U.S. Securities and Exchange Commission Investor Advisory Committee September 21, 2023

Panel Discussion Regarding Accredited Investors
Remarks from ACA CEO, Patrick Gouhin

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Great Connections

Gold Standard Education

Data Analytics

Advocacy in DC

World's largest professional society of active accredited angel investors - www.angelcapitalassociation.org

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Opening Remarks: Angel Capital Association

ACA is…

- A nonprofit professional society of accredited investors that has been around for nearly 20 years
- The steward of the angel investing community and works closely with other startup ecosystem builders to drive economic growth
- Not a trade organization and does not have corporate members or represent corporate interests
- Serving its individual members and the asset class they represent

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Opening Remarks: The Power of ACA

- "Entrepreneurs are the engine for economic growth and Angels are the fuel for the engine."
- The more qualified angel investors we help create, the more fuel will be provided to our entrepreneurs.
- ACA is 16K+ accredited investors in 250 Angel groups investing $950 million of their own personal capital into 3K to 5K startups each year.

Opening Remarks: Economic Impact Example by Angels

- Desert Angels (member group) study showed that over 10 years, every $1 million invested produced:
  - 58 jobs
  - $4.58 million in wages
  - $21 million in economic output – 21 X multiplier based on private investment!
- This one group invested over $47 million during the period of the study.

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Opening Remarks: Access & Inclusion are at Risk

- Increasing the thresholds without creating an option for a sophistication test would not only hinder capital formation but would also halt and reverse the modest gains made in getting more diversity into the investor ranks in recent years.

- Diversity is critical to attracting and investing in more diverse founders.

- Because of historical income gaps along racial lines, diverse investors have only relatively recently entered the ranks of accredited investors but if wealth criteria are raised, the more diverse investors at the lower end of the pay and wealth scale will be the first to be forced out of the investor pool.

- This would be an unfortunate setback in efforts to expand and diversify the base of investors (not contract it) and to spur innovation and economic growth.

Opening Remarks: ACA Recommends

1) MAINTAIN THRESHOLDS: That the current thresholds should be left alone as there are no significant issues of fraud in our angel investments and economic growth and innovation are occurring around the country

2) ADD ON RAMPS: That relevant measures of sophistication based on demonstrated competency should be added to allow otherwise capable investors who don't meet those thresholds, especially in underserved communities and in middle America, to participate in wealth creation and support entrepreneurial ventures. (Past efforts like Series 7, 65 or 82 exams don't address sophistication issues specific to early-stage investing.)

Opening Remarks: What Fraud is NOT (Example)

A not-so-rare occurrence…

- An entrepreneur is excited about a new idea
- They first go out and raise $100K from Friends & Family
- 6 months later they have a seed round and raise $500K
- A year down the road, things are looking promising and they raise another $ 1 million from angels and early stage VCs
- Three years down the road they raise $5 million institutionally, with some follow-on from earlier investors
- In year five, poof, they don't make it and company shuts down --but not from lack of effort or dedication, either there was no market acceptance, they couldn't get the science to work, someone else beat them to market or any of the other obstacles early stage companies could face

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Opening Remarks: Understanding the Angel Space

- A 50% failure rate does not equal Fraud - fraud & failure are completely different things

- ACA does not see deals where brokers take advantage of the elderly or unsophisticated - we interact with our founders directly both before and after the investment and do not use finders or broker/dealers

- Bad actors are not able to take advantage of the naïve as angel investing requires the pooling of capital from multiple investors and organizations, which naturally provides investors with checks and balances and eyes wide open

- Some have intimated that even with sophistication, there is simply not enough data available to make good investment decisions – We see a very different reality, albeit available information may be different than what is traditionally evaluated for established businesses

Opening Remarks: Understanding the Angel Space

- Mandating disclosure would not only be fruitless (because at the earliest stages there is nothing to disclose - the company is a hypothesis) it would drive the cost and difficulty of starting a company up without any corresponding protection value to investors

- Intense media coverage of a few spectacular later stage failures such as Theranos and FTX (and the fraud associated with them) have led many to conclude that fraud is rampant in this asset class and therefore further regulation is necessary to help "protect" investors. This perception is not grounded in the facts and statistics of the angel world in which we live - because of direct investment, fraud is exceptionally rare in angel investing

- IN a recent survey of TCA members in which 107 members indicated 2733 investments, only 10 (or 0.3%) were related to fraud (and the majority of those 10 were investments in the same "alleged" fraudulent company)

APPENDIX A

The following slides
have been compiled
to provide additional perspective
and consideration
for the valuable work Angels do
in driving economic growth around the country

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The Ripple Effect on Economic Growth

- Angels bring our capital, but more importantly all the associated skills, experience, etc.
- With fewer Angels there would be a chasm between the "Friends and Family" supported companies and those companies that VCs support
- NVCA has reported to ACA that approximately 90% of companies VCs invest in have angel capital before VC capital – in this regard we are the farm team, enabler and catalyst for future financing by institutional investors making sure they have solid companies on high growth trajectories to invest in
- Not withstanding the high overall failure rate, a sufficiently diversified portfolio of early-stage investments can yield attractive returns
  - Since TCA's founding in 1997, there have been 247 outcomes including 106 exits and 141 shutdowns. If you'd invested an equal amount in all 247 of those companies, you would have received a cash return amounting to 6.4 times your investment and an IRR of 25%.
  - But as is the case in early-stage investing, a small percentage of investments make for most of the return. Six of the exits were from 58x to 368x and missing all of these six drops the TCA portfolio return to 1.8x and 9.3% IRR. This is why diversification is so important.

Tech Coast Angels Outcomes from 526 Portfolio Companies

https://www.angelcapitalassociation.org/blog/failures-and-fraud-dont-exist-in-early-stage-ai/

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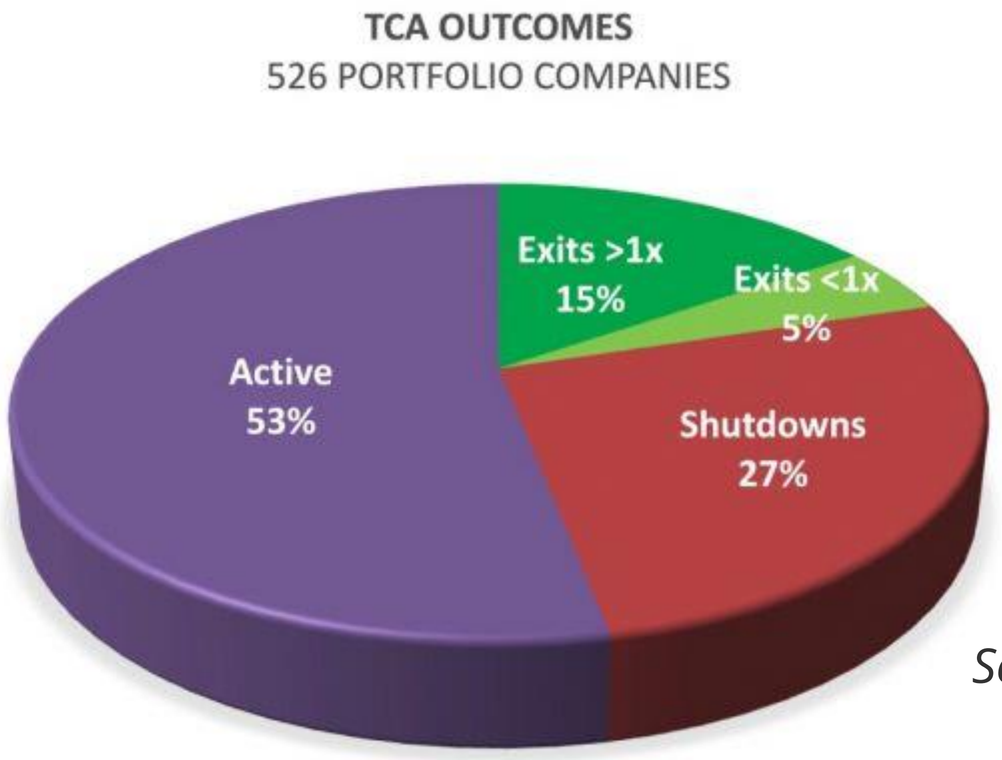

Source: June 2023 Survey of Tech Coast Angel members

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More on what is NOT Fraud

- Fraud typically does not include overly optimistic communications from the CEO to investors; many companies as they go into their final spiral before acknowledging failure have the problem of claiming things look better than they are, but angels do not consider those rose-colored glasses “fraud” And do not believe additional measures of investor protection are warranted

- Failures are quite common in early-stage investing, but the reason for failure almost never is because of fraud. While fraud equates to failure, failure does not equate to fraud: It is critical to understand that failure comes in multiple non-fraudulent forms

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Today’s Accredited Investor – Maintain the Momentum

- 16K ACA members pumping in $950 million annually with a 21X economic output multiplier…and no fraud to speak of
- We are working to Demystify Angel Investing to get more of the 16 million potential accredited investors off the bench and into game
  - Understand it is high risk but diversification is key – educate and follow best practices (as set forth with ACA Angel University)
  - First time in US history with so many baby boomers with significant time, wealth, health, subject matter expertise, and network (OPPORTUNITY!)
    - Let’s leverage that passion by putting 5 to 10% of net worth in a diversified portfolio where they can give back locally and mentor the next generation and generate 21X economic output with private funding

Today’s Accredited Investor – Maintain the Momentum

- It would be counter productive to knock some large percentage out of the game by arbitrarily raising thresholds when there is no problem to correct

- Such an increase in thresholds would also disproportionately effect underserved communities throughout the U.S. eroding some 20 plus years of momentum as angel communities have infiltrated middle America contributing to local growth

- Angels are everywhere, not just on the coasts and financial parameters are different so there is not a universal solution (To earn $400K in NYC, SF or Boston is not the same as in Topeka, Boise, or Cincinnati)

- We are making great progress in driving capital flow ACROSS the country, let’s not revert back to centralization in a few coastal cities

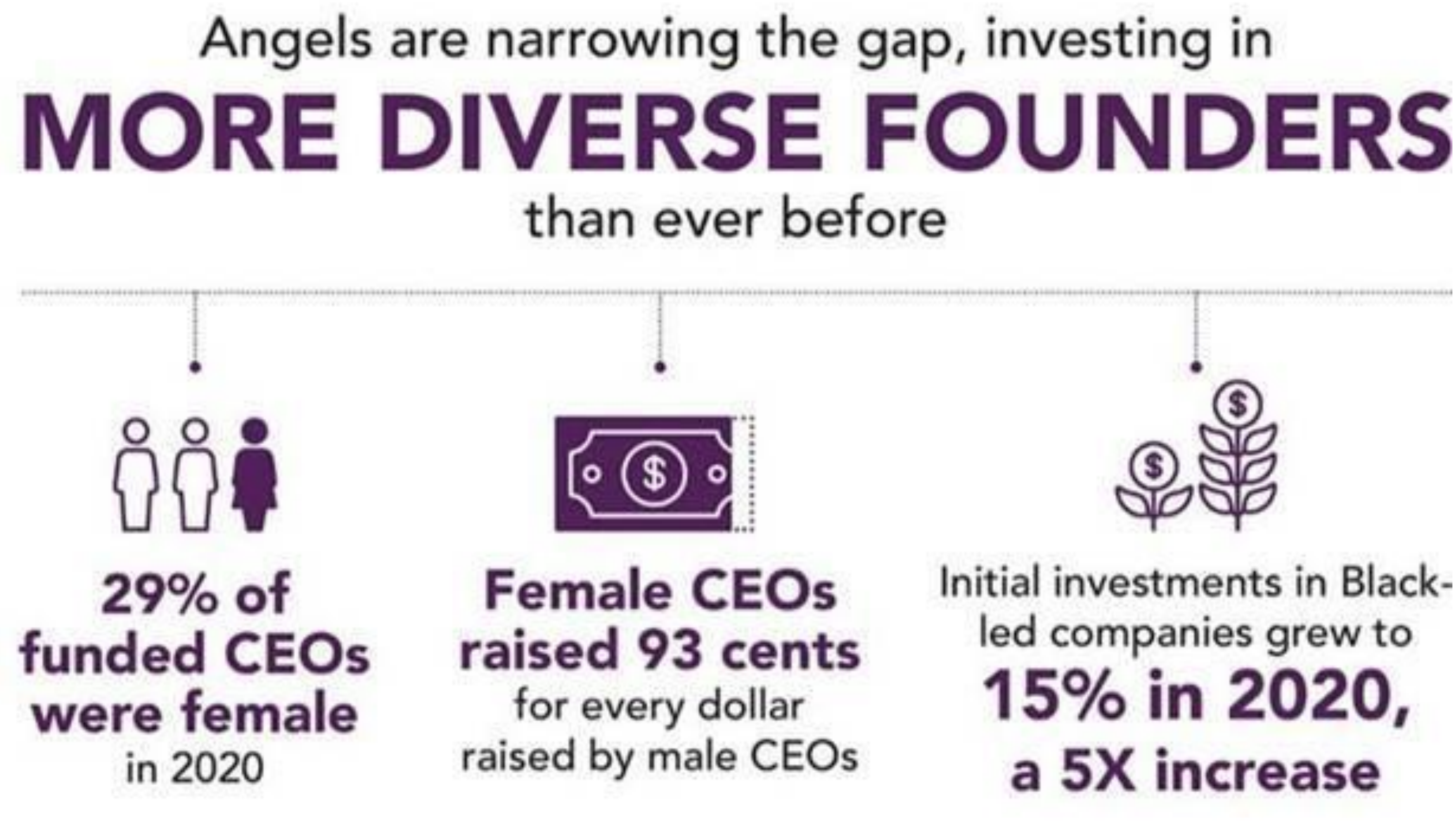
Sophistication Measures are a Move in the Right Direction

- We can responsibly open up Capital Formation in an intentional and educated manner

- This will allow underrepresented communities to have an alternative path to entry

- We know (because we see it in our member groups) more investors of color will result in more entrepreneurs of color
    - Because of our structure and approach we are able to mobilize quickly
    - We are already significantly moving the needle so do not want to cause harm
    - Admittedly, we have seen tough years (negative trends) follow good years so improvement is not to be taken for granted

Angel Progress has Outpaced the VC Community



Current Measures of Sophistication are NOT Adequate

- As long as eyes are wide open and risks are understood we can grow Capital Formation in a responsible way!

- ACA Angel University (now 9 classes) does this but is different than Series 65, Series 7 and Series 82 and for a different audience

- ACA would like to work with the SEC to turn ACA Angel University into ONE of the measures of sophistication

- Unsolicited proposal submitted into SEC on multiple occasions in past

Mutual Goals?

- Provide more incentives for Accredited Investors to participate in the angel investor asset class, not less
- Stimulate American Innovation: US based entrepreneurship sets us apart from other countries in the world (not only do we have new ideas and IP, but we have the money and infrastructure to support a very robust entrepreneurial ecosystem); but the world is catching up
- Our collective goal should be to ensure we maintain that lead, which in turns helps ensure a strong US economy
- Most big companies procure their innovation from the companies Angels support, and those companies provide all new net job growth in our country
- The startup ecosystem is creating jobs and Angel Capital is the primary first capital fueling that ecosystem!

Focusing on Diversity

- This is more than just an issue of capital formation, It is also an issue of halting and reversing the small gains we have made in trying to get more diversity into the investor ranks and into the ranks of the founders
- Raising financial thresholds would negatively impact efforts in terms of diversity as access and inclusion stops the underserved dead in their tracks
- Some of the truly life-changing companies started as angel investments—Apple, Uber, Zoom, Google, AirBnB, Kinkos, Starbucks, DoorDash, PayPal, Genentech…and on and on

Differentiating the Angel from the VC

- Generally speaking…Angels are using their own, after tax dollars to invest locally in innovative ideas after friends and family have been exhausted

- Angels are about financial return but also about giving back - we're all about investing and strengthening our local communities

    - Angels generally invest close to home, in their local communities

    - ACA members donate 1,000,000 volunteer hours per year to mentor companies in addition to the $650 million in capital that is deployed

Differentiating the Angel from the VC

- Angels are very different from all the other Reg D private money:
  - Unlike most deals, we do not have broker/dealers or other intermediaries involved in our deals
  - We meet our companies, we do our own DD, we absorb massive long-term illiquidity and we support the companies with lots of human capital
  - We are the exact opposite of a lot of private deals (particularly the sorts that involve fraud)
  - We are unique, uniquely valuable, and worthy of being considered for carveout from a lot of potential regulation and legislation

The Angel PR Challenge

- It’s easy for people to try and find reasons not to help investors, but it’s harder if they see the connection between angels and the entrepreneur
- Without angels being willing to step up to work with entrepreneurs in so many ways other than just money, there would be tangible differences
- It is not about the rich getting richer with Angels but about giving back and cultivating thriving ecosystems and pockets of innovation across the country

Raising Fund Caps - A Legislative Matter

- Initially limitation was 99 investors and no cap on fund size (this still applies if you have 99 or fewer investors)
- Changed a few years back to 249 investors (we were supportive) but this was coupled with a cap of $10 million
- Not sure what we were trying to solve or prevent with cap but we do not see abuse, just a constraint problem
- To get proper diversification a fund must invest in MANY companies
- The $10 million cap means each company gets a smaller check
  - A 2% management fee on a $10 million fund is $200K – consider all the back office work and admin support needed
  - Carried Interest is the only potential incentive for these GPs to have the potential of getting adequate pay for service
  - It means asset intensive industries are avoided
  - it means GPs must go after a higher level of LP with higher minimums
    - It is a very different game to find LPs with a $25K minimum investment than $250K minimum investment
  - It means the underserved communities are disproportionately effected by the constraints
  - There are proposals to raise the cap to $50 million while raising the investors to 500
  - ACA is supportive of this legislation and believes it will help fill a void in the earl stage capital formation space

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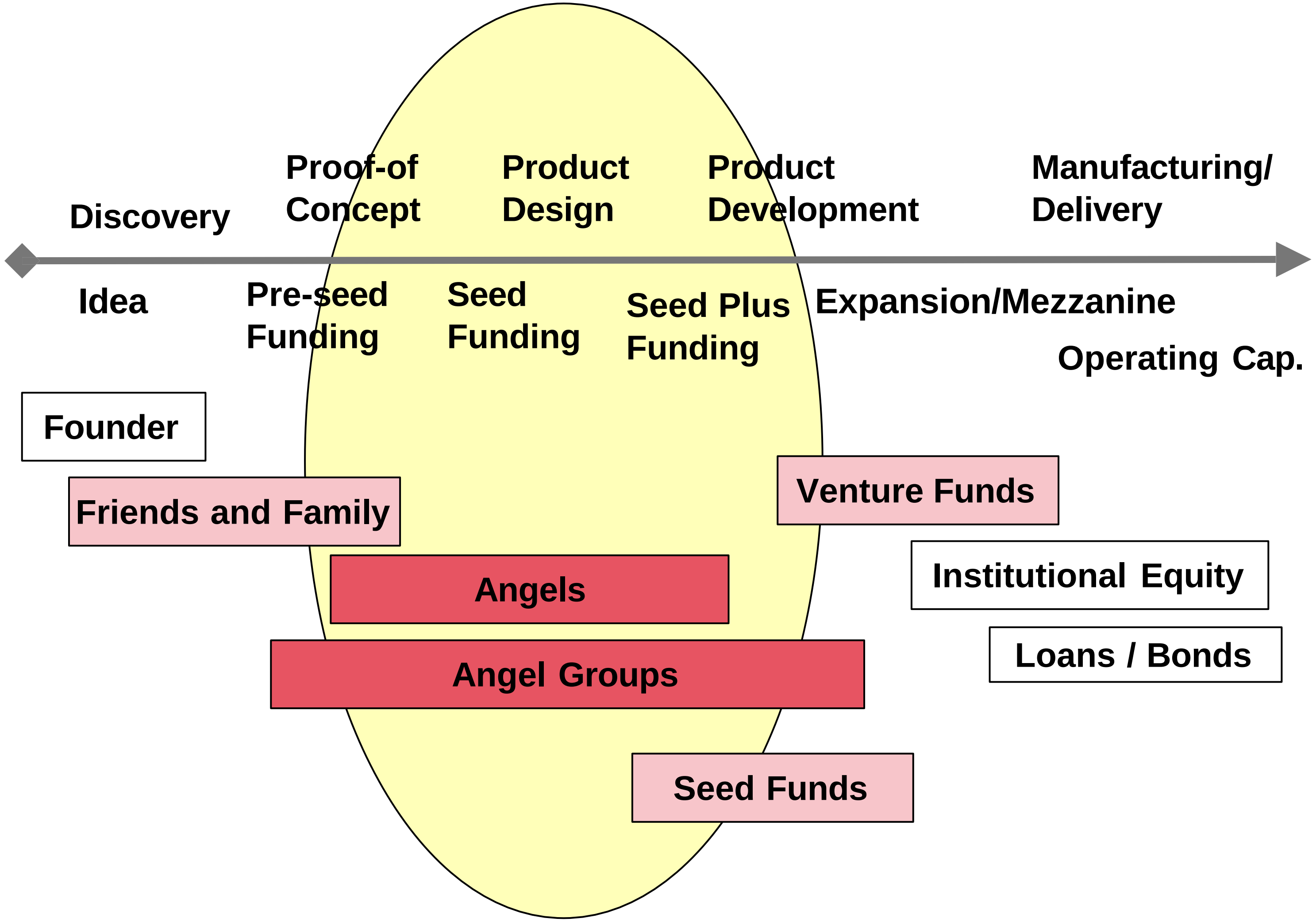
IRC Section 1202 – A Legislative Matter

- This provision benefits ENTREPRENEURS as well as investors
- Startups, being cash poor, don’t offer significant retirement benefits to their employees. Employee QSBS payouts provide employees (not just the CEO) with the equivalent (or more) of typical larger company retirement benefits
- The QSBS isn’t just just for investors and entrepreneurs, it is *broadly based* covering all those employees (from engineers to accounting clerks) who have foregone the most salary and benefits to take a risk to build something new and dynamic in their communities
- Perception is incorrect when we assume “1202 allows rich people to get richer”
- Reality is “1202 provides an additional incentive to entrepreneurs to take the big risks they take in starting up and developing new companies. And of course, it provides an incentive for investors to take that journey with entrepreneurs”
- ACA supports current proposed legislation that would bring further enhancements to IRC Section 1202

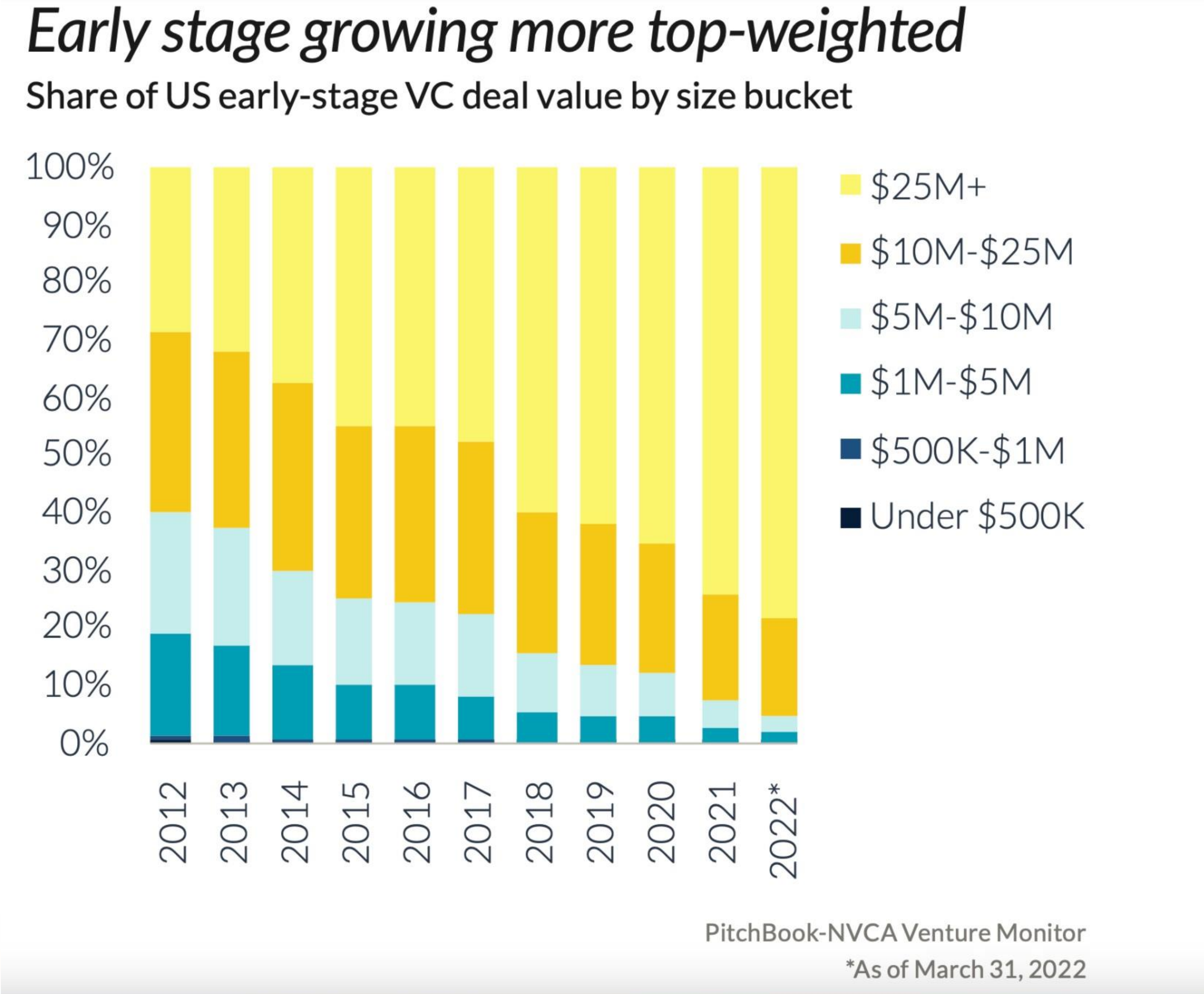
APPENDIX B

The following slides
have been compiled
to provide
a fundamental understanding
of who Angels are
and how they operate

STARTUP COMPANY FINANCING LIFE CYCLE



STAGES WHERE VCs PLAY



Angels Provide ~90% of Outside Equity for Startups

WHAT COMPANIES DO ANGELS INVEST IN

Most invest in businesses with the potential to deliver 10X+ returns to investors that tend to have one or more of the following characteristics:

- Disruptive new technologies
- Large or New and fast-growing markets
- New disruptive business models

TOP INDUSTRIES FOR ANGEL GROUP INVESTMENTS:

- Biotechnology
- Healthcare Technology
- eCommerce
- Green Technology
- Financial Technology

HOW MUCH SHOULD ANGELS INVEST

- Consider angel investing as part of your overall **asset allocation strategy**
  - Public Company Stock, Real Estate, Collectables, Commodities
  - Hedge Funds, Private Equity, Venture Capital

- Illiquid private company investments (e.g. Angel Investments, VC) should represent a **minority percent** of your asset allocation

- For the **majority** of angel investors who are not fulltime angel professionals, a **5% to 10%** allocation to angel investments is sufficient and prudent

- ***Don't put more into angel investing than you can afford to lose.***

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MAKING INVESTMENTS AND DIVERSIFICATION?

- **Diversification** is a core feature of all professional angel portfolios
  - Expect to make a minimum of 10 investments
  - But, diversification begins, not ends, at 10 companies - 20+ investments will greatly increase your likelihood of a positive overall return
- Also Consider building a portfolio with companies that are in different:
  - Industries or sectors
  - Stages of development
  - Types of entrepreneurs
  - Types of key risks

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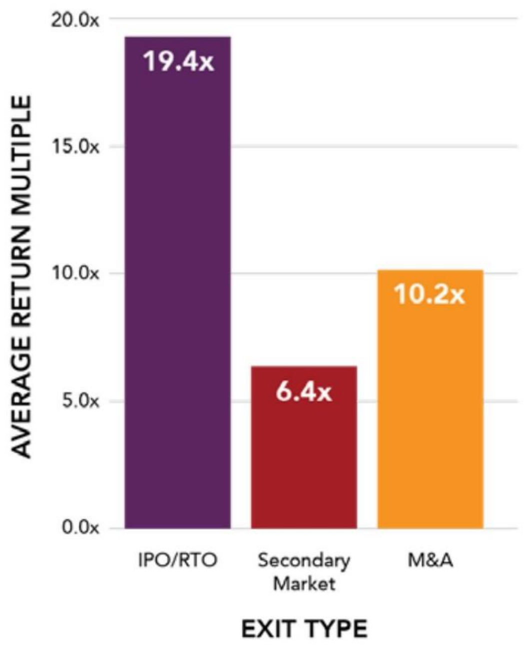
RISKS/RETURNS

- Angel investments are zero liquidity, long-term, high-risk investments. (5-10 years prior to return)
- Angel Investing returns are more challenging to track than public markets.
- At least 50% of companies go out of business; 10% cover other investments made
- Average IRR has been collected at 27% per 2 Rob Wiltbank studies

FIGURE 32. Average Return Multiples by Company Exit Type



Source: ACA Angel Funder's Report 2020

TYPICAL ANGEL FUNDING

- Stage
  - Very early in company development
  - Can be pre-revenue
- Amount -- $50k to $1M+ (more with syndication)
- Geography – May be regional/local
- Terms – Vary widely
- Security – Preferred stock (most desired by angels); Convertible note (acceptable to many angels); others

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IT'S MORE THAN JUST MONEY

- Angels bring:
  - Experience
  - Contacts/Networks
  - Advice
  - Board representation

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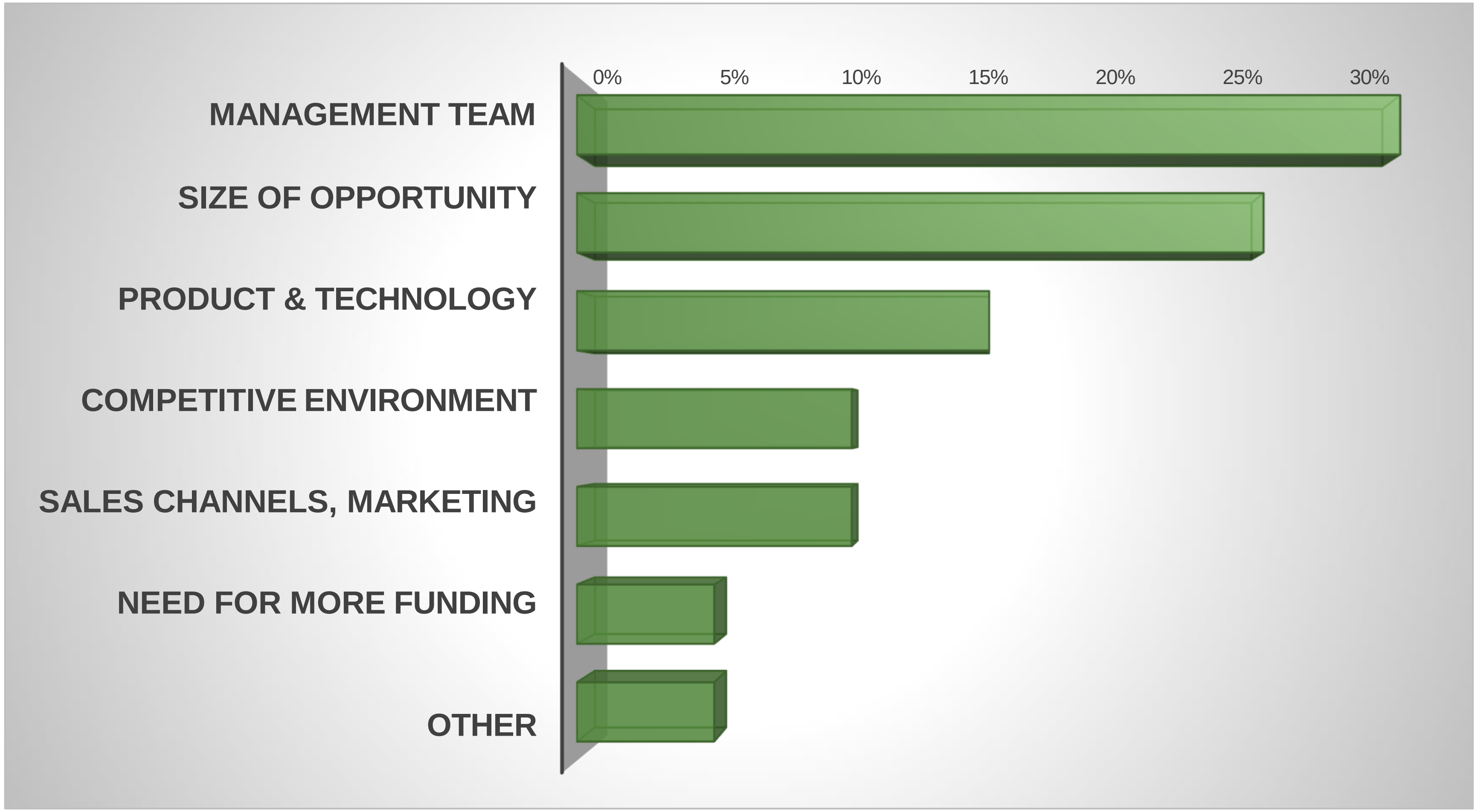
WHAT ANGELS LOOK FOR - WEIGHTING OF FACTORS



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ACA MEMBERS FUND GREAT COMPANIES