GATE Technologies, LLC

3. Business Address and telephone number:

[redacted]

4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?	5. Have any of the organizations you are representing received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?
☐ Yes ☑ No	☐ Yes ☑ No

6. If you answered .yes. to either item 4 or 5, please list the source and amount of each grant or contract, and indicate whether the recipient of such grant was you or the organization(s) you are representing. You may list additional grants or contracts on additional sheets.

N/A

7. Signature:

Please attach a copy of this form to your written testimony.