Chairman Garrett, Ranking Member Waters, my name is Kate Mitchell and I am a managing
director at Scale Venture Partners, a Silicon Valley-based venture capital firm that has
investments in information technology companies across the United States. Venture capitalists
are committed to funding America’s most innovative entrepreneurs. We work closely with them
to transform breakthrough ideas into emerging growth companies that drive U.S. job creation
and economic growth. We believe that IPOs drive job creation and economic growth because, as
our data show, 92 percent of a company’s job growth occurs after its IPO.

I am also a former chairman and current member of the National Venture Capital Association.
Companies that were founded with venture capital accounted for 12 million private-sector jobs
and $3.1 trillion in revenue in the U.S. in 2010, according to a 2011 study by IHS Global Insight.
That equals approximately 22 percent of the nation’s GDP. Almost all of these companies, which
include Apple, Cisco, Genentech and Starbucks, began small but remained on a disciplined
growth trajectory and ultimately went public on a U.S. stock exchange.

More recently, I served as chairman of the IPO Task Force, a private and independent group of
professionals representing the entire ecosystem of emerging growth companies — including
experienced CEOs, public investors, venture capitalists, securities lawyers, academicians and investment bankers. This diverse coalition came together initially as part of a working group conversation at the U.S. Department of the Treasury’s Access to Capital Conference in March 2011, where the dearth of initial public offerings, or IPOs, was discussed at length. In response to this shared concern, we formed the IPO Task Force to examine the challenges facing America’s troubled market for IPOs and make recommendations for restoring effective access to the public markets for emerging growth companies.

Our task force developed our proposals based on a consensus approach that considered, and in many cases rejected, a variety of possible approaches. We left behind many ideas based on the valuable input we received from the variety of interdisciplinary perspectives that our membership represented. We released our report, “Rebuilding the IPO On-Ramp,” in October of this year. We shared our findings and recommendations with Members of Congress and the Administration, including the Treasury Department and the Securities and Exchange Commission (SEC). I have submitted a copy of this report along with my written testimony today.

On behalf of the diverse members of the IPO Task Force, I am here today to support “H.R. 3606, the Reopening American Capital Markets to Emerging Growth Companies Act of 2011.” This bipartisan legislation will help restore effective access to the public markets for emerging growth companies without compromising investor protection. Restoring that access will spur U.S. job creation and economic growth at a time when we desperately need both. I appreciate the opportunity to discuss with you the challenges we face and the merits of this important bill.
Challenges Facing the U.S. IPO Market

For the last half-century, America’s most promising young companies have pursued IPOs to access the additional capital they need to hire new employees, develop their products and expand their businesses nationally and globally. Often the most significant step in a company’s development, IPOs have enabled emerging growth companies to generate new jobs for the U.S. economy, while public investors of all types have harnessed that growth to build their portfolios and retirement accounts.

The decision to pursue an IPO is a complex one because alternatives do exist: a company can seek to be acquired or can decide to remain private. The most prevalent outcome today for the CEO of an emerging growth company is to be acquired by a larger company. Yet the IPO remains appealing, although demonstrably less so than it was a decade ago, for a variety of reasons. In a survey the IPO Task Force conducted of more than 100 CEOs of companies considering an IPO in the next 24 months, 84 percent of CEOs cited competitive advantage as the primary motivation for going public, while two thirds of them indicated the need for cash to support future growth. And while 94 percent of CEOs agreed that a strong and accessible small-cap IPO market is critical to maintaining U.S. competitiveness, only 9 percent agreed that the market is currently accessible to them.

The data support that unfortunate conclusion. During the past 15 years, the number of emerging growth companies entering the capital markets through IPOs has plummeted relative to historical norms. From 1990 to 1996, 1,272 U.S. venture-backed companies went public on U.S.
exchanges, yet from 2004 to 2010, there were just 324 of those offerings. Those companies that do make it to the public markets are taking almost twice as long to do so. During the most recent decade, acquisitions have become the predominant path forward for most venture-backed companies. This is significant because M&A events do not produce the same job growth as IPOs. In fact, an acquisition often results in job losses in the short term as redundant positions are eliminated by the acquirer. While global trends and macroeconomic circumstances have certainly contributed to this prevalence of acquisitions over IPOs, the trend has transcended economic cycles and has hobbled U.S. job creation.

What is driving this precipitous decline in America’s IPO market? A number of analyses, including that of the IPO Task Force, suggest that there is no single event behind it. Rather, a complex series of changes in the regulatory environment and related market practices have driven up costs and uncertainty for emerging growth companies looking to go public, and have constrained the amount of information available to investors about such companies, making them more difficult to understand and invest in. These changes have included the advent of electronic trading, new order-routing rules, Regulation FD, the Gramm-Leach-Bliley Act of 1999, decimalization, the Sarbanes Oxley Act of 2002, the Global Research Analyst Settlement, and aspects of the Dodd-Frank Act of 2009. Every one of these developments and each piece of legislation addressed significant issues. Yet, the cumulative effects of these regulations over the years have produced an unintended consequence: They have limited the ability of emerging growth companies to go public.
In effect, these changes have shifted the focus of emerging growth companies away from pursuing IPOs and toward positioning themselves for acquisition by a larger company. In fact, approximately 85 percent of the emerging growth company CEOs surveyed by the IPO Task Force indicated that going public is not as attractive as it was in 1995. This shift toward acquisitions and away from IPOs by emerging growth companies is problematic for the U.S. economy because, as mentioned, acquisitions simply do not generate the same amount of job growth as IPOs. Consider the impact on jobs and the general economy if companies such as FedEx, Intel or Microsoft were acquired by larger corporations instead of going public and maintaining the independent growth that led them to be market leaders in their own right.

Addressing these multiple, interrelated factors and mitigating their effects will require a measured and nuanced response. Many of the new regulations in recent years have addressed specific concerns and delivered valuable protections to investors — protections that any efforts to rebalance the regulatory scales for emerging companies must recognize and respect. These new requirements have raised the bar for companies pursuing IPOs — in terms of size, compliance and cost — in ways that should inspire greater investor confidence in our markets. Similarly, many of the related market evolutions have increased access and lowered costs for some public investors. These factors have resulted in a fundamental restructuring of the U.S. capital markets system over the past 15 years. Our IPO Task Force report examines this restructuring and its implications in greater depth. For my purposes here, I will focus on the regulatory aspects of the current IPO challenge and how H.R. 3606 can mitigate it.
I believe the “Reopening American Capital Markets to Emerging Growth Companies Act of 2011” provides an opportunity to thoughtfully recalibrate these regulations to reduce barriers for ECG’s in three crucial ways. First, it recognizes emerging growth companies as a unique category facing acute challenges in accessing public capital. Second, it provides a limited, temporary and scaled regulatory compliance pathway, which the IPO Task Force referred to as an “on-ramp,” that will reduce the costs and uncertainties of accessing public capital. Third, it improves the flow of information to investors about the initial offerings for emerging growth companies. The legislation follows a balanced approach by structuring the on-ramp as a temporary feature available only for a limited period of one to five years, depending on the size of the company.

**Recognizing “Emerging Growth Company” Challenges**

The “Reopening American Capital Markets to Emerging Growth Companies Act of 2011” would establish a new category of issuer, called an “emerging growth company” (EGC) that has less than $1 billion in annual revenues at the time of SEC registration. These companies would benefit from a temporary regulatory on-ramp designed to provide EGCs with a smooth entryway into the IPO market while ensuring adequate investor protection. This on-ramp status would last only for a limited period of one to five years, depending on the company’s size, and it would encourage EGCs to go public while ensuring that they achieve full compliance as they mature and build the resources necessary to sustain the level of compliance infrastructure associated with larger enterprises.
As noted, EGC status, and the scaled regulation associated with the on-ramp, would last for a limited period of one to five years. Specifically, EGC status would cease at the first fiscal year-end after the company (1) reaches $1 billion in annual revenue; (2) has been public for five years; or (3) becomes a “large accelerated filer” with more than $700 million in public float (i.e., market value of shares held by non-affiliates). To put the bill’s limited scope in perspective, if the on-ramp provisions were in effect today, they would apply to only 14 percent of public companies and only 3 percent of total market capitalization, according to the IPO Task Force estimate. For example, Ford Motor Company would not qualify as an EGC eligible for the on-ramp. Nor would Zynga be expected to qualify. However, Carbonite and Horizon Pharmaceuticals would.

As someone who has spent the last 15 years seeking out, evaluating, investing in, and helping to build promising young companies, I cannot overemphasize the value of a robust and accessible IPO market. In our survey of emerging growth company CEOs, 86 percent of respondents listed accounting and compliance costs as a major concern of going public. Again, over 85 percent of CEOs said that going public was not as attractive of an option as it was in 1995. Given these concerns, for CEOs of successful companies deciding between pursuing an IPO or positioning themselves for an acquisition, the scaled disclosure and cost flexibility provided by the bill could help make an IPO the more attractive option.

Reopening Access through Scaled Regulation

The bill provides qualifying EGCs with a narrow, temporary and scaled regulatory compliance pathway that would reduce the costs of accessing public capital without compromising investor
protection. The bill’s transitional relief is limited to those areas of compliance that are significant cost drivers. While those requirements may sensibly apply to larger enterprises, allowing EGCs to phase in these costs would not compromise investor protection for smaller public companies that are following the scaled regulation that the SEC has already developed and approved for smaller reporting companies. In this way, the on-ramp benefits from the SEC’s prior regulatory actions that carefully balanced both investor protection and the promotion of efficiency, competition, and capital formation, consistent with Section 3(f) of the Securities Exchange Act of 1934. The scaled regulations under the bill include:

**Section 404(b) of Sarbanes-Oxley.** In addition to the typical cost of auditing their financial statements, large public companies must pay an outside auditor to attest to the company’s internal control over financial reporting. Studies have shown that compliance with Sarbanes-Oxley can cost companies more than $2 million per year, with much of that cost associated with the Section 404(b) requirements. All companies with a public float of less than $75 million are already exempt from Section 404(b) because Congress has recognized the substantial burden this requirement would impose on smaller companies. In addition, existing regulations provide that all newly public companies — regardless of their size or maturity — benefit from a transition period of up to two years before they are required to comply with Section 404(b) of Sarbanes-Oxley. Under current law, this transitional relief is available even for very large companies that would not qualify as EGCs. Moreover, this existing transitional relief is necessary even though the auditing standard for the Section 404(b) audit is intended to be flexible and scalable. (The Public Company Accounting Oversight Board’s Auditing Standard No. 5 expressly permits a top-down, scalable approach for the audit and recognizes that “a smaller, less complex company”
may “achieve its control objectives differently than a more complex company.”) Building on these concepts, H.R. 3606 provides EGCs with a limited and targeted extension of the existing transition period during the on-ramp for compliance with Section 404(b). The bill would not affect current requirements under which management is responsible for establishing and maintaining internal control over financial reporting and disclosure controls and procedures.

**Look-back for audited financials.** EGCs would be required to provide audited financial statements for the two years prior to registration, rather than three years. This two-year period already applies under existing SEC rules for companies with a public float of less than $75 million. For the year following its IPO, the EGC will go forward reporting three years of audited financials, similar to larger issuers, without facing an incremental cost burden because the third year will have already been audited in connection with the IPO. The transition period for this element, therefore, will only extend for a year, which is much shorter than the full on-ramp period.

**Exemptions from long form compensation disclosure.** The EGC will disclose its compensation arrangements using the established format that the SEC has adopted for smaller reporting companies. The bill would also exempt EGCs from the requirement to hold an advisory stockholder vote on executive compensation arrangements, including advisory votes on change-of-control compensation arrangements and the frequency of future advisory votes. The SEC has given smaller reporting companies an additional year to comply with the new rules, in light of the additional burden these requirements impose. The bill would extend this transitional relief for
EGCs during the on-ramp period. During that time, EGCs would still be required to comply with all stock exchange governance requirements, including director independence requirements.

The on-ramp period will give EGCs the opportunity to realize the benefits of going public in their first, critical years in the public markets. They will be able to allocate more of the capital they raise from the IPO process toward hiring new employees, developing new products, expanding into new markets and implementing other elements of their growth strategies — as opposed to funding the type of complex compliance apparatus designed for larger, more mature companies. At the same time, EGCs and their management will be able to devote more time, energy and other resources to managing the business, charting the path to future growth and implementing compliance systems that are appropriate for smaller, more nimble companies. Indeed, 92 percent of the public-company respondents in the IPO Task Force’s CEO survey identified the burden of administrative reporting as a significant challenge, while 91 percent noted that reallocating their time from company building to compliance management has been a major challenge.

The IPO Task Force’s membership included institutional investors who provided important perspectives that shaped the specific recommendations we made. In particular, the scaled regulation that we ultimately recommended, and which H.R. 3606 reflects, incorporated key recommendations from the investor community that this constituency believes is consistent with investor protection and will ensure full disclosure of all relevant information by EGCs as well as the availability and flow of information for investors.
Improving the Availability and Flow of Information for Investors

Along with compliance burdens, post-IPO liquidity ranked very high among the concerns of emerging growth company CEOs. Institutional investors in particular expressed concerns about the dearth of information and exposure they had to IPO companies versus what they receive for other securities, making it difficult to get enough information to make an informed investing decision about a new issue. In order to increase post-IPO liquidity, investors need efficient markets with abundant, accurate information about newly public companies. In an effort to make IPOs more attractive to EGCs and investors, the bill would improve the flow of information about EGCs to investors before and after an IPO. It will do so primarily by updating existing regulations to account for advances in modes of communication since the enactment, 78 years ago, of the Securities Act of 1933, and to recognize changes in the information available to investors in the Internet era. Current rules relating to analyst research were initially adopted more than 40 years ago — long before the fundamental changes that the Internet has brought regarding the availability of information, including instantaneous access to registration statements filed with the SEC. The SEC has amended these rules only modestly and incrementally since that time. Specifically, the bill will:

*Close the information gap for emerging growth companies.* Existing rules allow investment banks participating in the underwriting process to publish research on large companies on a continuous basis, but prohibit those investment banks from publishing research on EGCs. This bill would allow investors to have access to research reports about EGCs concurrently with their IPOs. In other words, H.R. 3606 extends to EGC investors the research coverage currently enjoyed by investors in very large companies. At the same time, the bill preserves the extensive
investor protections adopted in this area within recent years. For example, H.R. 3606 leaves intact robust protections such as:

- Sarbanes-Oxley Section 501, which requires analysts and broker-dealers that publish research reports to disclose any potential conflicts of interest that may arise when they recommend an issuer’s equity securities, including whether an analyst or broker-dealer currently owns other debt or equity investments in the issuer or has received compensation from the issuer for publishing the report or whether the issuer is a client of the broker-dealer.

- SEC Regulation AC, which requires broker-dealers to include in all research reports a statement by the research analyst certifying that the views expressed in the research report accurately reflect the research analyst’s personal views about the securities and to disclose whether the research analyst was compensated in connection with the specific recommendations.

- The Global Research Analyst Settlement of 2003, which severed the link between research and investment banking activities at large investment banks, required investment banks to use independent research and made analysts’ historical ratings and price targets publicly available.

As the SEC recognized in 2005, the “value of research reports in continuing to provide the market and investors with information about reporting issuers cannot be disputed.” We agree that research reports are indisputably valuable to investors and endorse the changes in H.R. 3606 that would permit research coverage of EGCs at the time of an IPO, rather than the current regime, which permits research only for large, established public companies. The bill’s changes would address the current information shortfall by providing a way for investors to obtain research
about IPO candidates, while leaving unchanged the robust and extensive investor protections that exist to ensure the integrity of analyst research reports.

*Permit emerging growth companies to “test the waters” prior to filing a registration statement.*

The bill would permit EGCs to gauge preliminary interest in a potential offering by expanding the range of permissible pre-filing communications to institutional and qualified investors. This would provide a critically important mechanism for EGCs to determine the likelihood of a successful IPO. For a company on the verge of going public, but not quite ready, getting that investor feedback beforehand improves the chances of a successful IPO at a later date. This benefits issuers and the public markets in the process by helping otherwise-promising companies avoid a premature offering. All of the antifraud provisions of the securities laws would still apply to these communications, and the bill ensures that the delivery of a statutory prospectus would still be required prior to any sale of securities in the IPO.

*Permit confidential pre-filing with the SEC.* Currently, foreign entities are permitted to submit registration statements to the SEC on a confidential basis under certain circumstances, even though U.S. companies are not. Since the recent introduction of H.R. 3606, the SEC staff has updated its policy in this area to permit confidential filings for foreign governments registering debt securities and foreign private issuers that are listed or are concurrently listing on a non-U.S. securities exchange. This accommodation is not available to domestic issuers. Allowing U.S. companies to make confidential submissions of draft registration statements would allow EGCs to commence the SEC review process in a far more efficient and effective manner. In particular, this process would remove a significant inhibitor to IPO filings by allowing pre-IPO companies
to begin the SEC review process without publicly revealing to competitors sensitive commercial and financial information before those pre-IPO companies are able to make an informed decision about the feasibility of an IPO. The bill would require U.S. companies that elect to use the confidential submission process to make public the filing of the initial confidential submission as well as all amendments resulting from the SEC review process, thereby providing full access to the information before an IPO that is traditionally disclosed to the public during the registration process. The bill would also require such a public filing at least 21 days before the pre-IPO company commences a road show with potential investors, providing ample time for public review of all changes made in all amendments to the registration statement occurring during the SEC review process.

**Conclusion**

With the U.S. economic recovery stalled, unemployment hovering near 9 percent and global competition ramping up, the time to revive the U.S. IPO market and jumpstart job creation is now. We believe that the “Reopening American Capital Markets to Emerging Growth Companies Act of 2011” can help us accomplish those goals without compromising important investor protections, including many of the reforms implemented in recent years.

The bill provides measured and limited relief, for a period of one to five years, to a small population of strategically important companies with disproportionately positive effects on job growth and innovation. We believe that these changes could provide powerful incentives for those emerging companies to more seriously consider an IPO as a feasible alternative when they are deciding between the growth potential of an IPO versus the safer and easier path of an
acquisition transaction. As a result, we believe these changes could bring those alternatives back to their historical balance — a balance that has, in prior years, allowed IPOs to occur more easily and, in so doing, supported America’s global economic primacy for decades.

I urge the members of this committee to support the passage of the “Reopening American Capital Markets to Emerging Growth Companies Act of 2011.” By doing so, we can re-energize U.S. job creation and economic growth by helping reconnect emerging companies with public capital — all while enabling the broadest range of investors to participate in the growth of those companies through a healthy and globally respected U.S. capital markets system. These outcomes are not only consistent with the spirit and intent of the current regulatory regime, but also essential to preserving America’s strength for decades to come.

In closing, I want to personally thank you for the opportunity to discuss these important issues with you today. I look forward to answering any questions you may have and, I thank you for your service to our country in your capacity as Members of Congress and your attention to this critical issue.
Rebuilding the IPO On-Ramp

*Putting Emerging Companies and the Job Market Back on the Road to Growth*

Issued by the IPO Task Force
October 20, 2011

Presented to The U.S. Department of the Treasury
# Table of Contents

I. Executive Summary .......................................................................................................................... 1
II. Brief Background and Purpose ....................................................................................................... 4
III. Emerging Growth Companies Drive U.S. Job Creation ................................................................. 5
IV. The IPO Market Decline .............................................................................................................. 6
V. Fewer IPOs: Less Job Growth ....................................................................................................... 7
VI. Regulatory and Market Roadblocks ............................................................................................ 8
   A. Impact on Supply of Emerging IPOs ......................................................................................... 9
   B. Changes to the IPO Channel .................................................................................................... 13
   C. Impact on Demand .................................................................................................................. 16
VII. Detailed Recommendations ......................................................................................................... 17
   A. Recommendation #1: Regulatory "On-Ramp" ........................................................................ 19
   B. Recommendation #2: Information Flow .................................................................................. 26
   C. Recommendation #3: IPO Tax Incentive ................................................................................. 30
   D. Recommendation #4: Industry Education ............................................................................... 31
VIII. Conclusion ................................................................................................................................. 32
IX. Appendices ................................................................................................................................. 33
Chart Index

Chart A: IPOs Finance Significant Job Creation ................................................................. 1
Chart B: IPOs are Down…Particularly Smaller IPOs............................................................ 2
Chart C: Innovative Companies Create Jobs and Grow Quickly.............................................. 5
Chart D: IPOs are Down…Particularly Smaller IPOs............................................................ 6
Chart E: Shift from IPOs to M&A....................................................................................... 7
Chart F: IPOs and Regulatory/Market Changes.................................................................. 8
Chart G: The Regulatory Cascade...................................................................................... 9
Chart H: The Costs of Going and Staying Public are High.................................................... 10
Chart I: Public Company CEOs: Most Significant IPO Challenges..................................... 12
Chart J: Channel Focus: Trading Drives Revenue for Largest Investment Banks.................... 13
Chart K: Demand Exists: Emerging Company IPOs Deliver Returns to Investors.................. 16
Chart L: Public Company CEOs: Most Significant IPO Challenges..................................... 25
I. Executive Summary

This report recommends specific measures that policymakers can use to increase U.S. job creation and drive overall economic growth by improving access to the public markets for emerging, high-growth companies.

For most of the last century, America’s most promising young companies have pursued initial public offerings (IPOs) to access the additional capital they need to hire new employees, develop their products and expand their businesses globally. Often the most significant step in a company’s development, IPOs have enabled these innovative, high-growth companies to generate new jobs and revenue for the U.S. economy, while investors of all types have harnessed that growth to build their portfolios and retirement accounts. We refer to these companies in this report as “emerging growth” companies (defined more specifically for purposes of this report on page 20).

Chart A: IPOs Finance Significant Job Creation

During the past 15 years, the number of emerging growth companies entering the capital markets through IPOs has plummeted relative to historical norms. This trend has transcended economic cycles during that period and has hobbled U.S. job creation. In fact, by one estimate, the decline of the U.S. IPO market had cost America as many as 22 million jobs through 2009.\(^1\) During this same period, competition from foreign capital markets has intensified. This dearth of emerging growth IPOs and the diversion of global capital away from the U.S. markets – once the international destination of choice – have stagnated American job growth and threaten to undermine U.S. economic primacy for decades to come.

In response to growing concerns, the U.S. Treasury Department in March 2011 convened the Access to Capital Conference to gather insights from capital markets participants and solicit recommendations for how to restore access to capital for emerging companies – especially public capital through the IPO market. Arising from one of the conference’s working group conversations, a small group of professionals representing the entire ecosystem of emerging growth companies – venture capitalists, experienced CEOs, public investors, securities lawyers, academicians and investment bankers – decided to form the IPO Task Force to examine the conditions leading to the IPO crisis and to provide recommendations for restoring effective access to the public markets for emerging, high-growth companies.

In summary, the IPO Task Force has concluded that the cumulative effect of a sequence of regulatory actions, rather than one single event, lies at the heart of the crisis. While mostly aimed at protecting investors from behaviors and risks presented by the largest companies, these regulations and related market practices have:

1. driven up costs for emerging growth companies looking to go public, thus reducing the supply of such companies,

\(^1\) D. Weild and E. Kim, Grant Thornton, A Wake-up Call for America at page 2 (November 2009).
2. constrained the amount of information available to investors about such companies, thus making emerging
growth stocks more difficult to understand and invest in, and

3. shifted the economics of the trading of public shares of stock away from long-term investing in emerging growth
companies and toward high-frequency trading of large-cap stocks, thus making the IPO process less attractive
to, and more difficult for, emerging growth companies.

These outcomes contradict the spirit and intent of more than 75 years of U.S. securities regulation, which originally
sought to provide investor protection through increased information and market transparency, and to encourage
broad investor participation through fair and equal access to the public markets.

Chart B: IPOs are Down...Particularly Smaller IPOs

To help clear these obstacles for emerging growth companies, the IPO Task Force has developed four specific and
actionable recommendations for policymakers and members of the emerging growth company ecosystem to foster
U.S. job creation by restoring effective access to capital for emerging growth companies. Developed to be targeted,
scalable and in some cases temporary, these recommendations aim to bring the existing regulatory structure in line
with current market realities while remaining consistent with investor protection. The task force’s recommendations
for policymakers are:

1. **Provide an “On-Ramp” for emerging growth companies using existing principles of scaled regulation.** We
   recommend that companies with total annual gross revenue of less than $1 billion at IPO registration and that
   are not recognized by the SEC as “well-known seasoned issuers” be given up to five years from the date of their
   IPOs to scale up to compliance. Doing so would reduce costs for companies while still adhering to the first
   principle of investor protection. (Page 19)

2. **Improve the availability and flow of information for investors before and after an IPO.** We recommend
   improving the flow of information to investors about emerging growth companies before and after an IPO by
   increasing the availability of company information and research in a manner that accounts for technological and
   communications advances that have occurred in recent decades. Doing so would increase visibility for emerging
growth companies while maintaining existing regulatory restrictions appropriately designed to curb past abuses.
   (Page 26)

3. **Lower the capital gains tax rate for investors who purchase shares in an IPO and hold these shares for a
   minimum of two years.** A lower rate would encourage long-term investors to step up and commit to an
allocation of shares at the IPO versus waiting to see if the company goes public and how it trades after its IPO.

(Page 30)

In addition to its recommendations for policymakers, the task force has also developed a recommendation for members of the emerging growth company ecosystem:

4. **Educate issuers about how to succeed in the new capital markets environment.** The task force recommends improved education and involvement for management and board members in the choice of investment banking syndicate and the allocation of its shares to appropriate long-term investors in its stock. Doing so will help emerging growth companies become better consumers of investment banking services, as well as reconnect buyers and sellers of emerging company stocks more efficiently in an ecosystem that is now dominated by the high-frequency trading of large cap stocks. (Page 31)

The recommendations above aim to adjust the scale of current regulations without changing their spirit. Furthermore, the task force believes that taking these reasonable and measured steps would reconnect emerging companies with public capital and re-energize U.S. job creation and economic growth – all while enabling the broadest range of investors to participate in that growth. The time to take these steps is now, as the opportunity to do so before ceding ground to our global competitors is slipping away.

For this reason, the members of the IPO Task Force pledge their continued participation and support of this effort to put emerging growth companies, investors and the U.S. job market back on the path to growth.
II. Brief Background and Purpose

In March 2011, the U.S. Department of the Treasury convened the Access to Capital Conference to gather insights from capital markets participants and solicit recommendations for how to restore effective access to capital for emerging companies, including public capital through the IPO market. Arising from one of the conference’s working group conversations, a small group of professionals representing the entire ecosystem of emerging growth companies – venture capitalists, experienced CEOs, public investors, securities lawyers, academicians and investment bankers – decided to form the IPO Task Force (Appendix A, page 33) in order to 1) examine the challenges that emerging growth companies face in pursuing an IPO and 2) develop recommendations for helping such companies access the additional capital they need to generate jobs and growth for the U.S. economy and to expand their businesses globally.

This report recommends specific measures that policymakers can use to increase U.S. job creation and drive overall economic growth by improving access to the public markets for emerging, high-growth companies.
III. Emerging Growth Companies Drive U.S. Job Creation

For most of the last century, America’s most promising young companies have pursued IPOs to access the additional capital they need to hire new employees, develop their products and expand their businesses globally. Often the most significant step in a company’s development, IPOs enabled these innovative, high-growth companies to generate new jobs and revenue for the U.S. economy, while investors of all types harnessed that growth to build their portfolios and retirement accounts. We refer to these companies in this report as “emerging growth” companies (defined more specifically for purposes of this report on page 20).

The role of these emerging growth companies in creating American jobs cannot be understated. From 1980 to 2005, firms less than five years old accounted for all net job growth in the U.S. In fact, 92 percent of job growth occurs after a company’s initial public offering, according to data from IHS Global Insight. Furthermore, in a survey of emerging growth companies that have entered the public markets since 2006, respondents reported an average of 86 percent job growth since their IPOs (See Appendix C, page 36).

Indeed, some of America’s most iconic and innovative companies – Apple, Cisco, FedEx, Genentech and Starbucks – entered the public markets through small-cap offerings at a time when the markets were more hospitable to small- and mid-cap stocks. These companies also received venture capital funding as startups. While none of the challenges or recommendations outlined in this report are exclusive to venture capital-backed companies, such companies serve as useful proxies when discussing the disproportionately positive impact of emerging growth companies on U.S. job creation and revenue growth. For example, while investment in venture-backed companies equates only to between 0.1 percent and 0.2 percent of U.S. gross domestic product each year, companies with venture roots employed 11 percent of the total U.S. private sector workforce and generated revenues equal to 21 percent of U.S. GDP in 2010.

<table>
<thead>
<tr>
<th>VC-Backed U.S. Revenues ($T)</th>
<th>As a % of Total U.S. GDP in 2008-2010</th>
<th>Outpaces 2008-2010 Total U.S. Sales Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000 $1.5</td>
<td>2003 $1.7</td>
<td>VC-Backed Growth 1.6%</td>
</tr>
<tr>
<td></td>
<td>2006 $2.9</td>
<td>(1.5%) Total Growth</td>
</tr>
<tr>
<td></td>
<td>2010 $3.1</td>
<td></td>
</tr>
</tbody>
</table>

21% of job growth occurs after a company’s IPO. Most of that growth occurs within the first five years of the IPO.  


(1) Source: Venture Impact Study 2010 by IHS Global Insight
(2) Source: Ibid.
(3) Source: Ibid.
IV. The IPO Market Decline

Over the last decade, the number of emerging growth companies entering the capital markets through IPOs has plummeted. This trend has persisted independent of the economic cycles during this same time. After achieving a one-year high of 791 IPOs in 1996, the U.S. averaged fewer than 157 per year from 2001 to 2008. In fact, only 45 companies went public in 2008.\(^1\) The numbers for the last two years have rebounded slightly, but remain well below historical norms and well below the amount required to replace the number of listed companies lost to mergers, acquisitions, de-listings and bankruptcy.

Venture-backed emerging growth companies illustrate the trend. From 1991 to 2000, nearly 2,000 such companies (which, as noted above, typically grow larger and faster than their peers) went public as compared to only 477 from 2001 to 2010.\(^2\) That represents a drop of more than 75 percent. In addition, the companies that make it to the public markets are taking twice as long to do so: The median age of a venture-backed company at the time of its IPO has nearly doubled in recent years. The average age at IPO of companies going public between 1997 and 2001 was approximately five and a half years, compared with more than nine years for companies going public between 2006 and 2011.\(^3\) As a result, many smaller companies have life spans as private companies longer than venture fund life cycles and employee stock option terms.

![Chart D: IPOs are Down...Particularly Smaller IPOs](image)

<table>
<thead>
<tr>
<th>Year</th>
<th>Pre-1999 Avg</th>
<th>Post-1999 Avg</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>547 IPOs / Year</td>
<td>192 IPOs / Year</td>
</tr>
</tbody>
</table>

**Sources:** JMP Securities, Dealogic, Capital Markets Advisory Partners, Grant Thornton

Over this same period, the prevalence of IPOs versus acquisitions of emerging growth companies has undergone a stunning reversal. Acquisitions by a shrinking number of larger companies (due to the lack of IPOs) have become the primary liquidity vehicle for venture capital-backed companies as compared to IPOs.\(^4\) This is significant because M&A events don’t produce the same job growth as IPOs – nor do they allow investors to participate as directly in the economic growth of a stand-alone company. In fact, M&A events result in job losses in the short term as the acquiring company looks to eliminate redundant positions between the two enterprises. Subsequent job growth may occur at the acquiring company, but only over time, and only after those initial job losses are recovered.

---

\(^1\) Source: JMP Securities, Dealogic.


\(^3\) Source: Ibid.

\(^4\) Source: VentureOne data.
V. Fewer IPOs: Less Job Growth

*Imagine how different Seattle, Cupertino or Austin would look today if — instead of going public — Microsoft, Apple or Dell had undergone an acquisition by an old-line conglomerate.*

Given the propensity of emerging growth companies for generating new jobs, it is little wonder that the primary casualty in the decline of America’s IPO market has been job creation. By one count, “up to 22 million jobs may have been lost because of our broken IPO market.”

Meanwhile, U.S. Labor Department statistics suggest that the number of unemployed and under-employed Americans reached approximately 25 million in 2011.

The adverse effects brought on by the IPO market decline across the entire American capital markets system have begun to undermine U.S. global economic primacy. The United States raised just 15 percent of global IPO proceeds in 2010, down from its average of 28 percent over the preceding 10 years.

*The losers in the IPO crisis are the U.S. workers who would have been hired by emerging growth companies had they been able to go public and generate new jobs through their subsequent growth.*

---

(1) D. Weild and E. Kim, Grant Thornton, A Wake-up Call for America at page 2 (November 2009).
VI. Regulatory and Market Roadblocks

While the costs of the IPO market’s decline to the U.S. economy are clear, its causes cannot be traced to one single event. Rather, a complex series of changes in the regulatory environment and related market practices, most of which were intended to solve problems unrelated to emerging growth company IPOs, has:

1. driven up costs for emerging growth companies looking to go public, thus reducing the supply of such companies,
2. constrained the amount of information available to investors about such companies, thus making emerging growth company stocks more difficult to understand and invest in, and
3. shifted the economics of investment banking away from long-term investing in such companies and toward high-frequency trading of large-cap stocks, thus making the IPO process less attractive to, and more difficult for, emerging growth companies.

These outcomes contradict the spirit and intent of more than 75 years of U.S. securities regulation, which originally sought to provide investor protection through increased information and market transparency, and to encourage broad investor participation through fair and equal access to the public markets. In most cases, the regulations were intended to address market issues created exclusively by the behavior of, and risks presented by, the largest companies. While some regulations succeeded in this aim, almost all of them have created unintended adverse effects on emerging growth companies looking to access public capital.

The collective result of these well-intentioned but “one-size-fits-all” regulations and the market changes they have engendered amounts to nothing less than a fundamental change in the structure of the U.S. capital markets. The losers in this restructuring are the U.S. workers who would have been hired by emerging growth companies had those companies been able to go public and generate new jobs through their subsequent growth.

Sources: JMP Securities, Dealogic, Capital Markets Advisory Partners, Grant Thornton.
A. Impact on Supply of Emerging IPOs

While 96% of emerging growth companies surveyed agreed that a strong and accessible small cap IPO market was important, only 13% agreed that the current market is easily accessible for small companies. (1)

An IPO represents one of the most significant steps in a young company’s growth cycle. Unfortunately, a series of rules, regulations and other compliance issues aimed at large-cap, already-public companies has increased the time and costs required for emerging companies to take this critical first step.

Many of the rules and regulations adopted over the last 15 years aimed to respond to scandals or crises at major public companies and to restore confidence in the public markets by requiring public companies to adopt more stringent financial and accounting controls. These requirements are included in the dozens of rulemakings (some of which are still pending) following the Sarbanes-Oxley Act of 2002, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, and various accounting and compliance requirements. Financial Accounting Standards Board (FASB) and Public Company Accounting Oversight Board (PCAOB) rules can further increase the compliance challenge, as discussed further below.

<table>
<thead>
<tr>
<th>1996-Today</th>
<th>Accounting &amp; Compliance from Policymakers &amp; Industry</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>Advent of Electronic Trading</td>
</tr>
<tr>
<td>1999</td>
<td>Gramm-Leach-Billey Overturns Separation Of Commercial &amp; Investment Banking</td>
</tr>
<tr>
<td>2001</td>
<td>Decimalization Introduced for All Exchange Traded Shares</td>
</tr>
<tr>
<td>2002</td>
<td>Sarbanes-Oxley Act</td>
</tr>
<tr>
<td>2002-Today</td>
<td>Additional Accounting &amp; Compliance from Policymakers &amp; Industry</td>
</tr>
<tr>
<td>2003</td>
<td>Global Analyst Settlement Separates Research &amp; Banking</td>
</tr>
<tr>
<td>2009-Today</td>
<td>Dodd-Frank Act</td>
</tr>
</tbody>
</table>

Two recent surveys of pre- and post-IPO companies – one initiated by the IPO Task Force (see Appendix C for summary results) and one conducted by a company currently in registration by reviewing public filings of its peers (2) – place the average cost of achieving initial regulatory compliance for an IPO at $2.5 million, followed by an ongoing compliance cost, once public, of $1.5 million (3) per year. These figures can represent a significant amount of an emerging company’s earnings before interest, taxes, depreciation and amortization (EBITDA) and can lower the company’s market cap based on EBITDA multiples by tens of millions of dollars. Respondents to the task force survey listed the regulatory burdens of going public as their primary concerns.

(1) IPO Task Force August 2011 CEO Survey (see Appendix C).  
(2) Survey conducted by a private company via an independent review of public filings for 47 IPOs raising less than $200M in 2011.  
(3) Results compiled from two different surveys. The first was initiated by the Task Force; methodology and summary results can be found in Appendix C. Survey conducted by a private company via an independent review of public filings for 47 IPOs raising less than $200M in 2011.
These high costs can force a grim tradeoff for management: 1) commit these resources to achieving and maintaining compliance in an uncertain IPO market, or 2) postpone (or forgo altogether) an IPO to continue developing the company’s product offering and building the enterprise at a lower growth trajectory. Given that completing an IPO involves a great deal of risk and uncertainty for an emerging growth company, especially in a down cycle, many companies are choosing the second option with the target exit being acquisition by a larger company. As described earlier, this outcome not only generates less short-term job growth, but can actually reduce the number of jobs in the short run when the acquiring company eliminates redundant positions.

While these rules apply to public companies, emerging growth companies must be ready to comply with them at, or very soon after, the time of their IPOs and typically must begin to build up a significant compliance infrastructure a year or two ahead of time. Currently, companies with market capitalizations of under $75 million (known as “Smaller Reporting Companies” or “SRCs”) are exempted from a broad range of rules that apply to all larger companies. While the idea behind this exemption is sound, the execution falls short of market realities. First, it creates a false dichotomy with in the equities space wherein a company is either a micro-cap or a large cap. This is akin to classifying all motor vehicles as either sub-compact cars or semi-trucks – with nothing in between. Second, the current system holds even the smallest cap companies to the large-cap standards before they can go public. As a result, emerging growth companies and U.S. workers pay the price – literally.

The continued implementation of various rules under the Dodd-Frank Act, along with proposed FASB and PCOAB initiatives under discussion, will likely further increase the compliance challenge for emerging growth companies. For example, matters under consideration in the PCOAB’s recent concept release on new auditor firm rotation threaten to increase costs even further for emerging growth companies. This requirement is in addition to the existing requirement that all individual auditors assigned to an account be rotated regularly with other auditors within the same firm. For an emerging company, hiring a new audit firm a year or two after an IPO is very expensive. This is because it often takes a company a year or two to fully educate its auditor about the company’s business model and for the auditor to use that knowledge to deliver services efficiently. For these reasons, the first year or two of the engagement are the most costly for a company. The rotation rule would force a company to drop its audit firm just as the relationship is becoming cost-efficient, and start the education process anew with a different audit firm. Relief under current and proposed rules for small companies does not compromise investor protection as the incidence of accounting fraud by small companies is no greater than for their large peers.\(^\text{(1)}\)

\(^{1}\) 10-Year Study by Audit Analytics Released May 2011.
Cumulatively, the unintended effects of these current and pending regulations – the increasing length of time between initial start-up and liquidity event, the increasing compliance costs associated with becoming and maintaining a public company in the U.S., the significantly larger market capitalization and revenue size required to go public, the financial, accounting and compliance infrastructure required to go public in today’s environment – have likely delayed, diverted or discouraged hundreds of companies from entering the public markets since the mid-1990s. The long-term economic impact for U.S. workers and consumers resulting from the lost jobs and revenues from these companies cannot be underestimated.

Recommendation #1:
Provide an “On-Ramp” for emerging growth companies using existing principles of scaled regulation.

1. Create a new category of issuer, “emerging growth company,” that lasts up to five years and is transitional.

2. Define such companies by the following criteria:
   1.2.1 Annual revenue of less than $1 billion
   1.2.2 Not recognized by the SEC as a “well-known seasoned issuer”
   1.2.3 Registered for an IPO, or less than five years post-IPO

3. Build on existing scaled disclosure rules to ease compliance burdens during the transition period while maintaining investor protection.

4. Apply scaled On-Ramp regulations only as long as a company qualifies as an emerging growth company.

Detailed recommendation on page 19.

The task force made its recommendations with the objective of maintaining the principles of investor protection and sought investor input into the limited measures that are recommended in this report. When analyzing the cohorts of emerging growth companies that went public over the last five years, emerging growth companies never exceed 15 percent of all companies listed on the exchange (see Appendix D, page 42). Market cap was rejected as a basis for determining status as an emerging growth company because, in a volatile market, companies often have limited visibility of or control over their market cap. A revenue-based test satisfied the objective of increased certainty regarding the applicability of key regulations.

The primary reasons emerging growth companies seek capital are to grow their businesses, pursue promising new products and innovations, and create jobs. Enabling them to use an On-Ramp (for some or all of the scaled regulation and disclosure) for a period of time after their IPOs will reduce their costs in trying to achieve these goals. Based on interviews with pre- and post-IPO companies, we would expect the On-Ramp scaling to reduce internal and external compliance costs for such companies by 30 percent to 50 percent. It will also allow them to build the resources to satisfy the additional regulatory burdens to which large, mature companies are accustomed. We expect that this will result in a larger supply of emerging growth companies going public and increased job creation over the long term.
Chart I: Public Company CEOs: Most Significant IPO Challenges

- Administrative Burden of Public Reporting: 92%
- Reallocation of CEO’s Time to Reporting/Compliance vs. Co. Building: 91%
- Administrative Burden of Regulatory Compliance: 89%
- Managing Public Company Communications Restrictions: 88%


*Per a 10-year study by Audit Analytics released in May 2011, the incidence of restatement by small companies is no different from their larger peers and is proportional to their percentage of the public company population.*
B. Changes to the IPO Channel

As described earlier, the extraordinary sequence of regulatory interventions and the market changes it has engendered have fundamentally changed the structure of the U.S. capital markets. This new market structure has shifted the economic incentives for financial institutions away from long-term investing in a company’s fundamental growth – upon which emerging growth companies and their IPOs rely – and toward short-term trading driven by volatility and changes in market price. In the process, it has broken the traditional relationship between buyers and sellers of emerging growth company stocks.

This shift began in the late 1990s with the rise of electronic trading, which led to lower commissions and reduced the role of traditional brokers, who helped to expose investors to a wide array of stocks – including small caps. The adoption of decimal pricing (wherein stocks are priced in pennies instead of by fractions of dollars) by 2001 further reduced the economic opportunity per trade for investment banks.

In the new, low-cost, frictionless environment promulgated by electronic trading and decimalization, investment banks now generate revenue primarily by executing a high volume of low-priced trades meant to capitalize on short-term changes in the price of highly liquid, very large-cap stocks.

The rise of algorithmic trading strategies and high-frequency execution (known collectively as high-frequency trading, or HFT) illustrates this shift in stark terms. High-frequency trading now accounts for nearly 75 percent of all equities trading volume at U.S. exchanges,\(^1\) compared with slightly more than 20 percent in 2004.\(^2\)

The problem for emerging growth company stocks is that high-frequency trading is driven by non-fundamental factors such as price discrepancies among various market makers, relationships between various stocks and commodities, and price movements, as opposed to by a particular company’s prospects for growth and profitability. In addition, HFT positions are closed out at the end of every day – the exact opposite of the type of long-term, fundamentals-based strategy that favors emerging growth IPOs. In this environment, large stocks can sometimes function more like commodities whose value is driven more by their volatility, liquidity and the amount of the company’s shares available for trading in the public market (its “float”) than by the long-term growth they may offer to their holders. With their large floats and high visibility with investors, large-cap stocks can support this model.

Most investment banking research, especially for the investment banking firms with significant trading and prime brokerage operations, is now focused on supporting these large cap companies, which represent most of the business of those firms.

\(^{1}\) Source: The Tabb Group, Aite Group.

\(^{2}\) Source: The Tabb Group.
By contrast, emerging growth stocks do not fit this model. They begin their “public” lives with modest liquidity levels and small floats – both of which they must grow over time through strong fundamental growth and increased visibility. Due to this relative lack of liquidity and float, emerging growth company stocks simply don’t produce enough trading volume to make money for the investment bank’s trading desk and therefore the investment bank as a whole. This undermines the incentive for investment banks to underwrite and make markets for newly public companies.

As the revenue drivers for investment banks have shifted to trading, the focus of their research departments has understandably followed suit. Already, decimalization had put the economic sustainability of sell-side research departments under stress by reducing the spreads and trading commissions that formerly helped to fund research analyst coverage. The Global Analyst Settlement of 2003 increased that stress by prohibiting the direct compensation of research analysts through investment banking revenue. This limited the compensation sources for analysts to trading revenues. As a result, most sell-side research analysts have shifted their attention to the high-volume, high-liquidity large-cap stocks that now drive revenues for their institutions and provide the basis for their compensation. This shift has resulted in less research coverage of emerging growth companies and thus less transparency and visibility into emerging growth companies for investors – an outcome that contradicts the original intent of the regulations in question. Instead, these regulations and market changes have produced less efficient markets in which long-term growth investors have less information about and access to the emerging growth companies that need capital the most.

Recommendation #2:

Improve the availability and flow of information for investors before and after an IPO.

2.1 Improve the availability and flow of research coverage.

2.2 Expand and clarify existing safe harbors.

2.3 Eliminate unnecessary research quiet periods.

2.4 Eliminate unnecessary restrictions on analyst communication.

2.5 Facilitate capital formation by expanding permissible communications between issuers and prospective investors and by providing for confidential IPO filings.

Detailed recommendation on page 26.

The task force developed the above recommendations under the premise that more information for investors is always better than less. It also allows emerging growth companies to “be heard” in the midst of the high-volume, large-cap-dominated trading landscape. Again, this remains consistent with historical first principles regarding the intent of U.S. securities regulation. Improving the flow of information about emerging growth companies to investors before and after an IPO can increase visibility for emerging growth companies while maintaining transparency for investors. In some cases, this will simply require an update of regulations that have been in place for 80 years to reflect today’s marketplace and communications realities.

Despite the shift in economics and the paucity of information about emerging growth companies, there remains a vibrant community of boutique investment banks and growth-company investors willing to execute and invest in emerging growth IPOs. In the current environment, however, gaining access to emerging growth IPOs has become a challenge. In the wave of investment bank consolidation triggered by the passage of the Gramm-Leach-Bliley Act of 1999, large institutions acquired many of the most prominent and successful “growth stock investment banks,” which increased the market strength of the largest investment banks. The combination of brand power and adverse market cycles has enabled the larger investment banks to garner a dominant market share of the dwindling IPO market. As a result, companies have shifted away from diversified investment banking syndicates that include
growth-oriented investment banking firms who, in the past, were allocated shares to place with investors looking for long-term growth. Instead, current practices favor syndicates that are dominated purely by the largest investment banks. In this model, the large investment banks have incentives to place IPO shares with their biggest trading counterparts, rather than long-term growth investors, who are the strongest holders of emerging growth company IPOs.

Once again, these changes have undermined their original intents by making it more difficult for public investors wishing to invest in the long-term growth of innovative, emerging companies to gain access to such stocks.

**Recommendation #4**

Members of the emerging growth ecosystem must educate issuers about how to succeed in the new capital markets environment.

4.1 Choice of balanced investment banking syndicate.

4.2 Increase issuer’s role in IPO allocation process with the goal to create an optimal mix of investors for the company.

4.3 Improve practice of investor communication.

Detailed recommendations on page 31.

The IPO Task Force developed the above recommendations with the goal of restoring the broken link between emerging growth companies and the public investors who wish to invest in them. By educating issuers about the new capital markets environment described above, we can help them become better consumers of investment banking services and find long-term institutional small-cap investors that best fit their evolving investor bases. This will help reconnect buyers and sellers of emerging growth stocks more efficiently. The Task Force believes responsibility for this education effort lies not with policymakers but rather with all members of the emerging growth company ecosystem.
C. Impact on Demand

As described in the prior section, demand for emerging growth company IPOs persists among a number of investor communities. This persistent demand in the face of shifting market economics underscores the value that smaller IPOs can still deliver to investors and the urgency of addressing the supply and channel issues outlined earlier in this report. Unfortunately, changes in the U.S. market structure have lowered the supply of such IPOs and have limited both the amount of available information and access to the shares of emerging growth companies for long-term growth investors.

In addition to addressing these measures, policymakers can reinforce demand for emerging growth company IPOs and maximize their effectiveness by using the tax code to create an additional incentive for investors. Such an incentive can draw long-term investors to buy at an emerging growth company's IPO, when that purchase will deliver the greatest benefit for the issuer, which is to bring them into the realm of being a publicly traded company and raise capital for growth. Without these first purchasers, an IPO cannot happen.

Recommendation #3:

Lower the capital gains tax rate for investors who purchase shares in IPO and hold these shares for a minimum of two years.

Detailed recommendation on Page 30.

Using tax policy to encourage long-term investing is a time-tested tool in U.S. regulatory practice. By lowering the capital gains rate for buyers of newly issued stock if they hold it for two years from the IPO date, policymakers can assist emerging growth companies in attracting long-term investors to their IPOs at the initial allocation — thereby helping to ensure that the companies successfully access the public markets and bring the benefits of job growth and appreciation in value to employees and investors alike.

Chart K: Demand Exists: Emerging Company IPOs Deliver Returns to Investors

<table>
<thead>
<tr>
<th>Post IPO Market Cap</th>
<th>1 Day</th>
<th>1 Month</th>
<th>3 Months</th>
<th>6 Months</th>
<th>1 Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>$200M-$500M</td>
<td>Average</td>
<td>27.5%</td>
<td>34.8%</td>
<td>45.1%</td>
<td>43.9%</td>
</tr>
<tr>
<td>$1B or more</td>
<td>Average</td>
<td>35.9%</td>
<td>39.7%</td>
<td>37.7%</td>
<td>32.8%</td>
</tr>
</tbody>
</table>

Source: JMP Securities, Dealogic.
Note: Includes all IPOs from 1/1/2011-9/30/2011.
VII. Detailed Recommendations

The precipitous decline of the U.S. IPO market – driven by a paucity of emerging growth companies going public – has stifled job creation, undermined U.S. economic strength and imperiled America’s global technology leadership. Historically one of the most reliable routes to growth for young companies, the small cap IPO market has been damaged and needs immediate repair.

This decline stems from a fundamental shift in the structure of the U.S. capital markets brought on primarily by regulations and related market forces. For some aspects of the new market reality, such as decimalization, there’s no turning back – nor should there be, as investors have benefited from greater market access and reduced trading costs. For a number of other factors, however, opportunities exist to make limited and reasonable adjustments that can help restore the access to the public capital that emerging growth companies need to hire new employees, develop their products and grow their businesses globally.

To this end, the IPO Task Force has developed four recommendations that can serve as a roadmap for policymakers and members of the emerging growth company ecosystem to revive America’s IPO market and the jobs growth it can generate. Developed to be targeted, scalable and in some cases temporary, these recommendations aim to bring the existing regulatory structure in line with current market realities while remaining consistent with its overarching goals of increased investor protection and participation. The task force’s recommendations for policymakers are:

1. **Provide an “On-Ramp” for emerging growth companies using existing principles of scaled regulation.** We recommend that companies with total annual gross revenue of less than $1 billion at IPO registration, and that are not recognized by the SEC as “well-known seasoned issuers” be given up to five years from the date of their IPOs to scale up to compliance. Doing so would reduce costs for companies while still adhering to the first principle of investor protection. (Page 19)

2. **Improve the availability and flow of information for investors before and after an IPO.** We recommend improving the flow of information to investors about emerging growth companies before and after an IPO by increasing the availability of company information and research in a manner that accounts for technological and communications advances that have occurred in recent decades. Doing so would increase visibility for emerging growth companies while maintaining existing regulatory restrictions appropriately designed to curb past abuses. (Page 26)

3. **Lower the capital gains tax rate for investors who purchase shares in an IPO and hold these shares for a minimum of two years.** A lower rate would encourage long-term investors to step up and commit to an allocation of shares at the IPO versus waiting to see if the company goes public and how it trades after its IPO. (Page 30)

In addition to its recommendations for policymakers, the task force has also developed a recommendation for members of the emerging growth company ecosystem:

4. **Educate issuers about how to succeed in the new capital markets environment.** The task force recommends improved education and involvement for management and board members in the choice of investment banking syndicate and the allocation of its shares to appropriate long-term investors in its stock. Doing so will help emerging growth companies become better consumers of investment banking services, as well as reconnect buyers and sellers of emerging company stocks more efficiently in an ecosystem that is now dominated by the high-frequency trading of large cap stocks. (Page 31)
Over the long term, the IPO Task Force believes that enacting these recommended changes will benefit all entrepreneurs who have developed successful, high-growth companies and who qualify for access to public, late-stage growth capital. Each of these action steps is outlined in greater depth in the sections that follow.

“This proposal adds to the ancient rule of caveat emptor, the further doctrine, ‘Let the seller also beware.’ It puts the burden of telling the whole truth on the seller. It should give impetus to honest dealing in securities and thereby bring back public confidence.” President Franklin D. Roosevelt, referring to The Securities Act of 1933.
A. Recommendation #1:

Provide an “On-Ramp” for emerging growth companies using existing principles of scaled regulation.

Our first recommendation is to modify the current framework for IPO issuers and new reporting companies by expanding the system of scaled securities regulation for these emerging growth companies. Congress and the Securities and Exchange Commission (SEC) have had a history of scaling regulation for companies and transactions when warranted, as discussed in the 2006 Final Report of the Advisory Committee on Smaller Public Companies.\(^{(1)}\)

In fact, as a result of the 2006 Report and its recommendations, in 2007 the SEC adopted rules providing regulatory relief and simplification for Smaller Reporting Companies (SRCs) in the form of scaled disclosure, noting at the time that scaled disclosure would “promote capital formation for smaller reporting companies and improve their ability to compete with larger companies for capital” as well as reducing their compliance costs and, in turn, the associated “costs to raise capital”.\(^{(2)}\) The SEC again provided regulatory relief in a 2010 rule exempting smaller companies from the provisions of Sarbanes-Oxley Section 404(b), which requires an auditor attestation of a registrant’s internal control over financial reporting.\(^{(3)}\)

Similar to these prior reforms, we believe that the modifications we propose for emerging growth companies are “necessary and appropriate in the public interest” and that the adoption of our proposals clearly would “promote efficiency, competition and capital formation”.\(^{(4)}\) While helpful for companies with market capitalizations of less than $75 million, the existing small company regulations do not provide relief for most companies considering an IPO, including high-growth, venture-backed companies that generate significant job growth like Apple, Intel, Cisco and Genentech before them. These companies go public in order to finance their growth and typically raise between $50 million and $150 million dollars to do so. While still far smaller and with fewer resources than larger companies, they must adhere to the same rules that the very largest companies do and therefore bear compliance costs disproportionate to their size. Based on interviews with pre- and post-IPO companies, we would expect the On-Ramp scaling recommendations that follow to reduce internal and external compliance costs for such companies by 30 percent to 50 percent.


\(^{(2)}\) See Release No. 33-8876 (Dec. 19, 2007) at 65 (simplifying the scaled disclosure system and expanding the number of companies that may use the scaled disclosure system available for Smaller Reporting Companies).

\(^{(3)}\) See Release No. 33-9142 (Sept. 15, 2010); see also Section 989G of the Dodd-Frank Act (providing that non-accelerated filers are completely exempt from Section 404(b) of the Sarbanes-Oxley Act). In addition, all newly public companies, regardless of size, benefit from a phase-in period for Section 404(b) compliance. See item 308 of Regulation S-K (providing relief for up to two years by permitting newly public companies to wait until their second annual report on Form 10-K to include management’s assessment of and the auditor’s attestation report on internal control over financial reporting). Separately, Section 404(a) of the Sarbanes-Oxley Act and related SEC rules require all other public companies to provide an annual management’s report on internal control over financial reporting.

\(^{(4)}\) See Securities Act Section 2(b); Exchange Act Section 3(f); Investment Company Act Section 2(c).
1.1 Create a new category of issuer, “emerging growth company,” that lasts up to five years and is transitional.

To address the higher relative compliance burdens that emerging growth companies face, and consistent with the concept of scaling regulation, we recommend creating a new category of issuer — an “emerging growth company” — that will be permitted to benefit from a modified regulatory framework that would provide a transitional five year On-Ramp following the IPO.

1.2 Define an “emerging growth company” according to the following criteria:

1.2.1 Designation as an emerging growth company would begin on the effective date of the IPO registration statement of any non-reporting issuer with total annual gross revenue of less than $1 billion as of the end of its most recently completed fiscal year.

1.2.1.1 Consideration could be given to limiting emerging growth company status to those issuers that are listing on a national securities exchange.

1.2.2 Designation as an emerging growth company would cease on the due date of the first annual report on Form 10-K for the year in which the earliest of the following occurs:

1.2.2.1 total annual gross revenue exceeds $1 billion;

1.2.2.2 the company satisfies the definition of a “well-known seasoned issuer” (<sup>1</sup>), or

1.2.2.3 the fifth anniversary of the effective date of the IPO registration statement.

The IPO Task Force believes that the temporary and limited nature of these regulations is important and consistent with other regulatory applications. An analysis of the companies that would have fallen under this regulation over the past five years shows that less than 15 percent of listed companies would be impacted at any one time.<sup>2</sup> For this reason, we refer to this as a regulatory “On-Ramp.” We believe that the targeted and temporally limited nature of the proposed On-Ramp distinguishes our recommendation from prior proposals for reform and would affect only a small number of companies relative to total market capitalization. We also note that investor protection concerns are further ameliorated in light of the fact that, as indicated in a 10-year study by Audit Analytics released in May 2011, the incidence of restatement by small companies is proportional to their percentage of the public company population (approximately 60 percent in each case).<sup>3</sup>

We believe that the On-Ramp concept will facilitate the SEC’s consideration of the effects of new rulemakings upon efficiency, competition and capital formation<sup>4</sup> and, in the interests of promoting capital formation, we recommend that the SEC use the On-Ramp as standing transition relief for any significant new rulemakings in the future.

---

<sup>1</sup> Securities Act Rule 405 defines a “well-known seasoned issuer” to include, in part, issuers that (i) are eligible for short-form registration on Form S-3 or Form F-3, (ii) have at least $700 million of common equity held by non-affiliates as of a date within 60 days of filing a shelf registration statement, an annual report on Form 10-K or Form 20-F or a registration statement update amendment mandated by Section 10(a)(3) of the Securities Act; and (iii) do not fall within the definition of an “ineligible issuer” or “asset-backed issuer.”

<sup>2</sup> See Appendix D


1.3 Build on existing scaled disclosure rules to ease compliance burdens during the transition period while maintaining investor protection.

We believe that the primary goals of most emerging growth companies that conduct an IPO are to secure capital to grow their businesses and pursue promising new products and innovations, thereby creating jobs and enhancing macroeconomic growth. Providing emerging growth companies with the ability to reduce regulatory compliance costs through scaled regulation and disclosure for a period of time after their IPOs would allow them to achieve those goals and build the resources to satisfy the additional regulatory burdens to which larger, more mature companies are accustomed. We believe this would help ameliorate the effects of regulations that have, over the course of the last decade, significantly and continuously increased the compliance burden associated with public company status and made IPOs more costly and difficult. As the SEC correctly anticipated in 2003, rules relating to the implementation of Section 404 of the Sarbanes-Oxley Act were expected to “discourage some companies from seeking capital from the public markets” because those “rules increase the cost of being a public company.” We believe our On-Ramp recommendation would mitigate the effects of these increased costs and encourage emerging growth companies to seek capital from the public markets.

Moreover, we believe that disclosure and governance requirements would remain largely unaffected by our recommendations and that this would ensure adequate investor protection. For example, in connection with undertaking an IPO, all companies would continue to be subject to liability for material misstatements or omissions in the registration statement and prospectus. Further, all companies would remain subject to liability for material misstatements or omissions in their current and periodic reports filed with the SEC. We believe that the existing regulatory regime, as modified by our recommendations, would appropriately balance investor protection and the compliance burden on emerging growth companies.

The idea of an On-Ramp for newly-public companies is not new. The SEC already provides an accommodation for IPO companies in the area of internal control over financial reporting, delaying the management assessment and auditor’s attestation of internal control over financial reporting until the company’s second Form 10-K. This concept is also incorporated into Rule 10A-3 under the Exchange Act and self-regulatory organization (SRO) listing...
standards with respect to audit committee composition, Board independence standards and other governance requirements. Moreover, the SEC previously recognized, when it adopted rules to implement Section 404 of the Sarbanes-Oxley Act, that the rules warranted a significant transition period to (a) alleviate “costs and burdens imposed on companies”; (b) give companies “additional time to develop best practices, long-term processes and efficiencies”; and (c) increase time to find “outside professionals that some companies may wish to retain” to facilitate their compliance efforts.\(^1\) Similarly, given the substantial time and resources needed to provide the additional disclosure and meet the compliance requirements that apply to Exchange Act reporting companies, the On-Ramp would provide emerging growth companies with a transition period to allow them to fully implement those requirements. Our recommendation would extend and expand that On-Ramp until the emerging growth company has sufficient internally-generated resources to maintain growth and emerge into a mature public company.

During the On-Ramp period, any issuer that satisfies the definition of an emerging growth company could elect to participate in a system of scaled regulation that would extend to emerging growth companies select elements of the scaled disclosure requirements currently available to SRCs, as well as additional elements of scaled regulation:

1.3.1 Financial statement requirements:

1.3.1.1 The ability to satisfy financial statement requirements applicable to registration statements and annual reports by presenting two years of audited financial statements that comply with Article 8 of Regulation S-X.

1.3.1.2 Exemption from the requirement to present five fiscal years of selected financial data under Item 301 of Regulation S-K, subject to phase in described below.

1.3.1.3 Presentation of financial statements for additional fiscal years would be phased in incrementally over time:

- At IPO — 2 years audited balance sheets and statements of operations and cash flows, selected financials (a summary table of key financial indicators) for the same two years, (the same as scaled disclosure requirements for Smaller Reporting Companies);
- One year later — 3 years audited statements of operations and cash flows and 2 years balance sheets, selected financial data for the same 3 years;
- Two years later — same as above plus 4 years selected financial data; and
- Three years later — same as above plus 5 years selected financial data.

1.3.2 Selected aspects of scaled disclosure in registration statements and annual reports equivalent to requirements applicable to Smaller Reporting Companies for:

1.3.2.1 Management discussion and analysis (MD&A) requirements under Item 303 of Regulation S-K.

1.3.2.2 Executive compensation disclosure under Item 402 of Regulation S-K.

\(^{1}\) Release No. 33-8238 (June 5, 2003) at text accompanying n.174.
1.3.3 Transition relief from SOX 404b, the outside auditor attestation of internal control over financial reporting under Item 308(b) of Regulation S-K to provide “additional time and defer costs for a newly public company, allowing it to focus on its assessment of internal control over financial reporting without the additional focus of the initial public offering.”

1.3.4 Exemption from administratively burdensome requirements, both currently effective and pending, under the Dodd-Frank Act and related SEC rulemaking, such as:

1.3.4.1 Say-on-pay, say-on-frequency and say-on-parachute votes under Section 951 of the Dodd-Frank Act.

1.3.4.2 Final disclosure requirements (when adopted) relating to conflict minerals.

1.3.4.3 Other substantive governance-related disclosure requirements (when adopted), such as pay-for-performance and CEO pay ratio.

1.3.5 We recommend that the FASB take steps to allow emerging growth companies to adopt new accounting standards using the same extended effective dates it allows for private companies.

---

(1) Release No. 33-8760 (Dec. 15, 2006) at 47 (implementing a transitional period of up to two years) (citing Sections 12, 13, 15 and 23 of the Exchange Act as statutory authority for such relief). Under similar statutory authority, the SEC repeatedly exempted non-accelerated filers from compliance with Section 404(b) of the Sarbanes-Oxley Act for the cumulative period of approximately eight years between enactment of the Sarbanes-Oxley Act and the Dodd-Frank Act.

(2) The SEC has acknowledged the additional burdens that these requirements impose on smaller companies, which is why the SEC exempted smaller companies from the say-on-pay and frequency votes until annual meetings occurring on or after January 21, 2013. See Release No. 33-9178 (Apr. 4, 2011) (concluding that “it is appropriate to provide additional time before Smaller Reporting Companies are required to conduct the shareholder advisory votes on executive compensation and the frequency of say-on-pay votes” based upon “the potential burdens on Smaller Reporting Companies” associated with the requirements for those advisory votes).

(3) Release No. 34-63547 (proposing to require conflict minerals disclosure to implement Section 1502 of the Dodd-Frank Act by adding Item 4(a) of Form 10-K and Item 104 of Regulation S-K).

(4) Section 953 of the Dodd-Frank Act directs the SEC to adopt rules requiring public companies to provide additional detailed disclosures regarding executive compensation matters, including disclosure of (a) each public company’s executive compensation compared to the company’s financial performance; and (b) the median total compensation of all employees and the ratio of that amount compared to the CEO’s total compensation. As of August 2011, the SEC has indicated that it will issue proposed rules under Section 953 before 2012.

The FASB, over the last several years, has a history of providing an extended period of time for private companies and smaller public companies to adopt new standards. This is particularly important for complex standards and those that, due to their nature, may require significant time to implement. Similar to the On-Ramp for scaled securities regulation, allowing emerging growth companies additional time to adopt new standards would allow them to implement the standards in a careful, thoughtful manner, while still enabling them to concentrate on the growth of the company.

1.3.6 The PCAOB, or alternatively the SEC, should exempt the auditors of emerging growth companies from the requirements of such auditing standards until the company completes the On-Ramp period. This would allow these companies to focus precious resources on growth, job creation and new product development.

In implementing new auditing standards, the PCAOB should carefully consider the cost of implementation for emerging growth companies, and other appropriate categories of issuers.

In particular, the PCAOB should consider whether to require the standard in an audit of certain categories of registrants and, if required, whether additional time is necessary for the implementation of the auditing standard for such categories of registrants.

The PCAOB does not yet have a history of providing exemptions or additional time for a certain category(ies) of companies, similar to the FASB, for adoption of new auditing standards.

- Recent concept releases issued by the PCAOB, such as “Auditor Independence and Audit Firm Rotation” and “Possible Revisions to PCAOB Standards Related to Reports on Audited Financial Statements and Related Amendments to PCAOB Standards,” if ultimately adopted as auditing standards (depending on the final requirements of course), are likely to be very costly and time-consuming for SEC registrants and their auditors. This is particularly true for emerging growth and small companies who are impacted on a disproportionate basis as these costs represent a larger portion of their revenue and EBITDA and ultimately their market capitalization.

- We believe that mandatory auditor rotation will be extremely disruptive to public companies, will increase audit costs and may even result in reduced audit quality. Several of the PCAOB standards conclude that auditors may consider their experience in prior years’ audits of a client and modify or reduce current-year testing as appropriate, which is reasonable to believe occurs in the majority of recurring audits. However, in the first year of a new audit engagement, auditors will require additional time and expense to become familiar with the company. Also, with only four major firms, two situations are likely to occur: (1) many SEC registrants may be limited in the number of firms to choose from as independence issues will most certainly arise, which could reduce the quality of audits if the registrant has no choice but to select a firm that does not have the expertise or geographic reach required for the audit and (2) competition would be significant, which could distract auditors by requiring more frequent solicitation of new business. In addition, each of the Big 4 firms has developed specific regional and industry expertise, which expertise these firms will have less incentive to develop with mandatory rotation. Finally, it is unclear whether rotation will actually reduce the conflicts cited by the PCAOB.
1.4 Apply scaled On-Ramp regulations only as long as a company qualifies as an emerging growth company.

Chart L: Public Company CEOs: Most Significant IPO Challenges

- Administrative Burden of Public Reporting: 92%
- Reallocation of CEO’s Time to Reporting/Compliance vs. Co. Building: 91%
- Administrative Burden of Regulatory Compliance: 89%
- Managing Public Company Communications Restrictions: 88%

B. Recommendation #2:

Improve the availability and flow of information for investors before and after an IPO.

Investment research coverage has declined dramatically in recent years as a result of economic and regulatory pressures that have reduced research budgets. Lack of research coverage adversely impacts trading volumes, company market capitalizations and the total mix of information available to market participants. In addition, existing restrictions on communications surrounding the offering process were designed for a pre-Internet era dependent upon paper-based communications between issuers and investors, and should be updated to reflect advances in technology and market expectations.\(^1\)

Recommendations

2.1 Improve the availability and flow of research coverage.

Adopt policies to promote research and improve the flow of information available to investors. We recommend a greater role for research in the capital formation process, subject to protections such as specified codes of conduct and disclosure of conflicts of interest and disclosure, consistent with Section 17(b) of the Securities Act of 1933, of any consideration received for paid research. We support and endorse the recommendations of the SEC Advisory Committee on Smaller Public Companies (the “Advisory Committee”\(^2\)) regarding policies to encourage research coverage of smaller public companies. Existing limitations are unnecessarily restrictive and unfairly favor institutional investors that have greater access to research analysts than retail investors.

2.2 Expand and clarify existing safe harbors.

Expand SEC safe harbors with respect to research reports (Securities Act Rules 137, 138 and 139) to (i) permit broker-dealers to initiate coverage and distribute research on IPO issuers without being deemed to have “offered” securities through the research reports and (ii) include “oral” (in addition to written) communications.\(^3\)

Nearly a decade ago, structural reforms and increased disclosure requirements introduced substantial regulatory requirements for research reports, including Section 501 of the Sarbanes-Oxley Act, Regulation AC and the provisions of the Global Research Analyst Settlement. As a result, analyst research reports are comprehensively regulated and include disclosure to investors regarding potential conflicts of interest that research analysts may face.

\(^1\) See SEC Release No. 33-8591 (Dec. 1, 2005), at 41-42 (noting that “the gun-jumping provisions of the Securities Act were enacted at a time when the means of communications were limited,” recognizing that “capital markets, in the United States and around the world, have changed very significantly since those limitations were enacted,” acknowledging that today’s “communications technology, including the Internet, provides a powerful, versatile, and cost-effective medium to communicate quickly and broadly” and concluding that “the gun-jumping provisions of the Securities Act impose substantial and increasingly workable restrictions on many communications that would be beneficial to investors and markets and would be consistent with investor protection”); see also SEC Release 34-58288 (Aug. 7, 2008) (recognizing “the speed at which technological advances are developing” and indicating that the SEC will continue to revisit its prior guidance “to update and supplement it as appropriate” as new technologies produce new investor tools); SEC Release No. 34 55146 (Mar. 30, 2007) (observing that “approximately 87.8% of shares voted were voted electronically or telephonically during the 2006 proxy season” and that “approximately 80% of investors in the United States have access to the Internet in their homes”).


\(^3\) Currently available safe harbors contain conditions that limit their availability in the IPO context. See Rule 138 (allowing an underwriter to publish or distribute research about a different security of the issuer, such as research about the nonconvertible debt of an issuer offering common stock, if (a) the issuer is Form S-3 or F-3 eligible (or is a foreign private issuer meeting certain specified criteria); and (b) the underwriter publishes or distributes reports on those types of securities in the regular course of its business); Rule 139 (allowing an underwriter to continue to publish or distribute research, but not to initiate coverage, (a) issuer-specific research on companies that are already public and eligible to use Form S-3 or F-3 (or that are foreign private issuers meeting certain specified criteria) if the underwriter publishes or distributes those reports in the regular course of its business; and (b) industry research for Exchange Act reporting companies if the underwriter publishes or distributes research in the regular course of its business and similar reports have included similar information about the issuer or its securities). In addition, although Rule 137 is available to broker-dealers that are not participating in a registered offering, Rule 137 (unlike Rules 138 and 139), does not provide a safe harbor from the research report being deemed an “offer” for purposes of Securities Act Section 2(a)(10) or 5(c). See Rule 137 (allowing a broker-dealer to publish or distribute research without becoming a statutory underwriter if the broker-dealer (a) is not a participant in a registered offering; (b) has not received compensation for participating in the securities distribution; and (c) publishes or distributes research in the regular course of its business).
The SEC adopted changes in 2005 that were intended as “measured amendments” making “incremental modifications” to Rules 137, 138 and 139, recognizing that “value of research reports in continuing to provide the market and investors with information about reporting issuers cannot be disputed.”[1] However, in practice, the existing rules do not allow research analysts to publish concurrently with an IPO.

We believe that further amendments are warranted to allow broker-dealers to initiate research coverage on IPO issuers, based upon the extensive and robust nature of substantive regulations currently in place, which we would leave unchanged, and based upon experience over the last six years following prior incremental modifications to these rules. Based on “enhancements to the environment for research imposed by recent statutory, regulatory, and enforcement developments,” as the SEC explained in 2005, “we believe it is appropriate to make measured revisions to the research rules that are consistent with investor protection but that will permit dissemination of research around the time of an offering under a broader range of circumstances.”[2]

2.3  Eliminate unnecessary research quiet periods.

2.3.1  Post-IPO: Eliminate the SEC’s effective 25-day post-IPO research quiet period and FINRA’s mandated post-IPO research quiet periods, as these restrictions do not benefit investors (particularly retail investors).[3]

---

[2] Id. at 156.
[3] Rule 2711(f) of the Financial Industry Regulatory Authority (“FINRA”) prohibits member firms from publishing or distributing research reports, or permitting research analysts to make any public appearance about an issuer, for (i) 40 calendar days, in the case of managers and co-managers of the IPO, and (ii) 25 calendar days, in the case of other participating FINRA members.
2.3.2  Pre- and Post-Lock Up:  Eliminate the FINRA-mandated research quiet period before and after the expiration, termination or waiver of an offering-related lock-up agreement. Limiting the amount of information available to investors during such periods does not improve their ability to make informed decisions. In each case above, we believe any potential conflicts of interest would be sufficiently addressed through (a) a prominent disclosure clearly indicating that the research is prepared by an analyst associated with a participating underwriter or dealer; as well as through existing protections under (b) SEC Regulation AC certification requirements; (c) FINRA conduct and communications rules and (d) existing antifraud and anti-manipulative provisions.

2.4  Eliminate unnecessary restrictions on analyst communication: Although current SEC and FINRA restrictions implemented to prohibit investment banking revenues and considerations from influencing research analysts and the content of research reports are important and should remain, we believe, while an issuer is in registration, that:

2.4.1  Investment banking personnel should be permitted to assist in arranging calls between investors and research analysts so that research analysts can educate investors about an offering. Today’s process requiring a sales person (or other non-banking personnel) to set up these calls offers no meaningful investor protection. Whether the analyst chooses to engage in the communication, and what the analyst communicates to the investor, would still be at the analyst’s own discretion and subject to applicable laws, rules and regulations.

2.4.2  Research analysts should be permitted to participate in company management presentations with salesforce personnel so that the issuer’s management does not need to make separate and duplicative presentations to analysts at a time when senior management resources are limited.

2.5  Facilitate capital formation by expanding permissible communications between issuers and prospective investors and by providing for confidential IPO filings.

2.5.1  Permit a broader range of pre-filing communications: The SEC has recently recognized, in proposing amendments to Securities Act Rule 163, that additional accommodations are necessary to allow “well-known seasoned issuers,” acting through underwriters, to “assess the level of investor interest in their securities before filing a registration statement.”

2.5.1.1  More broadly, we recommend allowing private companies to “test the waters” to gauge preliminary interest among prospective investors in advance of an initial filing of a registration

---

(1) See FINRA Rule 2711(f)(4) (requiring a 15-day quiet period surrounding the expiration of an offering-related lock-up agreement).

(2) Regulation AC requires broker-dealer research analysts to (a) certify in their research reports that the views expressed in the report accurately reflect their personal views; (b) disclose whether the analyst received compensation or other payments in connection with the recommendations or views given in the report; and (c) provide similar certifications in connection with the analyst’s public appearances. The SEC adopted these requirements “to promote the integrity of research reports and investor confidence in those reports.” Release No. 33-8193 (Apr. 14, 2003).

(3) We note that FINRA had previously proposed (i) the reduction of the post – IPO research quiet period to 10 days for all IPO participants, and (ii) the complete elimination of the secondary offering and lock-up related research quiet periods. See FINRA Regulatory Notice 08-55 (October 2008) (“Notice 08-55”); see also SEC Release No. 34-55072 (Jan. 9, 2007) (in which then NASD and NYSE (now FINRA) proposed various rule changes to implement certain recommendations made in the December 2005 “Joint Report by NASD and the NYSE on the Operation and Effectiveness of the Research Analyst Conflict of Interest Rules”; the 2007 proposed rule changes included the reduction of the post-IPO research quiet period to 25 days, the elimination of the post-secondary offering research quiet period, and the elimination (as proposed by NASD) or reduction to 5 days (as proposed by NYSE) of the lock-up related research quiet period). Notice 08-55 effectively superseded the 2007 rule change proposals, but the proposals set forth in Notice 08-55 have not yet been adopted and it is likely that FINRA will submit a new rule proposal in this regard in the near future.

(4) See, e.g., Rule 2711(c)(7).

(5) FINRA Rule 2711 does not, by its express terms, prohibit “three way” meetings attended by company management, research analysts and internal sales personnel, although FINRA guidance issued in May 2005 states that the “rule expressly permits research analysts to educate investors and member personnel about a particular offering or other transaction, provided the communication occurs outside the presence of the company or investment banking department personnel.” See FINRA (then NASD) Notice to Members 05-34.

(6) Release No. 33-9098 (Dec. 18, 2009) (proposing to amend Securities Act Rule 163 to allow underwriters, acting on behalf of “well-known seasoned issuers,” to offer securities before filing a registration statement to gauge investor interest without requiring public disclosure of an intent to conduct an offering).
Detailed Recommendations

2.5.1.2 More specifically, we recommend expanding permissible communications before and after filing a registration statement provided prospective investors meet certain qualitative standards and purchasers receive a statutory prospectus prior to purchase. For example, road shows and other communications should be permitted before the filing of the registration statement becomes public, assuming that confidential filings are permitted as described above.

2.5.2 We recommend permitting pre-IPO road shows to investors deemed not to require registration-level protection, such as qualified institutional buyers and accredited investors, provided that each purchaser receives a statutory prospectus prior to the time of sale, consistent with Exchange Act Rule 15c2-8 and Securities Act Rule 159. This would facilitate initial meetings between investors and management and would allow investors to become better prepared to make investment decisions at the time of the IPO. The limited context of a formal road show presentation can make it more difficult for some investors to engage in a meaningful deliberative process, particularly for the type of long-term investors whose participation is most desirable to IPO issuers. Moreover, investors have repeatedly asked for more contact with management during the marketing process.

2.5.3 Permit confidential initial filing of IPO registration statements: Permit U.S. issuers to file initial registration statements confidentially, similar to foreign private issuers. The SEC Staff’s current practice permits non-reporting foreign private issuers to submit initial registration statements confidentially to the Staff, which “often reviews and screens draft submissions of foreign registrants on a non-public basis.” In contrast, U.S. issuers currently must file their initial registration statements publicly. Confidential submissions offer foreign private issuers a significant advantage by facilitating resolution of the often complex issues encountered during an initial SEC review. Permitting the confidential review of U.S. issuers’ initial registration statements would remove for U.S. issuers a significant impediment to the IPO process. Doing so would allow U.S. issuers to initiate a potential IPO process, even during turbulent and uncertain market conditions, without immediately disclosing competitively sensitive or otherwise confidential information. Investors would be protected by ensuring that any prospectus with pricing information be made publicly available to investors prior to the SEC declaring the registration statement effective.

---

(1) Securities Act Rule 254 was intended to allow an issuer employing the SEC’s “small issues” exemption in Regulation A to use a written statement to gauge investor receptiveness to a possible offering so that the issuer could “determine whether to incur the expense of proceeding with a public offering of its securities . . . or to follow some other capital-raising plan.” SEC Release No. 33-6924 (Mar. 11, 1992). In practice, however, Regulation A has had no meaningful impact on capital formation due to its very limited scope. We recommend expanding the “test the waters” concept so that IPO issuers could meaningfully and cost-effectively gauge investor receptiveness to an IPO and determine whether to incur the time, effort and expense of going public.


C. Recommendation #3:

Lower the capital gains tax rate for investors who purchase shares in an IPO and hold these shares for a minimum of two years.

Recent regulations and subsequent changes in related market practices have made it more difficult for long-term investors to gain access to emerging growth company stocks. From the issuer’s perspective, it is especially critical for the IPO to attract such long-term investors at the initial allocation because that determines how much capital the company raises through the IPO.

Policymakers can reinforce demand for emerging growth stocks by lowering the capital gains rate for investors who purchase shares in an IPO and hold these shares for a minimum of two years. The capital gains tax rate has served as an effective tool for encouraging and rewarding long-term investing for decades, so this action would be wholly consistent with current practice.
D. Recommendation #4:

Members of the emerging growth ecosystem must educate issuers about how to succeed in the new capital markets environment.

Regulations and their effects on related market practices have triggered a fundamental change in the structure of the U.S. capital markets. This new market structure has shifted the economics for large investment banks toward high-frequency, short-term trading of large-cap stocks based on volatility and changes in market price, and away from long-term investing in an emerging company’s fundamental growth. The result is a radically different and much less hospitable environment for emerging growth IPOs. Some of the drivers of this shift – most notably electronic trading and decimalization – are permanent. Therefore, emerging growth companies looking to go public must develop a greater understanding of the new market’s realities, understand how investment banks have shifted their business models to capitalize on these changes, and use this understanding to inform their IPO strategies – including the choice of an investment banking syndicate, the optimal mix of investors at IPO, and the most effective investor communications activities.

Nearly 90% of pre-IPO emerging growth companies surveyed expressed concern about the size and vibrancy of the small cap buyer universe.\(^{(1)}\)

The IPO Task Force believes that responsibility for aiding issuers in this effort rests not with policymakers, but rather with all participants in the small-company IPO ecosystem. Toward this end, the task force has developed a number of recommendations for issuers that address the most common areas where knowledge deficits exist – based on the task force’s findings and input from its members and third-party advisors. While they do not require action on the part of policymakers, the IPO Task Force has included these recommendations below to demonstrate the breadth and the depth of the challenge that emerging growth IPOs now face and the urgency with which the preceding recommendations must be treated.

4.1 Choice of balanced investment banking syndicate.

4.1.1 Conduct thorough research on potential investment banking partners.

4.1.2 Understand the interplay between boutique firms and the largest advisory firms.

4.1.3 Understand the implications of different investment banking syndicate structures and align incentives around performance.

4.2 Increase the issuer’s role in the IPO allocation process with the goal to create an optimal mix of investors for the company.

4.2.1 Allocate shares of the initial public offering to a mix of short- and long-term investors.

4.2.2 Put at least one firm in a leadership position (sole or joint book runner) that will allocate stock to long-term holders of your shares versus traders.

4.2.3 Limit the number of investors to whom the IPO shares get allocated.

4.3 Improve practice of investor communication.

4.3.1 Conduct pre-IPO road shows and teach-ins with investors long before an IPO.

4.3.2 Provide frequent information to investors post-IPO. This should include attending investor conferences to maintain the relationships and build company exposure.

\(^{(1)}\) IPO Task Force August 2011 CEO Survey (see Appendix C).
VIII. Conclusion

With the U.S. economic recovery stalled, unemployment entrenched at more than 9 percent and global competition ramping up, the time to revive the U.S. IPO market and to jumpstart job creation is now. The IPO Task Force believes that by pursuing the recommendations presented in this report, policymakers can re-energize U.S. job creation and economic growth by helping reconnect emerging companies with public capital – all while enabling the broadest range of investors to participate in the growth of those companies through a healthy and globally respected U.S. capital markets system.

These outcomes are not only consistent with the spirit and intent of the current regulatory regime, but also essential to preserving America’s global economic primacy for decades to come. For this reason, the members of the IPO Task Force pledge their continued participation and support of this effort to put emerging companies, investors and the U.S. job market back on the path to growth.

“When I talk to entrepreneurs in emerging international markets today, most of them share a strong desire and stated goal: They want to grow their businesses into large public companies. In the U.S., I often hear the opposite from entrepreneurs – due to the costs, uncertainties and liabilities now involved with going public. They just don’t think the rewards are worth it – and that’s killing the capital formation cycle we’ve relied on for so long.” Scott Cutler, Sr. Vice President, Global Corporate Group, NYSE Euronext.
Appendix A

About the IPO Task Force

Arising independently from working group conversations at the U.S. Treasury Department’s Access to Capital Conference in March 2011, the IPO Task Force aims to illuminate the root causes of the U.S. IPO crisis and provide recommendations to policymakers for restoring access to the public markets for emerging, high-growth companies. It represents the entire emerging growth company ecosystem, including venture capitalists, experienced CEOs, public investors, securities lawyers, academicians and investment bankers. Upon completion of its activities, the IPO Task Force will report its findings and recommendations to the U.S. Department of the Treasury, as well as share this information with the Securities & Exchange Commission, Congress, the Small Business Administration, the Council on Jobs and Competitiveness, the National Advisory Council on Innovation and Entrepreneurship (NACIE), the Startup America Partnership, and the general public.

Members

We should note the members of the task force listed below participated as individuals and not as representatives of their organizations. Thus, their input for this report and the positions contained herein do not necessarily reflect the views or positions of the organizations for which they work or are affiliated.

Venture Capitalists:

- Kate Mitchell – Managing Director, Scale Venture Partners, Task Force Chairman
- Mark Gorenberg – Managing Director, Hummer Winblad Partners
- Tom Crotty – General Partner, Battery Ventures

Entrepreneurs

- Magid Abraham Ph.D. – President, CEO and Co-Founder, ComScore
- Josh James – former CEO, Omniture; CEO & Founder of Domo Technologies
- Desh Deshpande – former CEO and Co-Founder, Cascade Communications and Sycamore Networks; Chairman, Sparta Group; and Co-Chair of NACIE

Securities Attorneys

- Joel Trotter – Deputy Chair of the Corp. Dept., Latham & Watkins
- Steve Bochner – CEO and Member of the Board of Directors, Wilson, Sonsini, Goodrich & Rosati

Academicians/Accountants

- Bill Sahlman – Dimitri V. D’Arbeloff Chair, and Sr. Associate Dean for External Relations, Harvard School of Business
- Carol Stacey – Vice President, S.E.C. Institute
- Charles “Chuck” Robel – former Chairman, McAfee; private investor and retired head of PWC Tech Practice

Public Investors

- Karey Barker – Managing Director, Wasatch Advisors
Investment Bankers

- Henry Ellenbogen – Portfolio Manager, T. Rowe Price
- Paul Deninger – Sr. Managing Director, Evercore
- Carter Mack – President and Founder, JMP Securities
- Kevin McClelland – Managing Director, Head of Tech. Inv. Banking, JMP Securities
- Brent Gledhill – Head, Global Corporate Finance; Member of Executive Committee, William Blair & Company
- Brett Paschke – Managing Director, Head of Equity Capital Markets, Corp. Finance, Commitment Committee, William Blair & Company
Appendix B

Acknowledgments

The IPO Task Force wishes to express its gratitude to the following individuals, whose input and expertise contributed to the preparation of this report. Please note that their appearance on this list does not imply endorsement of this report or its recommendations.

Chuck Newhall, General Partner, Co-Founder, NEA

Dixon Doll, Co-Founder & General Partner, DCM

Mark Heesen, President, NVCA

Duncan Neiderauer, CEO and Director, NYSE Euronext, Inc.

Scott Cutler, Senior Vice President, Global Corporate Group, NYSE Euronext, Inc.

David Weild, Capital Markets Advisor at Grant Thornton; Founder & Chairman of Capital Markets Advisory Partners; former Vice Chairman of NASDAQ

Ed Knight, Executive Vice President, General Counsel, Chief Regulatory Officer, NASDAQ

Bob McCooey, Senior Vice President, NASDAQ

Jeff Cardon, Portfolio Manager, CEO and Director, Wasatch Advisors

Frank Currie, Partner, Davis Polk

Lise Buyer, Partner, Davis Polk

Tom Baruch, Founder & Partner Emeritus, CMEA and member of NACIE

Joseph A. Grundfest, Senior Faculty and W.A. Franke Professor of Law and Business; Arthur and Tom Rembe Rock Center for Corporate Governance, Stanford Law School, Former Commissioner of the S.E.C.

Bob Huret, Founding Partner, FTV Capital

David York, CEO & Managing Director, Top Tier Capital

Herb Wander, Partner, Corporate Practice, Katten Muchin Rosenman LLP

Robert Bartlett, Assistant Professor of Law, Berkeley Law

Greg Becker, President and CEO, Silicon Valley Bank

Various CEOs and institutional investors surveyed by the IPO Task Force
Appendix C
IPO Task Force August 2011 CEO Survey

Objective and Methodology

In August of 2011, the IPO Task Force set out to gather the perspectives of pre-IPO and Post-IPO CEOs regarding their top concerns, largest hurdles, and the greatest benefits of going public. The purpose was to inform the task force’s efforts to examine the causes of the decline of the U.S. IPO market and develop recommendations for restoring access to capital for emerging growth companies. The task force distributed the survey to pre- and post-IPO companies through the membership of the National Venture Capital Association (NVCA) and by NASDAQ (targeting listed companies that went public since 2006). Responses were collected anonymously during a three-week period in August 2011.

Post–IPO CEOs: Survey Respondents

- 35 Public Company CEOs (IPO 2006 or later)
- Industry Sector:
  - 57% IT
  - 29% Life Sciences
  - 9% Non-High Technology
- Average Employment in 2011 = 828
- Average job growth since IPO = 86%
Public Company CEOs: IPOs Are Important But Increasingly Difficult

<table>
<thead>
<tr>
<th></th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong &amp; Accessible IPO Market Is Important to U.S. Economy &amp; Global Competitiveness</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>U.S. IPO Market Is Accessible for Small Companies</td>
<td>23%</td>
<td>11%</td>
<td>66%</td>
</tr>
<tr>
<td>It Is Not as Attractive an Option to Go Public Today as It Was in 1995</td>
<td>86%</td>
<td>3%</td>
<td>12%</td>
</tr>
<tr>
<td>Going Public Was a Relatively Painless Experience</td>
<td>17%</td>
<td>14%</td>
<td>69%</td>
</tr>
<tr>
<td>Going Public Has Been a Positive Event in My Company’s History</td>
<td>83%</td>
<td>14%</td>
<td>3%</td>
</tr>
</tbody>
</table>

Why Post-IPO Companies Went Public

- Strengthen balance sheet: 89%
- Access to growth capital: 83%
- Fortify brand/credibility with customers: 63%
- Provide currency for acquisitions: 60%
Post-IPO CEO Survey:
Biggest Concerns About Going Public

<table>
<thead>
<tr>
<th>Concern</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting &amp; compliance costs</td>
<td>86%</td>
</tr>
<tr>
<td>Post-IPO liquidity</td>
<td>83%</td>
</tr>
<tr>
<td>SOX &amp; other regulatory risks</td>
<td>80%</td>
</tr>
<tr>
<td>Public disclosure impact on business</td>
<td>72%</td>
</tr>
<tr>
<td>Meeting quarterly performance expectations</td>
<td>66%</td>
</tr>
<tr>
<td>Managing public company communications restrictions</td>
<td>60%</td>
</tr>
</tbody>
</table>

Public Company CEOs: Most Significant IPO Challenges

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative Burden of Public Reporting</td>
<td>92%</td>
</tr>
<tr>
<td>Reallocation of CEO’s Time to Reporting/Compliance vs. Co. Building</td>
<td>91%</td>
</tr>
<tr>
<td>Administrative Burden of Regulatory Compliance</td>
<td>89%</td>
</tr>
<tr>
<td>Managing Public Company Communications Restrictions</td>
<td>88%</td>
</tr>
</tbody>
</table>
Post-IPO CEO Survey: Costs of Going and Staying Public Are High

**Average Cost $2.5M to Go Public**

- <$1M: 0%
- $1.2M: 35%
- $2.3M: 31%
- $3.4M: 20%
- $4M: 14%

**Annual Cost $1.5M to Stay Public**

- <$1M: 0%
- $1.25M: 46%
- $2.3M: 31%
- $3.4M: 6%
- $4M: 3%

Costs Including SOX, Legal, Accounting


Pre-IPO CEOs: Survey Respondents

- 109 CEOs of venture-backed companies considering an IPO in the next 24 months.
- Average Employment: 168
- Industry Sector Breakdown:
  - 42% IT
  - 11% Cleantech
  - 42% Life Sciences
  - 1% Non-High Technology
Pre-IPO CEOs Target IPOs To Finance Growth

Motivation for Pre-IPO Companies

<table>
<thead>
<tr>
<th>Motivation</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash to Support Future Growth</td>
<td>63%</td>
</tr>
<tr>
<td>Competitive Advantage from Being Public</td>
<td>84%</td>
</tr>
<tr>
<td>Premium Valuation from Being Public</td>
<td>61%</td>
</tr>
</tbody>
</table>


Pre-IPO CEO Sentiments Regarding U.S. IPO Market

<table>
<thead>
<tr>
<th>Statement</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong &amp; accessible small cap IPO market is critical to maintain U.S. competitiveness</td>
<td>94%</td>
<td>6%</td>
<td>0%</td>
</tr>
<tr>
<td>Currently, the U.S. IPO market is easily accessible for small cap companies</td>
<td>9%</td>
<td>11%</td>
<td>79%</td>
</tr>
<tr>
<td>It is not as attractive an option to go public today as it was in 1995</td>
<td>85%</td>
<td>7%</td>
<td>8%</td>
</tr>
<tr>
<td>Concern</td>
<td>Percent</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------------------------------------------------------------------------</td>
<td>---------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Size and vibrancy of small cap public buyer universe</td>
<td>88%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Breadth &amp; consistency of research coverage</td>
<td>81%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Costs and risks of SOX and other accounting and compliance requirements</td>
<td>80%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lack of long term holders of IPO stock</td>
<td>77%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Managing public company communications restrictions</td>
<td>71%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix D

Size Of Cohort That Qualifies For Regulatory “On Ramp”

<table>
<thead>
<tr>
<th>For companies that went public in the previous 5 years</th>
<th>03/30/2011</th>
<th>2010</th>
<th>2009</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Companies</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than $1B revenue and IPO less than $700mm</td>
<td>556</td>
<td>558</td>
<td>571</td>
<td>732</td>
<td>777</td>
</tr>
<tr>
<td>as % of total public companies</td>
<td>17%</td>
<td>17%</td>
<td>17%</td>
<td>13%</td>
<td>14%</td>
</tr>
<tr>
<td><strong>Total Market Capitalization at IPO</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less than $1B revenue and IPO less than $700mm</td>
<td>$305</td>
<td>$388</td>
<td>$279</td>
<td>$338</td>
<td>$355</td>
</tr>
<tr>
<td>as % of total market capitalization</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
<td>2%</td>
</tr>
</tbody>
</table>

Sources: Dealogic, Capital IQ, World Federation of Exchanges
United States House of Representatives  
Committee on Financial Services  

"TRUTH IN TESTIMONY" DISCLOSURE FORM

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

<table>
<thead>
<tr>
<th>1. Name:</th>
<th>2. Organization or organizations you are representing:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Katherine D. Mitchell</td>
<td>Scale Venture Partners</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>3. Business Address and telephone number:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>4. Have you received any Federal grants or contracts (including any subgrants and subcontracts) since October 1, 2008 related to the subject on which you have been invited to testify?</th>
</tr>
</thead>
<tbody>
<tr>
<td>☐ Yes       ☑ No</td>
</tr>
</tbody>
</table>

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

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

<table>
<thead>
<tr>
<th>7. Signature:</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Signature]</td>
</tr>
</tbody>
</table>

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