EXPANDING THE ON-RAMP:

Recommendations to Help More Companies Go and Stay Public

SPRING 2018

Our organizations share a common concern that the decline in public companies has created fewer opportunities for American families and businesses, and we present these recommendations to assist more companies in going and staying public.

CENTER FOR CAPITAL MARKETS COMPETITIVENESS

ASA American Securities Association

Bio Biotechnology Innovation Organization

EDA Equity Dealers of America

sifma

TECHNET THE VOICE OF THE INNOVATION ECONOMY

Nasdaq

NATIONAL VENTURE CAPITAL ASSOCIATION

INTRODUCTION

“Going public” has long been the goal of entrepreneurs who start a business from scratch, grow it into a thriving enterprise, then have the opportunity to offer shares to the general public through an initial public offering (IPO). Completing an IPO allows our nation’s fast-growing and most innovative companies to raise the capital needed to create jobs and expand opportunities for their employees and the customers they serve. Public offerings also allow “Main Street” investors to own a direct economic stake in the success of American enterprises.

The benefits that accrue to our economy and the jobs market when more companies are willing to go public are significant. A 2012 study by the Kauffman Foundation estimated that the 2,766 companies that went public from 1996 to 2010 collectively employed 2.2 million more people in 2010 than they did before they went public, while total sales among these companies increased by over $1 trillion during the same period.[1] Another study by IHS Global Insight in 2010 found that 92% of a company's job growth occurs after it completes an IPO.[2]

The public capital markets are also dynamic and help spur innovation through competition. Only about 12% of Fortune 500 companies in 1955 were still on the list in 2014, while the other 88% either have gone out of existence, merged with another company, or fallen out of the Fortune 500.[3] This dynamism has forced businesses to change with the times or be replaced by new entrants with innovative ideas and products that meet the needs of consumers and an ever-changing marketplace. In other words, the public capital markets facilitate the fast pace of innovation that has long defined the American economy and improved our standard of living.

Regrettably, over the years, the public company model has become increasingly unattractive to businesses: the United States is now home to roughly half the number of public companies than existed 20 years ago, while the number of public companies in the United States is little changed from 1982.[4] Not only are fewer companies going public, but the companies that do are typically doing so much later in their lifecycle. When companies go public at a relatively mature age, many of the early stage returns generated by those businesses accrue to institutional investors such as private equity funds or wealthy individuals who are allowed and able to invest in private offerings.

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Main Street investors thus have limited opportunities to participate early on in a company's growth cycle. All too often, Main Street investors are simply left out.

Another trend that has developed recently is companies adopting corporate structures that help founders maintain control. For example, dual class or multi-class share structures retain voting rights only for certain shareholders. While such structures have received criticism from some observers, policymakers should recognize that this trend has coincided with a steady rise in shareholder activism, and that companies should be free to choose a corporate structure that they believe will best enhance long-term performance. Instead of contemplating whether to prohibit or limit the use of such structures, policymakers should instead focus on the underlying causes of the trend and whether it is merely a symptom of a broken public company model. A broad focus on encouraging investor choice while assuring that issuer disclosure keeps investors sufficiently informed is necessary to prevent prescriptive regulations that harm market dynamism.

To be sure, the decline in public companies is a multifaceted issue that does not lend itself to easy solutions. Private capital markets in the United States are as strong as they have ever been and have become a viable alternative for businesses looking to raise large amounts of capital. Sovereign wealth funds, venture capital funds, private equity, and others have all ramped up private investment over the past decade. This is undoubtedly a positive development and a sign of strength within the American and global economies.

But there is no guarantee that private capital markets will always remain as robust as they are today, and policymakers cannot simply control many of the economic factors that contribute to the strength of private markets. What policymakers *can* control, however, are the laws and regulations that apply to businesses looking to raise capital, and on that issue it has become clear that the public company model has failed to keep up with the times. Strong private capital markets should not conceal the fact that the public company regulatory regime needs to be reformed.

To help address this issue, in 2012 Congress passed the Jumpstart Our Business Startups (JOBS) Act, which contained some of the most significant reforms to the IPO process and other regulations in years. Title I of the JOBS Act created an IPO "on-ramp" and established a new class of issuer under

> **Policymakers need to seriously address the impediments to both launching IPOs and to reverse the increase in costs associated with remaining a public company.**

securities law – the emerging growth company (EGC), defined as a business with less than $1 billion in gross revenue. EGCs are eligible for tailored regulatory treatment, including the ability to submit draft registration statements to the Securities and Exchange Commission (SEC) confidentially, a temporary and optional exemption from certain executive compensation rules, and a temporary and optional exemption from internal control requirements under Section 404 of the Sarbanes-Oxley Act of 2002.

By many measures, the JOBS Act has successfully breathed much-needed life into the IPO market. For example, in 2013 – the first full calendar year after the JOBS Act was passed – 226 IPOs were listed in the United States (the highest number since 2004), followed by 291 in 2014.[5] While the IPO market has since cooled, the vast majority of companies that are going public are still doing so as EGCs.

The scaling of regulatory requirements for EGCs has demonstrated that rules can be modernized and businesses can be relieved of regulatory burdens without undermining important investor protections. If anything, investors have benefited from the willingness of EGCs to go public and to become subject to the transparency requirements that are a hallmark of the U.S. corporate disclosure regime.

But the JOBS Act only began what needs to be done to modernize rules that apply to public companies. Since 2012, several pieces of bipartisan "JOBS Act 2.0" legislation have advanced in Congress, and support for further reforms from a diverse cross-section of industry participants remains strong. A significant and welcome development has been the renewed focus of the SEC on the public company crisis. In July 2017, SEC Chairman Jay Clayton remarked in his first public speech as chair, "The reduction in the number of U.S.-listed public companies is a serious issue for our markets and the country more generally.

To the extent companies are eschewing our public markets, the vast majority of Main Street investors will be unable to participate in their growth. The potential lasting effects of such an outcome to the economy and society are, in two words, not good."[6] Fortunately, the SEC has already begun to take action. In June 2017, the SEC announced that it would extend the confidential filing provisions of the JOBS Act to all issuers, and would also allow issuers to use these same provisions when conducting certain secondary offerings; the SEC continues to remain focused on other ways to help both business and investors by improving the regulatory regime for public companies.[7]

Additionally, in October 2017 the Treasury Department (Treasury) released a report on recommendations to improve the U.S. capital markets (Treasury Report) and to help more companies access them.[8] The Treasury Report noted that "To the extent that companies decide not to go public due to anticipated regulatory burdens, regulatory policy may be unintentionally exacerbating wealth inequality in the United States by restricting certain investment opportunities to high income and high net worth investors." The report included a number of positive ideas that could gather bipartisan support, boost capital formation, and preserve investor protections.

Our organizations represent a diverse cross-section of the American economy, but we all share a common concern that the decline in U.S. public companies has created fewer opportunities for American families and businesses, and presents a serious roadblock to the long-term health of the American economy. Policymakers need to seriously address the impediments both to launching IPOs and to reverse the increase in costs associated with remaining a public company, and we strongly believe that now is the time for this consideration. Our recommendations are laid out in this document.

[1] Kauffman Foundation, Post-IPO Employment and Revenue Growth for U.S. IPOs June 1996-2010

[2] IHS Global Insight, Venture Impact Study 2010

[3] Mark Perry, AEIdeas, August 18, 2014

[4] https://www.wsj.com/articles/americas-roster-of-public-companies-is-shrinking-before-our-eyes-1483545879

[5] https://www.sec.gov/info/smallbus/acsec/giovannetti-presentation-acsec-021517.pdf

[6] https://www.sec.gov/news/speech/remarks-economic-club-new-york

[7] Draft Registration Statement Processing Procedures Expanded, available at https://www.sec.gov/corpfinannouncement/draft-registration-statement-processing-procedures-expanded

[8] "A Financial System That Creates Economic Opportunities," pursuant to E.O. 13772 on Core Principles for Regulating the United States Financial System

ENHANCEMENTS TO THE JOBS ACT

Now that the JOBS Act has been in place for six years, we have a clearer understanding of how it has worked in practice and which provisions remain the most popular with EGCs and investors. With continued interest from policymakers to implement a "JOBS Act 2.0," included here is a targeted list of recommendations that would build on the model already created by the JOBS Act.

ENHANCEMENT ONE

For issuers that continue to meet the definition of an EGC, extend certain JOBS Act Title I "on-ramp" provisions from 5 years to 10 years.

The JOBS Act included important and useful provisions designed to ease certain disclosure and other requirements for EGCs, including the following:

- Streamlined financial disclosure;
- Allowance for confidential reviews of registration statements by SEC staff;
- Simplified executive compensation disclosure and;
- An exemption from certain executive compensation requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), including a requirement for say on pay, say on frequency, and say on golden parachute votes, and an exemption for the pay for performance disclosure and "pay ratio" disclosure requirements.

The vast majority of EGCs have taken advantage of all of these provisions, which has helped lead to a post-JOBS Act increase in the public offering market. We believe that as companies continue to mature five years after going public, extending the exemption from these requirements would be a further incentive for businesses to go public in the first place.

ENHANCEMENT TWO

Amend Section 5(d) of the Securities Act of 1933 to permit all issuers to engage in oral or written communications ("test the waters") with potential investors that are qualified institutional buyers (QIBs) or institutional accredited investors to determine interest in a securities offering.

Section 5(d) was amended by the JOBS Act in 2012 to permit EGCs to test the waters with QIBs and accredited investors to determine interest in an offering. However, pre-IPO companies that lose their EGC status are not permitted to continue oral or written communications with potential investors. Allowing all issuers – regardless of whether EGC status is maintained – to test the waters with potential qualified investors will allow issuers to take advantage of one of the more popular provisions of the JOBS Act.

The Treasury Report also included this recommendation, which noted that testing the waters gives companies "a better gauge of investor interest prior to undertaking significant expense and, in the event the company elects not to proceed with an IPO, information has been disclosed only to potential investors and not to the company's competitors."[9]

ENHANCEMENT THREE

Extend the JOBS Act exemption from Section 404(b) mandates of the Sarbanes-Oxley Act from 5 years to 10 years for EGCs that have less than $50 million in revenue and less than $700 million in public float.

The JOBS Act in effect provides EGCs with a five-year exemption from the internal controls requirements contained in Section 404(b) of the Sarbanes-Oxley Act. Costs associated with Section 404(b) have not been scalable for small and midsize public companies due in large part to a "one-size-fits-all" implementation that has failed to account for unique business models. Given this, many companies will be forced to divert resources away from productive uses such as research and development once their five-year exemption expires. Importantly, there is no evidence that the Section 404(b) exemptions under the JOBS Act have compromised investor protection or market confidence, and this recommendation would merely extend that exemption for a narrow set of issuers that have not yet begun generating the revenue necessary to pay for such compliance costs. This recommendation is modeled after bipartisan and bicameral legislation (the Fostering Innovation Act) which passed the House of Representatives in 2016 and 2017. This recommendation was also included in the Treasury Report, which noted that such a measure would "appropriately tailor compliance costs associated with being a smaller public company."[11]

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ENHANCEMENT FOUR

Remove counterproductive "phase out" rules that increase the complexity and uncertainty regarding EGC status. For example, some companies may find they no longer qualify as an EGC because they meet the definition of a "large accelerated filer."

Questions related to the phase out of EGC status for large accelerated filers create a great amount of uncertainty about whether companies can rely on EGC status after they go public. For example, in 2014 some 30% of EGCs that went public in 2012 complied with internal controls of Section 404(b) because they became large accelerated filers and therefore ceased to qualify as EGCs.[12] This recommendation would effectively allow EGCs to maintain their status - based on the JOBS Act EGC definition - even if they cross a market capitalization threshold that triggers requirements to become large accelerated filers. If the phase out rules were ultimately removed, the SEC would still retain authority to set a public float or other type of threshold to limit the size of company that could benefit from such a change.

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[9] Treasury Report at 30
[10] 115th Congress: H.R. 1645; S. 2126
[11] Treasury Report at 37
[12] The JOBS Act, Two Years Later: An Updated Look at the IPO Landscape. Latham & Watkins April 5, 2014

RECOMMENDATIONS TO ENCOURAGE MORE RESEARCH OF EGCS AND OTHER SMALL PUBLIC COMPANIES

The amount of analyst research concerning small public companies has significantly declined in recent years for a host of reasons. A recent report noted that about 61% of all companies listed on a major exchange with less than a $100 million market capitalization have no research coverage at all.[13] Lack of research can reduce interest from investors and impact the liquidity and overall trading environment in particular companies.

RECOMMENDATION ONE

Amend Rule 139 under the 1933 Securities Act to provide that continuing coverage by research analysts of any issuer (as opposed to only those that qualify for Form S-3/F-3) would not be deemed to constitute an offer or sale of a security of such issuer before, during or after an offering by such issuer.

If an analyst has already been covering an issuer, there is no clear reason why the distinction requiring the issuer to be "S-3 eligible" provides additional protection to investors. If an analyst has determined that the issuer has significant trading and float worth covering, the analyst should be permitted to continue its coverage through an offering by the issuer regardless of S-3 eligibility.

RECOMMENDATION TWO

Allow investment banking and research analysts to jointly attend "pitch" meetings in order to have open and direct dialogue with EGCs. A holistic review of the Global Research Analyst Settlement should also be conducted.

Under the JOBS Act, investment banking research and analysts may jointly attend pitch meetings. However, according to Section 105(b), analysts are prohibited from engaging in efforts to solicit investment banking business. To reconcile these two items, SEC guidance provides examples of what analysts may discuss which, in practice, is limited. Therefore, to err on the side of conservatism, bankers and analysts continue to not jointly attend pitch meetings, despite the clear intent of the JOBS Act.

The SEC should consider the removal of barriers prohibiting investment banks and analysts (including those from "settling" firms) from jointly attending meetings (including pitches) for EGCs, and expressly expand the permitted content that can be discussed at such meetings so long as no direct or indirect promises of favorable research are given. We also support Treasury's recommendation to conduct a holistic review of the Global Settlement and the research analyst rules, with the objective of harmonizing a single set of rules for financial institutions.[14]

RECOMMENDATION THREE

The SEC should examine why pre-IPO research has not materialized following passage of the JOBS Act.

One of the major changes made to the Securities Act was the liberalization of the "gun-jumping" rules to permit investment banks to publish pre-IPO research on EGCs (Sec 2(a)(3)). However, very few investment banks have published any pre-IPO research. The SEC should examine what, if any, regulatory or liability burdens continue to exist that may effectively prohibit investment banks from publishing pre-IPO research. The SEC should look at existing FINRA rules, Global Settlement implications, and Federal and State liability concerns, with the ultimate goal of developing recommendations to help more pre-IPO companies gain research coverage.

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[13] CapitalIQ as of June 9, 2017

[14] Treasury Report at 37-38

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IMPROVEMENTS TO CERTAIN CORPORATE GOVERNANCE, DISCLOSURE, AND OTHER REGULATORY REQUIREMENTS

The costs and burdens associated with being a public company have grown significantly over the years and have become a barrier to going and staying public. A report from the 2011 IPO Task Force – a group convened in response to a capital access roundtable held by Treasury that same year – showed that 92% of public company CEOs found the "administrative burden of public reporting" to be a significant barrier to completing an IPO.[15] Companies also find themselves under increasing pressure from activist investors, often times over immaterial matters that distract management from carrying out their core duties and that impose significant costs on shareholders. Many of these campaigns are bolstered by the influence of proxy advisory firms, which continue to wield enormous influence over corporate governance. The recommendations below would address a host of outdated rules that are in need of reform.

IMPROVEMENT ONE

Institute reasonable and effective SEC oversight of proxy advisory firms.

Proxy advisory firms have steadily increased their influence over public companies in recent years, and have in a sense become the *de facto* standard setters for corporate governance in the United States. Two firms – Institutional Shareholder Services and Glass-Lewis – control over 97% of industry market share, leaving little room or incentive for competition. These firms also operate with a startling lack of transparency and significant conflicts of interest, and have been prone to making errors in analysis and when developing voting recommendations. These issues are exacerbated by the lack of communication between the firms and small and midsize companies, which are more likely to have unique business models that require careful evaluation and which can be more impacted by adverse proxy recommendations. These challenges faced by small and midsized companies create a significant disincentive for businesses considering an IPO. In December 2017, the House of Representatives passed H.R. 4015, the Corporate Governance Reform and Transparency Act of 2017[16], bipartisan legislation that would require proxy advisory firms to register with the SEC and become subject to a robust oversight regime. The legislation would require proxy advisory firms to disclose and manage their conflicts of interest, provide issuers with a reasonable amount of time to respond to errors or flaws in voting recommendations, and demonstrate they have the expertise and capabilities to provide accurate and objective recommendations. Eventual enactment of H.R. 4015 or substantially similar legislation would improve the overall quality of proxy voting advice and address many of the longstanding issues that have plagued the proxy advisory firm industry. At a minimum, the SEC should withdraw the Egan-Jones and ISS no-action letters issued last decade.[17] These no-action letters effectively allow proxy advisory firms to avoid a case-by-case scrutiny of their own conflicts of interest, and have further entrenched their position in corporate governance in the United States.

IMPROVEMENT TWO

Reform shareholder proposal rules under Rule 14a-8 of the Securities Exchange Act, in particular by raising the "resubmission thresholds" that determine when a proponent is allowed to resubmit a proposal that has previously garnered low support.

The shareholder proposal system under Exchange Act Rule 14a-8 was originally intended as a means to facilitate constructive shareholder engagement at public companies. While it is not the only means an investor has to get the attention of management, as the SEC has stated previously, Rule 14a-8 "is popular because it provides an opportunity for any shareholder owning a relatively small amount of the company's shares to have his or her own proposal placed alongside management's proposals in the company's proxy material…"[18] Unless a company is able to use 1 of the 13 exemptions that exist under Rule 14a-8, it generally is required to include a shareholder's proposal with its proxy materials. The exemptions indicate that the SEC has never allowed unfettered access to a company's proxy statement. Regrettably, many of the longstanding guardrails put in place under this system to protect investors from abuse of the proxy process have steadily weakened, and the shareholder proposal system today has become dominated by a minority of special interests that use it to advance idiosyncratic agendas. Current rules also allow investors to *resubmit* proposals year after year even if they have been overwhelmingly rejected in the past. While there are many possibilities for reform of Rule 14a-8, an important and meaningful first step would be for the SEC to raise the level of support a proposal must receive before it is resubmitted again. The current "Resubmission Rule" allows a company to exclude a proposal from its proxy statement if it failed to receive the support of:

- 3% of shareholders the last time it was voted on (if voted on once in the past five years);
- 6% of shareholders the last time it was voted on (if voted on twice in the past five years); or
- 10% of shareholders the last time it was voted on (if voted on three or more times in the past five years).

Thus, the current rules allow a shareholder to resubmit a proposal even if, in some instances, over 90% of shareholders have voted against it. In 1997, the SEC proposed – but did not finalize – a rule raising these thresholds from the current 3%/6%/10% system to a more reasonable 6%/15%/30% system. We believe the 1997 proposal is a good starting point for the SEC to consider modernization of this outdated system. The Treasury Report also recommended that the resubmission thresholds be raised from current levels.[19]

Additionally, the SEC should consider certain improvements to the no-action process that governs shareholder proposals. For example, the SEC should withdraw *Staff Legal Bulletin 14H* (CF), issued in October 2015.[20] This legal bulletin created unnecessary complexity for issuers that have long relied on an exemption under Rule 14a-8(i)(9), which allows companies to exclude proposals that "directly conflict" with a management proposal.

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IMPROVEMENT THREE

Simplify quarterly reporting requirements and give EGCs the option to issue a press release with earnings results in lieu of a 10-Q.

According to the 2011 report of the IPO Task Force, 92% of public company CEO's said that the "administrative burden of public reporting" was a significant challenge to completing an IPO and becoming a public company. As annual (10-K) and quarterly (10-Q) reports have grown in size and complexity over the years, companies find it increasingly difficult and costly to maintain compliance with a 1930's-style disclosure system. The length of annual and quarterly reports also has the potential to make it more difficult for investors to determine the most salient information about a business. Granting EGCs the option of issuing a press release that includes earnings results every quarter – as opposed to a full 10-Q - will still provide investors with the material information they need to make informed decisions but reduce some of the unnecessary burden associated with the current quarterly reporting system.

IMPROVEMENT FOUR

Policymakers should continue efforts to modernize corporate disclosure and scale certain requirements for EGCs, and both Congress and the SEC should maintain the longstanding "materiality" standard[21] for corporate disclosure.

A troubling trend in recent years has been an increasing push to use the SEC's disclosure regime in order to advance agendas that are uncorrelated with the historical purpose of the securities laws. For example, the Dodd-Frank Act's conflict minerals and pay ratio rules have imposed billions of dollars' worth of costs on public company shareholders, but have done little to provide investors with material information. Such developments demonstrate the type of harm and unintended consequences that can occur when the securities laws are used for something other than their original purpose. Other attempts to erode the materiality standard for corporate disclosure threaten to inundate investors with immaterial information which hampers their decision making. The SEC should maintain the longstanding materiality standard and reject further efforts to use the securities laws for anything other than providing material information to investors, consistent with the goals of the federal securities laws.

Additionally, we believe that policymakers should further scale certain disclosure requirements for EGCs in order to accommodate their unique regulatory status. For example, we agree with recommendations made in the Treasury Report that at a minimum, Congress should exempt EGCs from Sections 1502 (conflict minerals), 1503 (mine safety), and 1504 (resource extraction) of the Dodd-Frank Act.[22] Additionally, in October 2017 the SEC – pursuant to a congressional mandate - proposed a number of amendments to Regulation S-K that would modernize and simplify disclosure requirements for public companies.[23] The SEC's proposals also include scaling of certain disclosure requirements for EGCs, and represent an important step toward reforming the outdated corporate disclosure regime. These are welcome proposals and will help reduce reporting burdens imposed upon small public companies without compromising investor protection.

IMPROVEMENT FIVE

Allow purchases of EGC shares to be qualifying investments for purposes of Registered Investment Adviser exemption determinations.

Registered Investment Adviser (RIA) rules promulgated by the SEC inadvertently discourage some venture capital firms from investing in EGCs. The 2010 Dodd-Frank Act sought to exempt venture capital funds from the costs and challenges associated with becoming an RIA. However, the definition of "venture capital fund" promulgated by the SEC in Rule 203(1)-1 of the Investment Advisers Act was too narrow and did not meet the Dodd-Frank statutory obligations of a full venture capital exemption.[24] The current definition ignores critical elements and developments related to the venture capital industry, including growth equity firms which can often be investors in EGCs around the time they are considering a public offering. Shares of EGCs, including the purchase of EGC shares on the secondary market, should be considered qualifying investments. Creating a more accurate venture capital exemption definition will expand the pool of possible investors for EGCs.

IMPROVEMENT SIX

Amend Form S-3 to eliminate the "baby-shelf" restrictions and allow all issuers to use shelf registration Forms S-3 and F-3.

Forms S-3 and F-3 - commonly referred to as "shelf registration" forms – are the most simplified registration forms that a company can file with the SEC, and typically bring significant cost savings for those companies that are eligible to use one or the other. However, EGCs and many small issuers are precluded from being able to use these forms, increasing the burden and making it more difficult to make an offer of securities on a timely basis. The SEC's Annual Government-Business Forum on Small Business Capital Formation has recommended over the past several years that all issuers become eligible for use of Forms S-3 and F-3.

The "baby-shelf" rules also significantly limit the amount of capital that small-market cap companies (primarily EGCs) can raise using a shelf registration statement. Therefore, a company looking to raise more capital than the baby-shelf rules allow is forced into completing either a private placement (typically at a large discount to market due to the restricted nature of the securities) or a confidential S-1 filing (which is expensive and time consuming for small market capitalization companies). Letting all companies use a shelf registration statement without a limit on the amount they can raise would significantly improve the capital formation process for small public companies.

IMPROVEMENT SEVEN

The SEC should address abuses or unlawful activity related to short sales.

There are extensive public disclosure obligations for investors who bet on a company's performance by 'going long' and buying a company's stock. However, no such requirements exist for those investors who take a short position in the company's stock, or utilize other investment instruments to enable an investor to profit from the loss of a company's equity value.

As the SEC rightfully noted in a 2014 study on short selling, "Short selling as employed by a variety of market participants can contribute substantially to overall market quality through its positive effects on price efficiency and market liquidity."[25]

Short selling undoubtedly serves a valuable market function, and a free market should allow investors to go either "long" or "short" depending on their view of a particular company or overall investment strategy.

However, the SEC has also noted that market manipulators can engage in abusive forms of short selling that unduly harm investors or the reputation of a company. For example, "short and distort" campaigns occur when a manipulator shorts the stock of a particular company, then spreads false or unverified rumors about the company in order to drive down its stock price which benefits the short seller. This problem is compounded given the role that technology, social media, and the fast movement of information increasingly play in the markets. The SEC should remain vigilant in taking action against manipulators that unlawfully engage in activities that harm the overall markets, and in ensuring there is sufficient public information about potential market manipulation. [26]

IMPROVEMENT EIGHT

Amend Rule 163 under the 1933 Securities Act to allow prospective underwriters to make offers of well-known seasoned issuer securities in advance of filing any registration.

In 2005, the SEC created a new class of registrant: well-known seasoned issuers (WKSIs), which are issuers that have a demonstrated reporting history with the SEC, meet certain market capitalization thresholds, and are generally widely followed in the marketplace. Because of their status, WKSIs benefit from expanded use of the SEC's communications rules under Rule 163 and under certain conditions are permitted to engage in oral or written communications with potential investors without violating the "gun jumping" provisions of the Securities Act. In 2009, the SEC proposed amending Rule 163 to allow underwriters or dealers to engage in such offers or communications "by or on behalf of" WKSIs.[27] Allowing underwriters to do so would make it easier for WKSIs to gauge investor interest and market conditions prior to completing an offering of securities. While the 2009 proposal was never finalized, we believe the SEC should pick up where it left off and amend Rule 163 so that underwriters and dealers can act as agents on behalf of WKSIs in making efforts in advance of the filing of the registration statement.

IMPROVEMENT NINE

Make XBRL compliance optional for EGCs, smaller reporting companies (SRCs), and non-accelerated filers.[28]

Public companies are currently required to provide their financial statements in an interactive data format using eXtensible Business Reporting Language (XBRL). XBRL "tags" certain data points in an issuer's filing statement and exports them in a standardized layout. The ostensible goal of XBRL is to make financial data comparable across issuers, but it falls prey to the one-size-fits-all approach that afflicts so many reporting requirements, resulting in significant costs for EGCs and other small companies without much, if any, benefits to investors. The data reported by XBRL are heavily weighted toward traditional metrics that provide little to no insight into the health of a small or pre-revenue business. Investors largely realize this shortcoming of XBRL and thus often do not utilize XBRL reports to evaluate emerging companies, yet every single public company faces an identical XBRL compliance requirement. We believe that EGCs, SRCs, and non-accelerated filers should be exempt from XBRL reporting requirements. These issuers would still be allowed to opt-in to compliance if they choose to do so, but otherwise would be free from a costly regulatory burden that provides no useful information to investors. The SEC's annual Government-Business Forum on Small Business Capital Formation has also included such an XBRL exemption on several occasions over the past decade.

IMPROVEMENT TEN

Increase the threshold for mutual funds to take positions in companies before triggering diversified fund limits from current 10% of voting shares to 15%.

As the size of mutual funds have increased in recent years, the diversified fund limit rules have constrained their ability to take meaningful positions in small-cap companies. Mutual funds have historically played an important role in helping to provide liquid markets for the shares of newly public companies. Modestly moving the threshold up to 15% would make investments in EGCs and other small-cap companies more attractive to mutual funds and help provide more robust secondary markets for the trading of these stocks.

IMPROVEMENT ELEVEN

Allow disclosure of selling stockholders to be done on a group basis under Rule 507 of Regulation S-K even if each selling stockholder a) is not a director or named executive officer of the registrant and b) holds less than 1% of outstanding shares.

Given legitimate business reasons (e.g. privacy, employee relations or competitive harm), disclosure of selling stockholders should be permitted on a group/aggregate basis if *each selling stockholder* within the group (a) is not a director or a named executive officer of the registrant and b) holds less than 1% of outstanding shares.

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[15] Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth, available at: https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf

[16] H.R. 4015 Supported by Nasdaq (http://business.nasdaq.com/marketinsite/2017/Proxy-Advisory-Reform-Legislation-Update.html); U.S. Chamber (https://www.uschamber.com/sites/default/files/171218_kv_hr_4015_corporate_governance_reform_and_transparency_act_house.pdf) ; BIO (https://www.bio.org/press-release/bio-applauds-house-passage-corporate-governance-reform-and-transparency-act); Equity Dealers of America, Corporate Governance Coalition for Investor Value (https://www.centerforcapitalmarkets.com/wp-content/uploads/2017/12/171219_Coalition_HR-4015_Corporate-Governance-Reform-and-Transparency-Act_House.pdf) National Venture Capital Association, TechNet (See December 15, 2017 Nasdaq letter signed by a broad coalition of public companies and trade associations).

[17] See Egan-Jones Proxy Services, SEC Staff No-Action Letter (May 27, 2004), available at http://www.sec.gov/divisions/investment/noaction/egan052704.htm; Inst'l Sh. Services, Inc., SEC Staff No-Action Letter (September 15, 2004), available at http://www.sec.gov/divisions/investment/noaction/iss091504.htm.

[18] Proposed Rule: Amendments to Rules on Shareholder Proposals Release No. 34-39093 (September 19, 1997).

[19] Treasury Report at 32

[20] https://www.sec.gov/interps/legal/cfslb14h.htm

[21] TSC Industries, Inc. vs. Northway Inc. 1976 "An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote…there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information available."

[22] Treasury Report at 29. Although Congress abrogated the resource extraction rule in P.L. 115-4 as signed by the President on February 14, 2017, the provision in the Dodd-Frank Act mandating adoption of the rule has not been repealed

[23] Release No. 33-10425; 34-81851; IA-4791; IC-32858, FAST Act Modernization and Simplification of Regulation S-K, 82 Fed. Reg. 50988 (Nov. 2, 2017).

[24] Release No. IA-3222, Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers, 76 Fed. Reg. 39645 (July 6, 2011).

[25] Short Sale Position and Transaction Reporting (June 5, 2014).

[26] For example, a short sale disclosure regime, as supported by the Biotechnology Innovation Organization, Nasdaq, National Venture Capital Association, and Equity Dealers of America would require that institutional investors disclose short positions in a similar manner that long positions are currently required to be disclosed. See e.g. December 2015 SEC rulemaking petition filed by Nasdaq, available at https://www.sec.gov/rules/petitions/2015/petn4-691.pdf; letter filed by BIO in support of Nasdaq petition, available at https://www.sec.gov/comments/4-691/4691-5.pdf; Nasdaq 2017 Blueprint to Revitalize the Capital Markets; A short disclosure regime was also endorsed by the 2016 SEC Government Business Forum on Small Business Capital Formation. Available at: https://www.sec.gov/info/smallbus/gbfor35.pdf.

[27] Release No. 33-9098 Revisions to Rule 163, 74 Fed. Reg. 68545 (December 28, 2009).

[28] This recommendation supported by U.S. Chamber, BIO, Equity Dealers of America, American Securities Association, National Venture Capital Association, Nasdaq, TechNet.

[29] Pub. L. 107-204

RECOMMENDATIONS RELATED TO FINANCIAL REPORTING

Audited financial statements communicate critical information to investors, promote capital formation, and bolster market confidence. Companies take very seriously their responsibilities to implement effective internal controls, and high standards and superior performance systems are essential for management, regulators, and auditors to execute their responsibilities. However, developments over the past several years have raised concerns regarding the unintended consequences of certain provisions of the Sarbanes-Oxley Act of 2002[29], and their implementation via the Public Company Accounting Oversight Board (PCAOB). While the JOBS Act exempted EGCs from the 404(b) auditor attestation requirement, several other proposals have been put forward that would provide an exemption from 404(b) based on an issuer's public float or revenue. Additionally, many market participants believe that costs associated with Section 404(b) have not been scalable largely due to the manner in which the law has been implemented. We believe that policymakers should work to make these costs scalable based on a reasoned determination of what is driving them, and by carefully considering the overall economic costs and benefits prior to implementing any changes.

RECOMMENDATION ONE

In considering its proposal to broaden eligibility for the smaller reporting company (SRC) definition, the SEC should consider aligning the SRC definition with the definition of a non-accelerated filer after the careful study of the costs and benefits of such an approach that the rulemaking process affords. The SEC should also institute a revenue-only test for pre or low revenue companies that may be highly valued. As appropriate after final action on the SRC proposal, a retrospective review of any policy changes related to Section 404(b) and a revenue-only test may be helpful to determine how these provisions work in practice.

Under current SEC rules, companies qualify as both an SRC and a non-accelerated filer if their public float falls below $75 million. By providing growing businesses with scaled disclosure opportunities, these issuer categorizations allow for important cost savings: SRCs benefit from scaled obligations under Regulation S-K and Regulation S-X, while non-accelerated filers are exempt from Sarbanes-Oxley 404(b).

In 2016, the SEC issued a proposed rule[30] that would increase the public float cap for SRCs, but not non-accelerated filers, to $250 million. This proposal is an important first step in acknowledging the limiting nature of the current $75 million public float cap. As the SEC stated in its proposing release, raising the financial thresholds in the SRC definition would help achieve the goals of promoting capital formation, and reducing compliance costs for small companies, while keeping in place important protections for investors. According to the SEC, roughly 32% of all issuers currently meet the criteria for SRC eligibility, while 42% of all current issuers would become eligible as SRCs if the public float cap were raised to $250 million.[31]

The SEC also noted in the proposal that raising the public float threshold for SRCs – and maintaining the current $75 million cap for non-accelerated filers – would bifurcate the Sarbanes-Oxley 404(b) exemption that currently applies to both these classes of issuers. In explaining its decision to not extend the Section 404(b) exemption to SRCs below a $250 million public float, the SEC stated that a 2011 study it conducted[32] found that the benefits in terms of cost savings for small registrants would not justify the costs in terms of loss of investor protection.

> **Developments over the past several years have raised concerns regarding the unintended consequences of certain provisions of the 2002 Sarbanes-Oxley Act.**

However, the proposal also stated that academic research published after the 2011 study has resulted in "mixed" findings, and the SEC sought public comment on whether SRCs under the proposed public float cap should be allowed to maintain an exemption from Section 404(b). Notably, the idea of exempting companies with up to $250 million in public float from Section 404(b) was included in the Treasury Capital Market Report. It has also been endorsed by the SEC Advisory Committee on Small and Emerging Companies[33], the SEC Government-Business Forum on Small Business Capital Formation[34], and numerous commenters on the SEC's SRC proposal.[35]

As the SEC considers aligning the SRC definition with the non-accelerated filer definition, it should weigh the benefits that would accrue to the economy by lessening compliance burdens on small and mid-size companies against any potential decrease in investor protection. The SEC should also take into consideration the fact that many companies may still choose to maintain compliance with Section 404(b) even if they are afforded an exemption from it - at the very least, shareholders could encourage issuers to maintain internal control systems similar to 404(b).

The 2016 SRC proposal also proposed adopting an alternative "revenue only" test for companies to qualify as a small reporting company if they had less than $100 million in revenue, regardless of their public float. While this issue has traditionally only been viewed through the lens of public float or market capitalization, revenue may be a more appropriate arbiter of company size (and, importantly, of a company's ability to pay for expensive compliance burdens). Accordingly, a revenue-only test of $100 million (which the SEC proposed as part of the SRC proposal) should be considered as an alternative for companies to the existing public float standard. As appropriate after final action on the SRC proposal, a retrospective review of any policy changes related to Section 404(b) and a revenue-only test may be helpful to determine the benefits to businesses and investors, any unanticipated impact upon existing investor protections, or the scalability of internal control costs.

RECOMMENDATION TWO

Modernize the Public Company Accounting Oversight Board inspection process related to internal control over financial reporting (ICFR).

One major focus of the Sarbanes-Oxley Act was to create a system of management assessments and auditor attestations regarding the effectiveness of internal control over financial reporting (ICFR) under Section 404. In order to provide companies with principles-based guidance to facilitate the conduct of management's assessment of the effectiveness of ICFR, the SEC in 2007 issued Commission Guidance Regarding Management's Report on Internal Controls over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (Management Guidance).[36]

The goal of the Management Guidance was to allow companies to prioritize and focus on "what matters most" in assessing ICFR, such as material issues that pose the greatest risk of material misstatements. The SEC's guidance allows management to exercise significant judgment in designing, conducting, and documenting an assessment of ICFR tailored to a company's individual facts and circumstances.

However, companies are continuing to experience ICFR-related issues primarily as a result of the audit process and the consequences of PCAOB inspections. The principles-based Management Guidance has not remained as effective given the continuing interpretations of the PCAOB's standards for attestations during the inspection process. As such, we believe that the existing Management Guidance should be reviewed and revised appropriately in order to ensure that it is working as intended. The PCAOB should also consider forming an ICFR task force that could address issues that arise for companies as a result of the PCAOB inspection process and its consequences for audit firms and auditors. Furthermore, pre and post-implementation reviews conducted by the PCAOB would help improve audit standard setting, prevent harmful impacts, and address those unintended consequences that actually occur in the process of implementing PCAOB auditing standards.

> **Companies are continuing to experience ICFR-related issues primarily as a result of the audit process and the consequences of PCAOB inspections.**

[30] Release No. 33-10107; 34-78168, Amendments to Smaller Reporting Company Definition, 81 Fed. Reg. 43130, (July 1, 2016).
[31] Id. at 18
[32] Study and Recommendations on Section 404(b) of the Sarbanes-Oxley Act of 2002 for Issuers With Public Float Between $75 and $250 million (Apr. 2011), available at https://www.sec.gov/news/studies/2011/404bfloat-study.pdf
[33] "Recommendations about Expanding Simplified Disclosure for Smaller Issuers," September 23, 2015. Recommendation #1 proposes expanding the SRC definition to include companies with a public float of up to $250 million; Recommendation #3 proposes the same change to the non-accelerated filer definition. https://www.sec.gov/info/smallbus/acsec/acsec-recommendations-expanding-simplified-disclosure-for-smaller-issuers.pdf
[34] Public float increases were proposed by the Forum each year from 2009 to 2016. A revenue test was proposed each year during the same period, save 2011. Reports available at https://www.sec.gov/info/smallbus/sbforumreps.htm.
[35] Including Nasdaq, Inc., the NYSE Group, the Biotechnology Innovation Organization, the National Venture Capital Association, the Independent Community Bankers of America, the Advanced Medical Technology Association, CONNECT, the Council of State Bioscience Associations, and the Corporate Governance Coalition for Investor Value, among others. Comment letters available at https://www.sec.gov/comments/s7-12-16/s71216.htm.
[36] Release Nos. 33-8810; 34-55929, Commission Guidance Regarding Management's Report on Internal Control Over Financial Reporting Under Section 13(a) or 15(d) of the Securities Exchange act of 1934, 72 Fed. Reg. 35323, (June 27, 2007).
[37] Treasury Report at 61

EQUITY MARKET STRUCTURE

Over the past two decades, the U.S. equity markets – and by extension investors – have benefited tremendously from advances in technology and venue competition that have reduced trading costs, increased liquidity, and made U.S. markets more efficient. However, many of these improvements have not accrued evenly across the equities markets. The trading environment for many small and mid-size stocks remains less liquid and efficient when compared with large capitalization companies. We believe that regulators should move away from a "one-size-fits-all" market structure and tailor regulation to help improve trading of EGCs and other small issuers.

RECOMMENDATION ONE

Intelligent tick sizes should be examined as a way to help improve trading for EGCs and small capitalization stocks.

In 2000, the SEC issued its "decimalization" order which transitioned the trading of most U.S. stocks to penny increments as opposed to fractions. While decimalization may have been a proper regulatory structure for large capitalization, highly traded stocks, narrow spreads often generated by penny increments can actually serve as a disincentive for market makers to trade the shares of EGCs or other small issuers. Exchanges should have the flexibility to work with issuers and other industry participants to design and implement intelligent tick sizes for a targeted number of stocks with distressed liquidity. Such initiatives should be data-driven and strive to inform market participants as to the benefits of intelligent tick sizes and how they should be properly designed. The Treasury Report included such a recommendation, and also noted that "as companies grow and their liquidity profile changes, they could update their tick size."[37]

Regulators should move away from a "one-size-fits-all" market structure and tailor regulation to help improve trading of EGCs and other small issuers.

RECOMMENDATION TWO

Allow EGCs or small issuers with distressed liquidity the choice to opt out of unlisted trading privileges (UTP) to help concentrate liquidity and reduce fragmentation.

For a variety of reasons, venue competition in the equity markets has increased dramatically over the past 20 years. Instead of a small number of national securities exchanges, stocks can now trade across dozens of different venues, including exchanges, alternative trading systems, and internalization through broker-dealers. While increased competition has contributed to some of the reduced costs mentioned above, it has also introduced a significant amount of market fragmentation that hinders the trading of illiquid stocks. We believe that EGCs and small or microcap issuers with distressed liquidity should be able to suspend their unlisted trading privileges - which allow their stock to be traded on all of the more than a dozen registered national securities exchanges - in order to concentrate exchange trading and liquidity on a single exchange. Such a program should apply only to a limited universe of smaller public companies where distressed liquidity is an acute problem – not to larger issuers that enjoy a fully liquid trading environment. The Treasury Report included such a recommendation and noted, "Consolidating trading to fewer venues would simplify the process of making markets in those stocks and thereby encourage more market makers to provide more liquidity in those issues."[38] However, off-exchange trading of EGCs and small issuers should continue to be allowed because certain types of trades (e.g. VWAP and error trades) cannot be effected on an exchange.

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[38] Treasury Report at 60

CONCLUSION

The problems that companies face today in going and staying public developed over a long period of time, and they cannot be fixed overnight. The recommendations included in this report represent a roadmap of positive reforms that have a strong amount of support from a broad spectrum of industry participants. We look forward to working closely with the SEC, Congress, and all other stakeholders to help make these reforms a reality, and to reinvigorate a public company model that has long been a key asset for the United States economy.