Statement of Robert B. Thompson, Peter P. Weidenbruch Jr Professor of Business Law, Georgetown University Law Center, before the Subcommittee on Capital Markets and Government-Sponsored Enterprises, Committee on Financial Services, United States House of Representatives

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Thank you for the opportunity to testify today on the subject of "Reducing Barriers to Capital Formation." Even as we have seen the economy slowly strengthen over recent reporting periods the growth of capital formation, as measured for example by the number of Initial Public Offerings, remains lower than some expectations. The JOBS Act, effective 15 months ago, lowered a variety of barriers to capital formation with more reductions still coming in a longer than hoped-for regulatory pipeline. At the same time, innovations in capital markets have also lowered barriers to capital raising and shifted how capital is raised. My comments today will focus on those two topics.

JOBS added five deregulatory features to our national securities laws: two new exemptions from the registration provisions of the 1933 Act (crowdfunding and a new "Reg A+"), revisions to a third exemption (Rule 506) that will greatly expand its use by removing the ban on general solicitation, and two major changes to disclosure obligations under the 1934 Act-- the "on ramp" provisions that reduce the reporting obligations of an Emerging Growth Company ("EGC") as to more than a half dozen requirements and an increase of the threshold of section 12(g) that quadruples the number of record shareholders a company can have without being required to submit to the periodic reporting and other requirements of the 1934 Act (so long as those companies do not raise capital via an IPO or list their stock on a national securities exchange). The three 1933 exemptions await rule-making from the applicable agency, here the Securities and Exchange Commission (and two of the rule-makings have extended beyond deadlines Congress put in the statute), so that it is difficult as yet to evaluate the impact of those changes. The new section 12(g) always seemed likely to have its effect the longest time into the future, so that it is the fifth deregulatory feature—the on ramp--where we have seen the greatest change since JOBS.

Most companies going public today come within the definition of Emerging Growth Companies and are eligible to use the less detailed regulatory requirements for up to five years after they go public. These companies can initiate the SEC registration process confidentially and communicate with many institutions to test the waters as to buying interest. EGCs during the on-ramp period are exempt from internal control audits inserted by section 404(b) of the Sarbanes-Oxley legislation more than a decade ago, may disclose less in the way of financial data in general and executive compensation in particular, and may use longer phase-in periods for new accounting standards.

The one year anniversary of JOBS spurred multiple analyses of its impact. Measuring jobs that can be tied to an IPO has always been a difficult metric to develop and the first year experience leaves that discussion on going. As to the number of IPOs themselves, the first year didn't produce much difference from the period before JOBS, even though the economy has gotten better. But we can see evidence that those companies who do choose to go public are taking advantage of the reduced barriers to raising capital, although not in a uniform fashion.

One examination of EGCs filing a public registration and pricing in the first year after JOBS found the following pattern in use of the on ramp provisions:[1]

- Nearly all EGCs indicated an intention to take advantage of the section 404(b) exclusion during their EGC period;
- About three quarters took advantage of reduced disclosure as to executive compensation;
- Almost half provided two years rather than 3 years of financial statements (the number drops to 30% of those who had at least three years of financial data to report; of the half that reported three years of data, 1/3 provided less than the usual 5 years of selected financial data);
- One-third of EGS filings began with a confidential submission to the SEC (and a similar number of firms publicly in registration but not yet priced had previously submitted at least one registration for confidential review);

[1] Latham & Watkins LLC, The JOBS Act After One Year: A Review of the New IPO Playbook (April 5, 2013). Of 500 issuers identifying themselves as EGCs who publicly filed registration statements in the first year after JOBS (as of March 31, 2013), the study reviewed 184 issuers that either successfully completed an IPO listing on a major U.S. securities exchange or who the study's authors believed would be likely to complete such an IPO. Most of the data here report on the 101 EGC offerings that had been priced (i.e. successfully completed) as of March 31. About three-quarters of issuers that priced an IPO in the first year after JOBS identified themselves as an EGC.

- Only a minority of firms indicated a choice to take advantage of extended phase in of accounting rules that might be put in place in the future (i.e. 80% of EGCs would be subject to these changes from the time they become effective).

JOBS also loosened the regulatory bite as to restrictions on issuer communications with prospective buyers. The statute's broadened definition of research that would be permitted in communication with purchasers does not seem to have yet changed behavior except perhaps for expanding publishing of research reports before and after the expiration, termination, or waiver of a lock-up agreement between the underwriter and the company or its shareholders.[2]

The diversity of EGC conduct in reaction to the new freedoms provided by JOBS is useful information, both in terms of provisions that issuers believe are most onerous, and the disclosures that they see benefit in continuing to make. Investors and issuers understand that credible information is essential to permit investors to accurately price their investments. The burden of increasing disclosure obligations on smaller public issuers (including items like conflict minerals) suggest the value of considering two levels of public issuers, one to which all disclosure rules would apply, and the other that would apply to larger issuers for which public expectations are greater and extend beyond shareholders.[3]

The new section 12(g) threshold, which I described earlier as having less of an immediate effect, does impose a bite that merits current attention. The threshold for staying private, which has long been based on having less than 500 shareholders of record, now requires companies to know the number of accredited investors (.i.e. less than 2000 shareholders of record if no more than 499 are non-accredited), and know that on an annual basis. One year into the new regime, the method by which companies are going to make this determination remains unclear. Issuers are used to determining who is accredited at the time that they issue stock to them pursuant to specific exemptions, but doing so on an annual basis thereafter when financial reversals may have occurred to some investors and others may have drifted away will create the need for a more intense ongoing relationship between issuers and

[2] Id at 17.

[3] Along with Professor Donald Langevoort of Georgetown, I have written about this possibility in *Publicness in Contemporary Securities Regulation after the JOBS Act*, 101 GEORGETOWN L. J. 337 (2013). We have focused on the 1933 Act aspects of JOBS in *Redrawing the Public-Private Boundaries in Entrepreneurial Capital Raising* in 98 CORNELL L. REV. (forthcoming 2013) available at http://papers.ssrn.com/so13/papers.cfm?abstract_id=2132813.

their shareholders than we have seen before. The movement of "record" title to securities from individual, beneficial owners to centralized intermediaries such as broker-dealers or various depository entities can reduce this problem but that move typically has occurred at the time that firms go public and this requirement is going to hit firms well before that point. It is time for the Congress to move beyond this 50 year old anachronistic concept of "record" ownership, first inserted into the statute when stock transfers could only occur by written instruments and adopt a concept more suitable for an electronic age.

The changes to Rule 506 removing the long-standing limitations on general solicitation, (once they take affect after completion of SEC rule-making) are likely to expose the definition of accredited investors to additional stress. The expansive part of this definition takes in individual investors based on financial thresholds that have not changed since 1982, despite three decades of inflation. Being able to market to investors with $1 million in net assets and more than $200,000 of annual income goes much deeper into the investor pool than it did thirty years ago, such that a modern look of that definition is needed to bring that metric current.

While the changes in regulatory coverage have eased the burdens on raising capital in substantial ways, the impact of market changes may be even more dramatic. For example, holders of stock not traded on national exchanges can find more liquidity for their investments than ever before in platforms like SecondMarket and SharesPost. As a result more firms can stay outside thresholds triggering public reporting status longer. Recent data indicated that the amount of money raised in private placements ([particularly rule 506) have surpassed the amount raised in registered public offerings.[4] This pre-dates recent regulatory changes and likely reflects the changes in the financial market that have permitted companies to raise more of their capital needs from private funds and venture capital without going to a registered offering, again postponing their exposure to public company regulation. This shift does not do as much for small start-ups, for which continued focus of crowdfunding and other developing ideas should be pursued.

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[4] See VLAD IVANOV & SCOTT BAUGUESS, CAPITAL RAISING IN THE U.S.: THE SIGNIFICANCE OF UNREGISTERED OFFERINGS USING THE REGULATION D EXEMPTION (February 2012) at 3, available at http://www.sec.gov/info/smallbus/acsec/acsec103111_analysis-reg-d-offering.pdf (SEC economic study showing Reg D in 2010, even before dropping the ban on general solicitation produced 8% more capital than public offerings).

When considering the effects of market changes on capital raising, one change that has not received the attention it deserves is the institutionalization of our shareholder base. In contrast to 1950, for example, when the institutional share of equity in American corporations was in the single digits, today institutions hold the majority of equity and in our largest corporations their share exceeds 70%. Institutions are also a significant share of the IPOs market. Most of institutional money, in turn, comes from various instruments for retirement savings that receive tax- favored treatment under our laws; thus most equity owners are intermediaries for beneficiaries whose retirement funds are on the line. For a substantial segment of these funds, there are additional layers of intermediation with institutions providing significant sums of money to asset managers and hedge funds who then invest in equity and elsewhere. A focus on reducing barriers to capital formation should take explicit account of the extent to which intermediaries are the investors providing the capital and how that shapes barriers to investments.