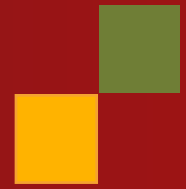


Funding Small Businesses

A New Approach



SUMMARY.

The capital market attributes and needs of Main Street small businesses and those of big business and Wall Street are very different. They therefore need separate rules and regulations and corresponding oversight. For years the small business community has expressed dissatisfaction with the current regulatory environment, formally reflected in the repeated suggestions for change introduced at the SEC's annual forum on small business capital formation, with no perceptible result.

Given the SEC's budgetary constraints and increased workload such as that resulting from Dodd-Frank implementation, it is unlikely to address the needed changes in the foreseeable future. Yet the nation and the small business community cannot afford to wait.

The capital market needs of small business are more important than ever, as small business has over the last 30 years been the only sector of the economy that has consistently created more jobs than it has lost. But the number of startups has been in decline and those that have launched are smaller than before and are hiring fewer workers. Lack of funding is cited as one of the chief culprits, and the current regulatory environment as one of the main barriers to funding.

The inevitable conclusion is that the system is not working and that any solution requires an entirely new approach. This is the reason behind our proposed legislation, which envisions a fundamental shift in how small business capital markets are regulated and provides a mechanism to break the current logjam that simultaneously addresses the needs of regulators, small businesses and their investors.

A NEW SRO

Our proposed legislation calls for the creation of a new SRO (self-regulatory organization) tasked with:

1. Overseeing all areas related to capital markets for small businesses.
2. Reviewing and modifying existing regulations pertaining to small business capital markets.
3. Establishing new rules, regulations and structures as necessary to facilitate small business capital formation and the subsequent transfer of securities, coupled with protection of investors.

The proposed new SRO is identified as Small Business Capital Markets, Inc. (SBCM), an independent, non-profit, non-governmental corporation. SBCM is modeled on the Public Company Accounting Oversight Board (PCAOB), and as such it will be tasked with the above functions, under the supervision and ultimate oversight of the SEC.

It will take over from FINRA any oversight and functions currently related to small business capital markets and the structures that support them including brokers, dealers and trading platforms. It shall also relieve the SEC from the burden of review and modifications of all rules and regulations related to small business capital markets, subject to SEC oversight and supervision.

SBCM shall be organized with a board of directors tasked with overall supervision and management and who themselves are subject to supervision and oversight by the SEC. The board must be composed of individuals who understand and are committed to the capital needs of small businesses, understand the existing rules and regulations, and have the ability to carry out the objectives spelled out above. The board shall cooperate with and receive input from various stakeholders and advisors in pursuit of SBCM's mandate.

THE SMALL BUSINESS CAPITAL MARKETS ACT

An Act to create Small Business Capital Markets, Inc. , a self regulatory organization (SRO) to govern the issuance and trading of securities of small business issuers (as defined in the Act)

OUTLINE

1. ESTABLISHMENT OF SMALL BUSINESS CAPITAL MARKETS, INC. (SBCM)

Establishment of SBCM as a self regulatory organization, and SEC oversight of SBCM.

- (a) STATUS – The Board shall not be an agency or establishment of the United States government, and, except as otherwise provided in this Act, shall be subject to, and have all the powers conferred upon a nonprofit corporation by, the California Nonprofit Corporation Act. No member or person employed by, or agent for, the Board shall be deemed to be an officer or employee of or agent for the Federal Government by reason of such service.
- (b) ESTABLISHMENT OF BOARD. There is established the board of directors of the Small Business Capital Markets (“Board”) to oversee the regulation of all transactions subject to this Act
- (c) DUTIES OF THE BOARD
 - (i) to regulate the issuance of securities of small business issuers
 - (ii) to regulate the trading of securities of small business issuers
 - (iii) to regulate brokers and dealers who trade securities of Small Business Issuers
 - (iv) to establish or adopt by rule quality control, ethics and other standards relating to the issuance and trading of securities of Small Business Issuers and the regulation of exchanges and brokers and dealers who trade securities of Small Business Issuers
 - (v) to conduct investigations and disciplinary proceedings concerning, and impose appropriate sanctions where justified upon, small business issuers, their affiliates, exchanges, broker-dealers and other persons subject to this Act
 - (vi) perform such other duties or functions as the board by rule or order determines are necessary or appropriate to facilitate capital formation for Small Businesses Issuers and protection of investors.
 - (vii) to enforce compliance with this Act, the rules of the Board, professional standards, and the securities laws relating to the issuance and trading of covered securities of small business issuers, and regulation of exchanges and broker-dealers subject to this Act
- (d) COMMISSION DETERMINATION. The board shall take such action as may be necessary or appropriate to enable the Securities and Exchange Commission to ensure, not later than 60 days after the date of enactment of this Act, that the Board is so organized, has the capacity to carry out the requirements of this Act, and to enforce compliance with this Act.
- (e) BOARD MEMBERSHIP
 - (i) COMPOSITION-the Board shall have ___ members, appointed from among prominent individuals of integrity and reputation who have a demonstrated commitment to the interests of investors, capital formation and the public, and understanding of the

responsibilities for and nature of the requirements of securities laws with respect to issuance and trading of securities of Small Business Issuers and regulation of exchanges, and broker dealers trading in securities of Small Business Issuers.

(ii) LIMITATION- Not less than ____ members shall be or have been practicing securities lawyers specializing in issuance and trading of securities of Small Business Issuers.

(iii) FULL-TIME INDEPENDENT SERVICE-each member of the Board shall serve on a full-time basis, and may not, concurrent with service on the Board, be employed by any other person or engage in any other professional or business activity. No member of the Board may share in any of the profits of, or receive payments from, any transactions subject to this Act unless disclosed to and approved by the Board, without the vote of such member.

(iv) APPOINTMENT OF BOARD MEMBERS

(A) Initial Board-not later than ____ days after the date of enactment of this Act, the President of the United States, after consultation with the Securities and Exchange Commission, the Chairpersons of the Committee on Banking, Housing, and Urban Affairs and the Committee on Small Business and Entrepreneurship of the Senate, and the Committee on Financial Services and the House Small Business Committee of the House of Representatives, shall appoint the chairperson and other initial members of the Board, and shall designate the term of service for each.

(B) Vacancies-a vacancy on the Board shall not affect the powers of the Board, but shall be filled in the same manner as provided for appointments under this section.

(v) TERM OF SERVICE

(A) In General-the term of service of each Board member shall be five years, and until a successor is appointed, except that-

(i) the terms of office of the initial Board members (other than the chairperson) shall expire in annual increments, one-fifth of the Board members on each of the first four anniversaries of the initial date of appointment; and

(ii) any Board member appointed to fill a vacancy occurring before the expiration of the term for which the predecessor was appointed shall be appointed only for the remainder of that term

(B) TERM LIMITATION-no person may serve as a member of the Board, or as chairperson of the Board, for more than two terms, whether or not such terms of service are consecutive.

(vi) REMOVAL FROM OFFICE-a member of the Board may be removed by the Commission from office, in accordance with section 3(d), for good cause shown before the expiration of the term of that member

(f) POWERS OF THE BOARD—In addition to any authority granted to the Board otherwise in this Act, the Board shall have the power, subject to section 3.

(i) to sue and be sued, complain and defend, in its corporate name and through its own counsel, with the approval of the Commission, in any Federal, State, or other court;

(ii) to conduct its operations and maintain offices, and to exercise all other rights and powers authorized by this Act, in any State, without regard to any qualification, licensing, or other provision of law in effect in such State (or a political subdivision thereof);

(iii) to lease, purchase, accept gifts or donations of or otherwise acquire, improve, use,

sell, exchange, or convey, all of or an interest in any property, wherever situated;

(iv) to appoint such employees, accountants, attorneys, and other agents as may be necessary or appropriate, and to determine their qualifications, define their duties, and fix their salaries or other compensation (at a level that is comparable to private sector self-regulatory, accounting, technical, supervisory, or other staff or management positions);

(v) to allocate, assess, and collect accounting support fees established for the Board, and other fees and charges imposed under this Act; and

(vi) to enter into contracts, execute instruments, incur liabilities, and do any and all other acts and things necessary, appropriate, or incidental to the conduct of its operations and the exercise of its obligations, rights, and powers imposed or granted by this title.

(g) **RULES OF THE BOARD**—The internal rules of the Board shall, subject to the approval of the Commission—

(i) provide for the operation and administration of the Board, the exercise of its authority, and the performance of its responsibilities under this Act,

(ii) permit, as the Board determines necessary or appropriate, delegation by the Board of any of its functions to an individual member or employee of the Board, or to a division of the Board, including functions with respect to hearing, determining, ordering, certifying, reporting, or otherwise acting as to any matter, except that—

(A) the Board shall retain a discretionary right to review any action pursuant to any such delegated function, upon its own motion;

(B) a person shall be entitled to a review by the Board with respect to any matter so delegated, and the decision of the Board upon such review shall be deemed to be the action of the Board for all purposes (including appeal or review thereof); and

(C) if the right to exercise a review described in subparagraph (A) is declined, or if no such review is sought within the time stated in the rules of the Board, then the action taken by the holder of such delegation shall for all purposes, including appeal or review thereof, be deemed to be the action of the Board.

(iii) establish ethics rules and standards of conduct for Board members and staff, including a bar on practice before the Board (and the Commission, with respect to Board-related matters) of one year for former members of the Board, and appropriate periods (not to exceed one year) for former staff of the Board; and

(iv) provide as otherwise required by this Act.

(h) **ANNUAL REPORT TO THE COMMISSION**—The Board shall submit an annual report (including its audited financial statements) to the Commission, and the Commission shall transmit a copy of that report to the Committee on Banking, Housing, and Urban Affairs and the Committee on Small Business and Entrepreneurship of the Senate, and the Committee on Financial Services and the House Small Business Committee of the House of Representatives, not later than 30 days after the date of receipt of that report by the Commission.

2. DEFINITIONS

“Act” means the Small Business Capital Markets Act of 2010.

“Affiliate” has the same meaning as defined in Rule 405 of the Securities Act of 1933.

“Board” means the Board of Directors of Small Business Capital Markets, Inc.

“Broker” or “Dealer” has the same meaning as defined in Section 3(a)(4) of the Securities Exchange Act of 1934.

“Commission” means the Securities and Exchange Commission.

“Exchange” means any exchange (as defined in Section 3(a)(1)) which lists securities of Small Business Issuers for trading.

“Issuer” has the same meaning as defined in Section 2(a)(4) of the Securities Act of 1933.

“Person” has the same meaning as defined in Section 2(a)(2) of the Securities Act of 1933.

“Security” has the same meaning as defined in Section 2(a)(1) of the Securities Act of 1933.

“Small Business” means an issuer of securities who is either of the following –

- (i) subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 and whose voting and non-voting common equity held by non-affiliates of the issuer have an aggregate market value of *[\$state threshold market value]* million or more;
- (ii) not subject to the reporting requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934 and has a tangible net worth of not more than *[\$state threshold market value]* million or average net income after Federal income taxes (excluding any carry-over losses) for the preceding two year no greater than *[\$state threshold market value]* million.

“Small Business Broker” means a broker or dealer who effects any transactions in securities of Small Business Issuers.

3. COMMISSION OVERSIGHT OF THE BOARD.

- (a) GENERAL OVERSIGHT RESPONSIBILITY—The Commission shall have oversight and enforcement authority over the Board, as provided in this Act. The provisions of section 17(a)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(a)(1)), and of section 17(b)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(b)(1)) shall apply to the Board as fully as if the Board were a 'registered securities association' for purposes of those sections 17(a)(1) and 17(b)(1).
- (b) TIME FOR REVIEW AND APPROVAL – Whenever the Commission is required under this Act to review any provision or matter of this Act, it shall promptly review and approve or disapprove such provision or matter, and if the Commission fails to approve or disapprove such provision or matter within 30 days of submission of such provision or matter, it shall be conclusively presumed that such provision or matter was reviewed and approved by the Commission.
- (c) RULES OF THE BOARD—
 - (i) DEFINITION—In this section, the term 'proposed rule' means any proposed rule of the Board, and any modification of any such rule.

(ii) PRIOR APPROVAL REQUIRED—No rule of the Board shall become effective without prior approval of the Commission in accordance with this section, other than as provided in section 5(a)(iii)(B) with respect to initial or transitional standards.

(iii) APPROVAL CRITERIA—The Commission shall disapprove a proposed rule, if it finds that the rule is not consistent with the requirements of this Act and the securities laws, or that such disapproval is necessary or appropriate in the public interest or for the protection of investors.

(iv) PROPOSED RULE PROCEDURES—The provisions of paragraphs (1) through (3) of section 19(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(b)) shall govern the proposed rules of the Board, as fully as if the Board were a 'registered securities association' for purposes of that section 19(b).

(v) COMMISSION AUTHORITY TO AMEND RULES OF THE BOARD—The provisions of section 19(c) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(c)) shall govern the abrogation, deletion, or addition to portions of the rules of the Board by the Commission as fully as if the Board were a 'registered securities association' for purposes of that section 19(c).

(d) COMMISSION REVIEW OF DISCIPLINARY ACTION TAKEN BY THE BOARD—

(i) NOTICE OF SANCTION—The Board shall promptly file notice with the Commission of any final sanction on any person subject to this Act, in such form and containing such information as the Commission, by rule, may prescribe.

(ii) REVIEW OF SANCTIONS—The provisions of sections 19(d)(2) and 19(e)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78s(d)(2) and (e)(1)) shall govern the review by the Commission of final disciplinary sanctions imposed by the Board (including sanctions imposed under section 6 of this Act for noncooperation in an investigation of the Board), as fully as if the Board were a self-regulatory organization and the Commission were the appropriate regulatory agency for such organization for purposes of those sections 19(d)(2) and 19(e)(1), except that, for purposes of this paragraph—

(A) section 6(b)(iv) of this Act (rather than section 19(d)(2)) shall govern the extent to which application for, or institution by the Commission on its own motion of, review of any disciplinary action of the Board operates as a stay of such action;

(B) references in that section 19(e)(1) to 'members' of such an organization shall be deemed to be references to persons subject to this Act;

(iii) COMMISSION MODIFICATION AUTHORITY—The Commission may enhance, modify, cancel, reduce, or require the remission of a sanction imposed by the Board upon a person subject to this Act, if the Commission, having due regard for the public interest and the protection of investors, finds, after a proceeding in accordance with this subsection, that the sanction—

(A) is not necessary or appropriate in furtherance of this Act or the securities laws;
or

(B) is excessive, oppressive, inadequate, or otherwise not appropriate to the finding or the basis on which the sanction was imposed.

(e) CENSURE OF THE BOARD; OTHER SANCTIONS—

(i) RESCISSION OF BOARD AUTHORITY—The Commission, by rule, consistent with the public interest, the protection of investors, and the other purposes of this Act and the securities laws, may relieve the Board of any responsibility to enforce compliance with any provision of this Act, the securities laws, the rules of the Board, or professional standards, provided the Commission must determine that the Board has been grossly negligent in exercising such responsibility.

(ii) CENSURE OF THE BOARD; LIMITATIONS—The Commission may, by order, as it determines necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, censure or impose limitations upon the activities, functions, and operations of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that the Board—

(A) has violated or is unable to comply with any provision of this Act, the rules of the Board, or the securities laws; or

(B) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by a registered person subject to this Act.

(iii) CENSURE OF BOARD MEMBERS; REMOVAL FROM OFFICE—The Commission may, as necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of this Act or the securities laws, remove from office or censure any member of the Board, if the Commission finds, on the record, after notice and opportunity for a hearing, that such member—

(A) has willfully violated any provision of this Act, the rules of the Board, or the securities laws;

(B) has willfully abused the authority of that member; or

(C) without reasonable justification or excuse, has failed to enforce compliance with any such provision or rule, or any professional standard by any registered person thereunder.

4. REGISTRATION WITH THE BOARD

(a) MANDATORY REGISTRATION – Beginning 180 days after the date of the determination of the commission under section 101(d), it shall be unlawful for any person that is not a registered Small Business Broker to effect any transaction in, or to induce or attempt to induce the purchase or sale of any securities of Small Business Issuers.

(b) APPLICATIONS FOR REGISTRATION –

(i) FORM OF APPLICATION – A Small Business Broker shall use such form as the Board may prescribe, by rule, to apply for registration under this section.

(ii) CONTENTS OF APPLICATIONS – Each Small Business Broker shall submit, as part of its application for registration, in such detail as the Board shall specify –

[Specify standards for offering, selling and trading securities of Small Business Issuers]

(c) SBCM REPLACES FINRA-

(i) All regulatory functions covering Small Business Issuers shall be assumed by SBCM replacing FINRA's authority and responsibility.

(iii) CONSENTS—Each application for registration under this subsection shall include—

(A) a consent executed by the Small Business Broker to cooperation in and compliance with any request for testimony or the production of documents made by the Board in the furtherance of its authority and responsibilities under this title (and an agreement to secure and enforce similar consents from each of the associated persons of the Small Business Broker as a condition of their continued employment by or other association with such firm); and

(B) a statement that such firm understands and agrees that cooperation and compliance, as described in the consent required by subparagraph (A), and the securing and enforcement of such consents from its associated persons, in accordance with the rules of the Board, shall be a condition to the continuing effectiveness of the registration of the Small Business Broker with the Board.

(d) ACTION ON APPLICATIONS—

(i) TIMING—The Board shall approve a completed application for registration not later than 45 days after the date of receipt of the application, in accordance with the rules of the Board, unless the Board, prior to such date, issues a written notice of disapproval to, or requests more information from, the prospective registrant.

(ii) TREATMENT—A written notice of disapproval of a completed application under paragraph (1) for registration shall be treated as a disciplinary sanction for purposes of sections 7(c) and (d).

(e) PERIODIC REPORTS—Each registered Small Business Broker shall submit an annual report to the Board, and may be required to report more frequently, as necessary to update the information contained in its application for registration under this section, and to provide to the Board such additional information as the Board or the Commission may specify, in accordance with subsection (b)(2).

(f) PUBLIC AVAILABILITY—Registration applications and annual reports required by this subsection, or such portions of such applications or reports as may be designated under rules of the Board, shall be made available for public inspection, subject to rules of the Board or the Commission, and to applicable laws relating to the confidentiality of proprietary, personal, or other information contained in such applications or reports, provided that, in all events, the Board shall protect from public disclosure information reasonably identified by the subject Small Business Broker as proprietary information.

(g) REGISTRATION AND ANNUAL FEES—The Board shall assess and collect a registration fee and an annual fee from each registered Small Business Broker, in amounts that are sufficient to recover the costs of processing and reviewing applications and annual reports.

5. QUALITY CONTROL, AND ETHICS STANDARDS AND RULES.

(a) QUALITY CONTROL, AND ETHICS STANDARDS—

(i) IN GENERAL—The Board shall, by rule, establish, including, to the extent it determines appropriate, through adoption of standards proposed by 1 or more professional groups of Small Business Brokers designated pursuant to paragraph (3)(A)

or advisory groups convened pursuant to paragraph 5(a), and amend or otherwise modify or alter, such quality control standards, and such ethics standards to be used by registered Small Business Brokers in the offering, sales and trading of securities of Small Business Issuers, as required by this Act or the rules of the Commission, or as may be necessary or appropriate in the public interest or for the protection of investors.

(ii) **RULE REQUIREMENTS**—In carrying out paragraph (1), the Board—

(A) shall include in the standards that it adopts, requirements that each registered Small Business Broker shall set forth standards for offering, selling and trading in securities of Small Business Issuers.

(B) shall include, in the quality control standards that it adopts with respect to the offering, selling and trading in securities of Small Business Issuers, requirements for every registered Small Business Broker relating to—

(I) monitoring of professional ethics of associates of such registered Small Business Brokers

(II) consultation within such firm on quality control and ethics questions;

(III) supervision of work;

(IV) hiring, professional development, and advancement of personnel;

(V) the acceptance and continuation of engagements;

(VI) internal inspection; and

(VII) such other requirements as the Board may prescribe, subject to subsection (a)(1).

(iii) **AUTHORITY TO ADOPT OTHER STANDARDS**—

(A) **IN GENERAL**—In carrying out this subsection, the Board—

(I) may adopt as its rules, subject to the terms of section 5, any portion of any statement of quality control or ethical standards or other professional standards that the Board determines satisfy the requirements of paragraph (1), and that were proposed by 1 or more professional groups of Small Business Brokers that shall be designated or recognized by the Board, by rule, for such purpose, pursuant to this paragraph or 1 or more advisory groups convened pursuant to paragraph (4); and

(II) notwithstanding clause (i), shall retain full authority to modify, supplement, revise, or subsequently amend, modify, or repeal, in whole or in part, any portion of any statement described in clause (i).

(B) **INITIAL AND TRANSITIONAL STANDARDS**—The Board shall adopt standards described in subparagraph (A)(I) as initial or transitional standards, to the extent the Board determines necessary, prior to a determination of the Commission under section_1(d), and such standards shall be separately approved by the Commission at the

time of that determination, without regard to the procedures required by section _____ that otherwise would apply to the approval of rules of the Board.

(iv) **ADVISORY GROUPS**—The Board shall convene, or authorize its staff to convene, such expert advisory groups as may be appropriate, which may include Small Business Brokers and other experts, as well as representatives of other interested groups, subject to such rules as the Board may prescribe to prevent conflicts of interest, to make recommendations concerning the content (including proposed drafts) of quality control, ethics, or other standards required to be established under this section.

(b) COOPERATION WITH DESIGNATED PROFESSIONAL GROUPS OF SMALL BUSINESS BROKERS AND ADVISORY GROUPS—

(i) **IN GENERAL**—The Board shall cooperate on an ongoing basis with professional groups of Small Business Brokers designated under subsection 5(a)(iii)(A) and advisory groups convened under subsection 5(a)(4) in the examination of the need for changes in any standards subject to its authority under subsection (a), recommend issues for inclusion on the agendas of such designated professional groups of Small Business Brokers or advisory groups, and take such other steps as it deems appropriate to increase the effectiveness of the standard setting process.

(ii) **BOARD RESPONSES**— The Board shall respond in a timely fashion to requests from designated professional groups of Small Business Brokers and advisory groups referred to in paragraph (1) for any changes in standards over which the Board has authority.

(d) **EVALUATION OF STANDARD SETTING PROCESS**—The Board shall include in the annual report required by section 1(h) the results of its standard setting responsibilities during the period to which the report relates, including a discussion of the work of the Board with any designated professional groups of Small Business Brokers and advisory groups described in paragraphs (3)(A) and (4) of subsection (a), and its pending issues agenda for future standard setting projects.

6. INSPECTIONS OF REGISTERED SMALL BUSINESS BROKERS

(a) **IN GENERAL**—The Board shall conduct a continuing program of inspections to assess the degree of compliance of each registered Small Business Brokers and associated persons of that firm with this Act, the rules of the Board, the rules of the Commission, or professional standards, in connection with its related matters involving issuers.

(b) INSPECTION FREQUENCY—

(i) **IN GENERAL**—Subject to paragraph (2), inspections required by this section shall be conducted—

(A) annually with respect to each registered Small Business Broker that annually deals with more than \$ *[state threshold of value]* of securities of Small Business Issuers.

(ii) **ADJUSTMENTS TO SCHEDULES**—The Board may, by rule, adjust the inspection schedules set under paragraph (1) if the Board finds that different inspection schedules are consistent with the purposes of this Act, the public interest, and the protection of investors. The Board may conduct special inspections at the request of the Commission or upon its own motion.

(c) PROCEDURES—The Board shall, in each inspection under this section, and in accordance with its rules for such inspections—

- (i) identify any act or practice or omission to act by the registered Small Business Broker, or by any associated person thereof, revealed by such inspection that may be in violation of this Act, the rules of the Board, the rules of the Commission, the firm's own quality control policies, or professional standards;
- (ii) report any such act, practice, or omission, if appropriate, to the Commission and each appropriate State regulatory authority; and
- (iii) begin a formal investigation or take disciplinary action, if appropriate, with respect to any such violation, in accordance with this Act and the rules of the Board.

(d) CONDUCT OF INSPECTIONS—In conducting an inspection of a registered Small Business Broker under this section, the Board shall—

- (i) inspect and review selected offering, selling or trading activity of the firm at various offices and by various associated persons of the firm, as selected by the Board;
- (ii) evaluate the sufficiency of the quality control system of the firm, and the manner of the documentation and communication of that system by the firm; and
- (iii) perform such other testing of the supervisory, and quality control procedures of the firm as are necessary or appropriate in light of the purpose of the inspection and the responsibilities of the Board.

(e) RECORD RETENTION—The rules of the Board may require the retention by registered Small Business Brokers for inspection purposes of records whose retention is not otherwise required by section 5 or the rules issued thereunder.

(f) PROCEDURES FOR REVIEW—The rules of the Board shall provide a procedure for the review of and response to a draft inspection report by the registered Small Business Broker under inspection. The Board shall take such action with respect to such response as it considers appropriate (including revising the draft report or continuing or supplementing its inspection activities before issuing a final report), but the text of any such response, appropriately redacted to protect information reasonably identified by the Small Business Broker as confidential, shall be attached to and made part of the inspection report.

(g) REPORT—A written report of the findings of the Board for each inspection under this section, subject to subsection 5(h), shall be—

- (i) transmitted, in appropriate detail, to the Commission and each appropriate State regulatory authority, accompanied by any letter or comments by the Board or the inspector, and any letter of response from the registered Small Business Broker; and

(ii) made available in appropriate detail to the public (subject to section 6(v)(A) and to the protection of such confidential and proprietary information as the Board may determine to be appropriate, or as may be required by law), except that no portions of the inspection report that deal with criticisms of or potential defects in the quality control systems of the firm under inspection shall be made public if those criticisms or defects are addressed by the firm, to the satisfaction of the Board, not later than 12 months after the date of the inspection report.

(h) INTERIM COMMISSION REVIEW—

(i) REVIEWABLE MATTERS—A registered Small Business Broker may seek review by the Commission, pursuant to such rules as the Commission shall promulgate, if the firm—

(A) has provided the Board with a response, pursuant to rules issued by the Board under subsection (f), to the substance of particular items in a draft inspection report, and disagrees with the assessments contained in any final report prepared by the Board following such response; or

(B) disagrees with the determination of the Board that criticisms or defects identified in an inspection report have not been addressed to the satisfaction of the Board within 12 months of the date of the inspection report, for purposes of subsection__

(ii) TREATMENT OF REVIEW—Any decision of the Commission with respect to a review under paragraph (1) shall not be reviewable under section 25 of the Securities Exchange Act of 1934 (15 U.S.C. 78y), or deemed to be 'final agency action' for purposes of section 704 of title 5, United States Code.

(iii) TIMING—Review under paragraph (1) may be sought during the 30-day period following the date of the event giving rise to the review under subparagraph (A) or (B) of paragraph (1).

7. INVESTIGATIONS AND DISCIPLINARY PROCEEDINGS

(a) IN GENERAL—The Board shall establish, by rule, subject to the requirements of this section, fair procedures for the investigation and disciplining of registered Small Business Brokers and associated persons of such firms.

(b) INVESTIGATIONS—

(i) AUTHORITY—In accordance with the rules of the Board, the Board may conduct an investigation of any act or practice, or omission to act, by a registered Small Business Broker, any associated person of such firm, or both, that may violate any provision of this Act, the rules of the Board, the provisions of the securities laws relating to the offering, selling and trading of Small Business Securities and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, regardless of how the act, practice, or omission is brought to the attention of the Board.

(ii) TESTIMONY AND DOCUMENT PRODUCTION—in addition to such other actions as the Board determines to be necessary or appropriate, the rules of the Board may—

- (A) require the testimony of the firm or of any person associated with a registered Small Business Broker, with respect to any matter that the Board considers relevant or material to an investigation;
- (B) require the production of any document or information in the possession of a registered Small Business Broker or any associated person thereof, wherever domiciled, that the Board considers relevant or material to the investigation, and may inspect the books and records of such firm or associated person to verify the accuracy of any documents or information supplied;
- (C) request the testimony of, and production of any document in the possession of, any other person, including any client of a registered public accounting firm that the Board considers relevant or material to an investigation under this section, with appropriate notice, subject to the needs of the investigation, as permitted under the rules of the Board; and
- (D) provide for procedures to seek issuance by the Commission, in a manner established by the Commission, of a subpoena to require the testimony of, and production of any document in the possession of, any person, including any client of a registered Small Business Broker, that the Board considers relevant or material to an investigation under this section.

(iii) NONCOOPERATION WITH INVESTIGATIONS—

(A) IN GENERAL—If a registered Small Business Broker or any associated person thereof refuses to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation under this section, the Board may—

- (I) suspend or bar such person from being associated with a registered Small Business Broker, or require the registered Small Business Broker to end such association;
- (II) suspend or revoke the registration of the Small Business Broker; and
- (III) invoke such other lesser sanctions as the Board considers appropriate, and as specified by rule of the Board.

(B) PROCEDURE—Any action taken by the Board under this paragraph shall be subject to the terms of section 1(g).

(iv) COORDINATION AND REFERRAL OF INVESTIGATIONS—

(A) COORDINATION—The Board shall notify the Commission of any pending Board investigation involving a potential violation of the securities laws, and thereafter coordinate its work with the work of the Commission's Division of Enforcement, as necessary to protect an ongoing Commission investigation.

(B) REFERRAL—The Board may refer an investigation under this section—

- (I) to the Commission;

(II) to any other Federal functional regulator (as defined in section 509 of the Gramm-Leach-Bliley Act (15 U.S.C. 6809)), in the case of an investigation that concerns a Small Business Broker that is subject to the jurisdiction of such regulator; and

(III) at the direction of the Commission, to—

- (i) the Attorney General of the United States;
- (ii) the attorney general of 1 or more States; and
- (iii) the appropriate State regulatory authority.

(v) USE OF DOCUMENTS—

(A) CONFIDENTIALITY—Except as provided in subparagraph (B), all documents and information prepared or received by or specifically for the Board, and deliberations of the Board and its employees and agents, in connection with an inspection under section 6 or with an investigation under this section, shall be confidential and privileged as an evidentiary matter (and shall not be subject to civil discovery or other legal process) in any proceeding in any Federal or State court or administrative agency, and shall be exempt from disclosure, in the hands of an agency or establishment of the Federal Government, under the Freedom of Information Act (5 U.S.C. 552a), or otherwise, unless and until presented in connection with a public proceeding or released in accordance with subsection (c).

(B) AVAILABILITY TO GOVERNMENT AGENCIES— Without the loss of its status as confidential and privileged in the hands of the Board, all information referred to in subparagraph (A) may—

(I) be made available to the Commission; and

(II) in the discretion of the Board, when determined by the Board to be necessary to accomplish the purposes of this Act or to protect investors, be made available to—

- (i) the Attorney General of the United States;
- (ii) the appropriate Federal functional regulator (as defined in section 509 of the Gramm-Leach Bliley Act (15 U.S.C. 6809)), other than the Commission, with respect to an audit report for an institution subject to the jurisdiction of such regulator;
- (iii) State attorneys general in connection with any criminal investigation; and
- (iv) any appropriate State regulatory authority; each of which shall maintain such information as confidential and privileged.

(vi) IMMUNITY—Any employee of the Board engaged in carrying out an investigation under this Act shall be immune from any civil liability arising out of such

investigation in the same manner and to the same extent as an employee of the Federal Government in similar circumstances.

(c) DISCIPLINARY PROCEDURES—

(1) NOTIFICATION; RECORDKEEPING—The rules of the Board shall provide that in any proceeding by the Board to determine whether a registered Small Business Broker, or an associated person thereof, should be disciplined, the Board shall—

- (A) bring specific charges with respect to the firm or associated person;
- (B) notify such firm or associated person of, and provide to the firm or associated person an opportunity to defend against, such charges; and
- (C) keep a record of the proceedings.

(2) PUBLIC HEARINGS—Hearings under this section shall not be public, unless otherwise ordered by the Board for good cause shown, with the consent of the parties to such hearing.

(3) SUPPORTING STATEMENT—A determination by the Board to impose a sanction under this subsection shall be supported by a statement setting forth—

- (A) each act or practice in which the registered Small Business Broker, or associated person, has engaged (or omitted to engage), or that forms a basis for all or a part of such sanction;
- (B) the specific provision of this Act, the securities laws, the rules of the Board, or professional standards which the Board determines has been violated; and
- (C) the sanction imposed, including a justification for that sanction.

(iv) SANCTIONS—If the Board finds, based on all of the facts and circumstances, that a registered Small Business Broker or associated person thereof has engaged in any act or practice, or omitted to act, in violation of this Act, the rules of the Board, the provisions of the securities laws relating to the preparation and issuance of audit reports and the obligations and liabilities of accountants with respect thereto, including the rules of the Commission issued under this Act, or professional standards, the Board may impose such disciplinary or remedial sanctions as it determines appropriate, subject to applicable limitations under paragraph (4), including—

- (A) temporary suspension or permanent revocation of registration under this title;
- (B) temporary or permanent suspension or bar of a person from further association with any registered Small Business Broker;
- (C) temporary or permanent limitation on the activities, functions, or operations of such firm or person (other than in connection with required additional professional education or training);
- (D) a civil money penalty for each such violation, in an amount equal to—

(i) not more than \$100,000 for a natural person or \$2,000,000 for any other person; and

(ii) in any case to which paragraph (5) applies, not more than \$750,000 for a natural person or \$15,000,000 for any other person;

(E) censure;

(F) required additional professional education or training; or

(G) any other appropriate sanction provided for in the rules of the Board.

(v) INTENTIONAL OR OTHER KNOWING CONDUCT— The sanctions and penalties described in subparagraphs (A) through (C) and (D)(ii) of paragraph (4) shall only apply to—

(A) intentional or knowing conduct, including reckless conduct, that results in violation of the applicable statutory, regulatory, or professional standard; or

(B) repeated instances of negligent conduct, each resulting in a violation of the applicable statutory, regulatory, or professional standard.

(vi) FAILURE TO SUPERVISE—

(A) IN GENERAL—The Board may impose sanctions under this section on a registered Small Business Broker or upon the supervisory personnel of such firm, if the Board finds that—

(I) the firm has failed reasonably to supervise an associated person, either as required by the rules of the Board relating to offering, selling or trading of Small Business Securities or quality control standards, or otherwise, with a view to preventing violations of this Act, the rules of the Board, the provisions of the securities laws relating to the offering, selling or trading of Small Business Securities and the obligations and liabilities of Small Business Brokers with respect thereto, including the rules of the Commission under this Act, or professional standards; and

(II) such associated person commits a violation of this Act, or any of such rules, laws, or standards.

(B) RULE OF CONSTRUCTION—No associated person of a registered Small Business Broker shall be deemed to have failed reasonably to supervise any other person for purposes of subparagraph (A), if—

(I) there have been established in and for that firm procedures, and a system for applying such procedures, that comply with applicable rules of the Board and that would reasonably be expected to prevent and detect any such violation by such associated person; and

(II) such person has reasonably discharged the duties and obligations incumbent upon that person by reason of such procedures and system,

and had no reasonable cause to believe that such procedures and system were not being complied with.

(vii) EFFECT OF SUSPENSION—

(A) ASSOCIATION WITH A SMALL BUSINESS BROKER—It shall be unlawful for any person that is suspended or barred from being associated with a registered Small Business Broker under this subsection willfully to become or remain associated with any registered public accounting firm, or for any registered public accounting firm that knew, or, in the exercise of reasonable care should have known, of the suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(B) ASSOCIATION WITH AN ISSUER—It shall be unlawful for any person that is suspended or barred from being associated with a Small Business Broker under this subsection willfully to become or remain associated with any Small Business Issuer, and for any Small Business Issuer that knew, or in the exercise of reasonable care should have known, of such suspension or bar, to permit such an association, without the consent of the Board or the Commission.

(d) REPORTING OF SANCTIONS—

(i) RECIPIENTS—If the Board imposes a disciplinary sanction, in accordance with this section, the Board shall report the sanction to—

(A) the Commission;

(B) any appropriate State regulatory authority or any foreign accountancy licensing board with which such firm or person is licensed or certified; and

(C) the public (once any stay on the imposition of such sanction has been lifted).

(ii) CONTENTS—The information reported under paragraph (1) shall include—

(A) the name of the sanctioned person;

(B) a description of the sanction and the basis for its imposition; and

(C) such other information as the Board deems appropriate.

(e) STAY OF SANCTIONS—

(1) IN GENERAL—Application to the Commission for review, or the institution by the Commission of review, of any disciplinary action of the Board shall operate as a stay of any such disciplinary action, unless and until the Commission orders (summarily or after notice and opportunity for hearing on the question of a stay, which hearing may consist solely of the submission of affidavits or presentation of oral arguments) that no such stay shall continue to operate.

(2) EXPEDITED PROCEDURES—The Commission shall establish for appropriate cases an expedited procedure for consideration and determination of the question of the duration of a stay pending review of any disciplinary action of the Board under this subsection.

8. REGULATORY POWER OF THE BOARD – The Board shall promulgate regulatory rules to interpret and establish safe harbors for the following statutory provisions insofar as such statutes govern securities of Small Business Issuers:

(A) Under the Securities Act of 1933

I. Private Offering Exemption

- (a) transactions by any person other than an issuer, underwriter or dealer under Section 4(1)
- (b) transactions by an issuer not a dealer involving a public offering under Section 4(2)
- (c) transactions involving offers and sales of an issuer solely to one or more accredited investors under Section 4(6).
- (d) Rules 504, 505, and 506.

II. Registered Public Offering

- (a) Section 3(b), Regulation A
- (b) Section 5, Registration of Securities
- (c) Section 10, Information Required in Prospectus

III. Exemption from State Regulation of Securities Offerings

- (a) Under Section 18 of the Securities Act of 1933 (Rule 506 offerings)

(B) Under the Securities Exchange Act of 1934

- (a) Section 12 – Regulation of Securities
- (b) Section 13 – Periodic and Other Reports
- (c) Section 15 – Registration and Regulation of Brokers and Dealers

(C) Under the Investment Company Act of 1940

- (a) Section 6(2)(5) – Expand the exemption to venture funds and other investment vehicles that invest solely in securities of Small Business Issuers

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