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Before the House Financial Services Committee
Subcommittee on Capital Markets and GSEs

“The JOBS Act at Five:
Examining Its Impact and Proposals to Further Enhance Capital Formation”

March 22, 2017

Chairman Huizenga and Ranking Member Maloney,

Thank you for the opportunity to testify on “The JOBS Act at Five: Examining Its Impact and Ensuring the Competitiveness of the U.S. Capital Markets.”

Almost one year ago, Nelson Griggs, Nasdaq’s Head of Listings, testified before this subcommittee that, despite the success of the JOBS Act, “there (were) dark clouds still affecting the private company view of the public markets.” Unfortunately, those dark clouds still exist today.

I will review in my testimony how the JOBS Act affected the “going public” decision. There is no doubt that the JOBS Act did ease some unneeded strictures that applied to public companies. Still, despite these improvements and the benefits of going public to private companies, their employees and the investing public, many private companies remain reluctant to take the next step and go public. We believe these companies may view the public markets as too costly and overburdened by ill-suited regulation. However, we feel that, with certain measured changes, the public markets can be modernized and revitalized. We will then see the markets realize their full potential to create jobs, increase the savings of the public investor and contribute to improved productivity.

<u>What we learned from the JOBS Act:</u>

One of the most consequential examples of bipartisanship in the 112th session of Congress was the JOBS Act. By trimming unwarranted or outdated regulation, the JOBS Act enabled deeper and vibrant markets without sacrificing investor protection. As we testified last year, we identified several benefits to investors, and did not detect any investor protection concerns that resulted from the JOBS Act.

It is also important to understand that Nasdaq does not benefit from taking a company public before its time. Our strength as a global listing venue, which is home to five of the six largest

companies in the world and the destination of 70% of all IPOs today, is due to our regulatory integrity.[1]

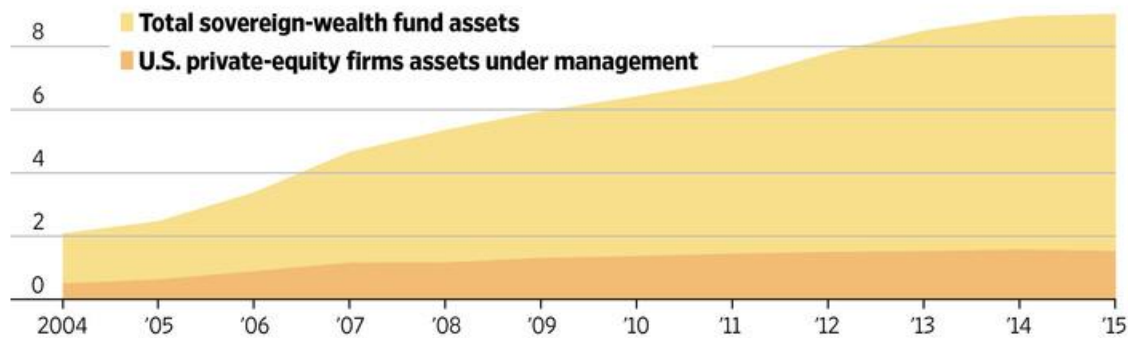
That said, investors do not benefit from an overregulated public market. Indeed, they are impacted when companies choose to avoid a public listing in order to escape unnecessary regulation. Let me illustrate that point by referring to the growth experienced by Nasdaq's largest listed companies. As you can see in Chart 1, most of the growth of these companies was experienced while being listed on Nasdaq. Why is that important? It means that hundreds of billions of dollars of wealth were created for the millions of individuals (including rank and file employees) who invested in these companies through the public market.

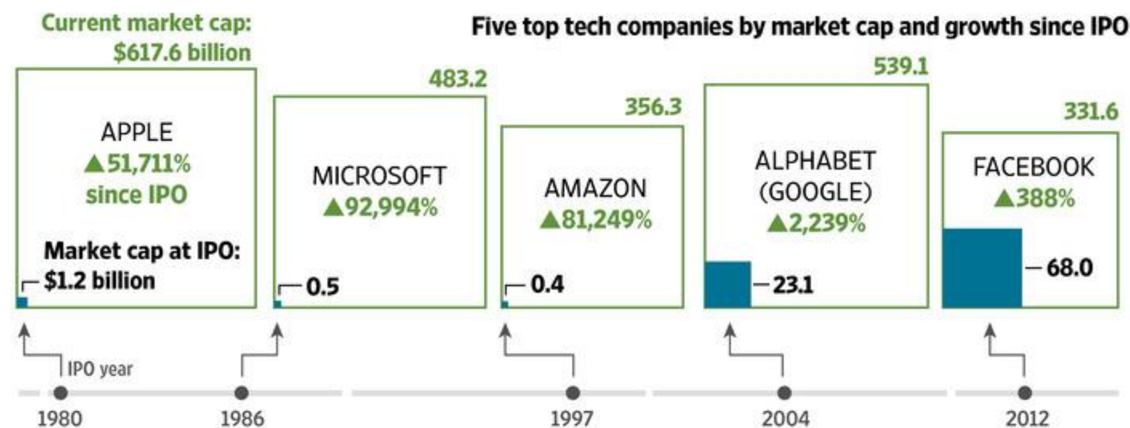
Chart 1: Private-Investing Climate[2]

Private-Investing Climate

As more money has accumulated in private-equity firms and sovereign-wealth funds, companies are tapping them for capital and delaying going public, sometimes delivering sizable early investment gains to private rather than public investors.

$10 trillion





Sources: Sovereign Wealth Fund Institute (assets); PitchBook (PE assets); Thomson Reuters (market cap) THE WALL STREET JOURNAL.

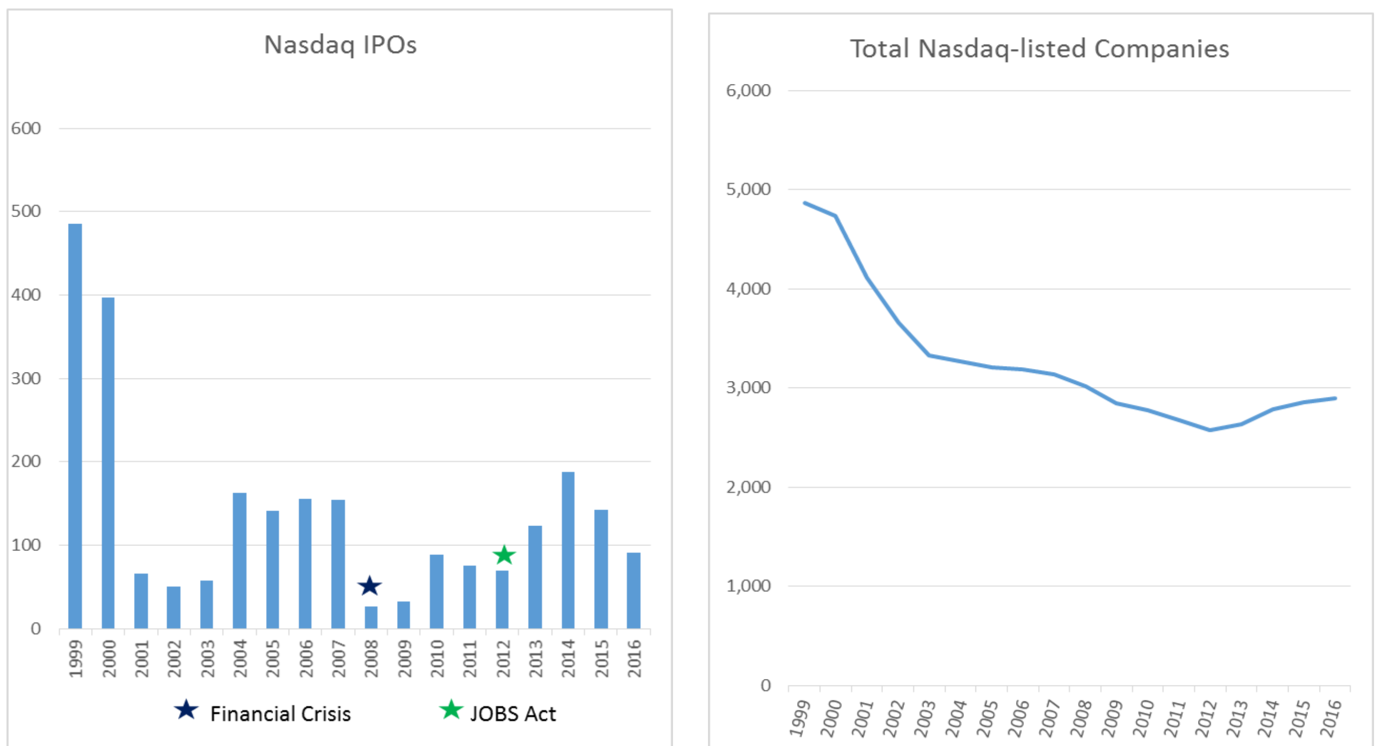
[1] In 2016, as part of our Listing Qualifications regulatory program, we reviewed 46,140 SEC filings, conducted over 4,100 background reviews of officers and directors, and delisted 63 companies for regulatory non-compliance.
[2] https://www.wsj.com/articles/americas-roster-of-public-companies-is-shrinking-before-our-eyes-1483545879.

Amazon is a dramatic example of this benefit: Amazon grew from a company with a market cap of less than a billion dollars to one with a market cap of over $350 billion all while a public company. Furthermore, Amazon grew from Jeff Bezos' garage to a company with 341,000 employees, adding over 100,000 jobs last year alone[3].

If these companies had stayed private, many investors would be less financially secure with the inevitable adverse impact to the funding of their children's education and their own retirements.

As the decline in Nasdaq IPOs over the last three to four years shown in Chart 2 demonstrates, it appears companies are not fully embracing the public markets. This chart also shows the decline in the number of Nasdaq-listed companies over the last several years, as IPOs declined.[4]

Chart 2: Current State of Public Markets[5]



Let's look more closely at the JOBS Act. The JOBS Act contained three primary areas of focus:

1. Supporting certain technology-enabled micro-financing known as crowd funding;
2. Allowing companies to stay private longer by increasing the threshold number of shareholders before the company must register; and

[3] http://www.geekwire.com/2017/amazon-soars-340k-employees-adding-110k-people-single-year/
[4] The same trend is found on the NYSE.
[5] Source: Nasdaq data.

3. Providing tailored regulatory exemptions for emerging growth companies (EGCs) to ease their path to a public company.

The provisions of the JOBS Act that allows companies to stay private longer were successful, enabling private markets that are global and deep. Private funding is plentiful for many private companies that need capital at this time. Today, private capital has its source not just from venture capital firms but also from private equity, corporate-controlled venture capital, hedge funds, sovereign wealth funds and mutual funds. (Chart 1 shows how sovereign wealth funds have grown from less than $2 trillion in assets to over $8 trillion in 10 years.) Many private companies can also access the debt markets easily in today's lower rate environment. Also, raising the shareholder threshold from 500 to 2,000 holders (and by excluding employees from that count) gave private companies more flexibility. Thus, the JOBS Act allows more companies to take advantage of the private environment for much longer.

In response to the developments in the private market, Nasdaq created the Nasdaq Private Market (NPM). Through NPM, Nasdaq leveraged its technological know-how and regulatory experience to create a better experience for private companies.[6]

Yet, our focus on being the home of hundreds of companies that were once start-up's and now are multi-billion dollar enterprises still compels us. The continued health of the modern IPO market, especially for early stage, high growth companies, is central to our corporate mission. In our view, as the economic cycle shifts and the potential for liquidity in the private markets abates, the need for a vibrant public market may become crucial to our economic health and we need to prepare for that stage.

What we see clearly today, more than we did a year ago, is that the JOBS Act had a positive impact on companies, particularly those that have been eager and ready to go public after the 2008 financial crisis and only needed a slight push. As it turned out, the JOBS Act's more significant exemptions were those that allowed EGCs to "test the waters" and file confidentially. Other regulatory exemptions are not relied upon as much, because the marketplace (which includes investors, accountants, bankers, board members and the investment community) made its own evaluation of the best practices for companies, as it always does. Whether or not there is a government mandate, demand in the marketplace continues to impose certain regulations, especially as they relate to financial disclosure and controls.

Significantly, the JOBS Act also allowed companies that are focused on going public to do so. Soon after passage, Nasdaq saw an initial surge by hundreds of companies to list on the public markets. This was most pronounced in the Healthcare sector. However, despite a favorable environment in terms of volatility and valuation, the last year has seen a significant reduction in new IPOs - - almost to a near standstill.

[6] Since 2014, NPM, has facilitated $4.3 billion in liquidity for 80 companies.

Costs of compliance and mitigation of legal risks are too high:

Being a public company establishes a brand identity and credibility with customers, suppliers and governments. As a public company, its stock obtains a liquid value that can be used to fund critical R&D, update plants and equipment, upgrade technology, hire talented employees and provide the currency for strategic mergers and acquisitions.

We believe "Listed on Nasdaq" resonates with the global marketplace and with companies that list on Nasdaq, including Apple, Microsoft, Alphabet, Facebook, Herman Miller, which, Mr. Chairman, is a great $1.8 billion manufacturer based in your hometown of Zeeland, Michigan, and Macatawa Bank Corporation, a $345 million community bank with locations throughout your district. Nasdaq believes that these inherent benefits are both deep and transformative for everyone, including the company's employees, officers and directors, and investor owners. Therefore, we believe in the public company model.

Nevertheless, there are challenges that are unique to the public company experience, and, over the years, it has become more costly. Being public is not for everyone, but it could and should be for more.

We are privileged to talk to thousands of companies each year: some private and many already public. What their CEOs tell us is that the primary challenge is not about going public. The challenge today is *being public*. Being a public company is a major achievement. The company self-selects to take on more regulation because it views the benefits as offsetting the burdens, most of which are designed to promote transparency, facilitate a secondary market for shares and protect investors. Public companies are the best of the best, choosing to live their corporate lives with a high degree of discipline, scrutiny and transparency.

But, increasingly over the past decade, there is a new cost for public companies: that the government will intervene into their business models (and not into their private competitors) to impose mandates unrelated to core investor protection or financial performance - - for example, certain policy issues like conflict minerals disclosure and pay ratio and political activity disclosure are encroaching on the public company model. The idea that, by choosing to be a public company, you are expected to accept the mingling of unrelated policy goal within the public company structure is of concern to many.

Furthermore, the impact of new obligations on a public company includes not just costs of the lawyers, accountants and technology support to comply but also expenditure of valuable time and attention from senior management and the board. In a highly competitive global marketplace, costs that do not relate to the core operations of the company are hard to justify.

Legal risks are another area where costs are exploding for public companies. As every study points out, shareholder lawsuits tend to punish long term shareholders to the benefit of short term holders. Despite Congressional action in the 1990s, the number of securities class action cases

has risen to its highest level in 20 years, according to Stanford University Law School's Securities Class Action Clearinghouse.

Let me cite a few examples where simple reforms could restore balance to the current rules. First, as Congress has properly focused more recently, there are hidden costs associated with a proxy advisory system that does not always balance standard-setting with a fair and transparent process. Also, Nasdaq has petitioned the SEC to address the lack of disclosure by short term investors with significant stakes, who may be pursuing well-funded strategies to invisibly drive down a share price, in contrast to the significant disclosure requirements imposed on long term investors. Further, the anachronistic regime currently in place for a public company to communicate with its investors, characterized by "street name shares" that are mostly held by brokers at DTCC, seems ripe for the application of modern technology.

The SEC on its own or through Congressional action can update old standards that no longer make sense in a digitized/internet capable world where information flows continuously and immediately. We should address issues like the proxy access rules where investors with just nominal ownership can advance a specific agenda that may detract from the creation of long-term shareholder value. The SEC disclosure regime should be updated to eliminate unnecessary duplication and provide more timely information to investors. For instance, many disclosures in Forms 10-K and 10-Q are repeated quarter after quarter with no real investor benefit.

The SEC has also created a trading environment for public companies that fails to take into account the size and needs of smaller public companies. Market structure is a real cost. Mr. Chairman, a small regional bank in your district is expected to attract liquidity and trading volume under the same rules that apply to trading Apple or Google. The smallest company listed from Michigan has its trading spread out among 11 exchanges and about 40 dark pools. CEOs and CFOs see the trading characteristics of small issues and are dismayed to observe that price discovery is shredded over 50 venues in order to comply with a national standard designed for the trading of billion dollar plus companies. Simply put, regulation that applies a one-size-fits-all market structure does not serve investors well.

Consequences of companies shunning the public markets:

In the past, we have listed many reasons to support a vibrant runway for companies to go public through an IPO on Nasdaq or another exchange. These include the truly eye-opening figure that, as indicated in the IPO Task Force's Report, the post-IPO job growth for a company is an amazing 92%.[7] Other studies put the job growth 156%.[8]

Simply put, public companies create more jobs. Mergers and acquisitions have many benefits but they often lead to initial job losses. Often overlooked is the fact that, in many cases, the R&D

[7] "Rebuilding the IPO On-Ramp," available at: https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

[8] Kenney, Patton and Ritter (2012) surveyed 1,700 companies that went public from June 1996 to 2010.

and strategic direction of the acquired company is fundamentally different from the acquirers, so new and novel products and ideas are abandoned.

Today's market, where companies elect to wait much longer to go public or choose never to go public, also robs a group that is rarely mentioned in the debate about over-regulation. Remember the investors who the rules are supposed to protect? They lose the opportunity to grow their savings through investment in these companies. Companies no longer go public early in their life-cycle. Today's investors are often missing participation in the significant early growth that occurs in a company's life cycle or miss the investment opportunity altogether because the public markets are not as attractive as they could be. Millions of Americans are depending on their 401(k) and investments to help them pay for homes, education for their children and retirement. But, they are missing the opportunities that their parents had when they bought Apple in the 1980s or Microsoft in the 1990s or Google in the 2000s.

On the other hand, the SEC's policies allow accredited investors to invest in companies early, and be able to enjoy the growth phase of the company life-cycle. We need to reexamine this system and ensure it is also fair to average investors.

Recommendations:

This Subcommittee has worked diligently to propose new initiatives that would modernize and streamline regulation while preserving important investor protections. Many were included in the Financial Choice Act released late last year.

- For instance, included in the Choice Act is former Chairman Scott Garrett's venture exchange legislation, the Main Street Growth Act. This bill would lay the foundation for a modern market structure for early stage, high growth companies, by allowing companies to choose a market structure that aggregates liquidity for their shares and allows exchanges to adopt intelligent tick sizes.
- Second, Nasdaq remains supportive of Rep. Sean Duffy's proxy advisory firm transparency legislation, the Corporate Governance Reform and Transparency Act, which among other things, requires proxy advisory firms to register with the SEC, disclose any potential conflicts of interest and be more transparent about their methodologies for formulating proxy recommendations.
- Third, we renew our call from our testimony last year that Congress allow companies of all sizes to file for their IPO on a confidential basis and permit other types of registration statements, besides IPOs, to be initially submitted on a confidential basis. We also believe the testing the waters flexibility could be extended to all companies without harming investors.
- Forth, the proxy access rules can be modernized and updated.
- Fifth, the corporate disclosure rules could be streamlined, and modern technology could be utilized to bring that system and shareholder record keeping and communication into the 21st Century.

We have worked constructively with this Committee, the Chamber of Commerce, TechNet, the Business Roundtable and others in the past to add to this discussion. We are engaged internally to identify the most complete range of solutions and the full policy implications of any proposed solution. In the near future, we plan to release our full blueprint to revitalize the public company model and incentivize more IPOs. We will certainly share that with the Committee.

Conclusion:

Nasdaq believes that the JOBS Act was a success, but the job is not over. We look forward to continuing our collaboration with this Subcommittee to work towards a balanced public policy that encourages capital formation through both the private and public markets.

We remain committed to advocating policies and legislation that foster efficient markets for investors. We support business growth for companies large and small, public and private.

Thank you again for your invitation to testify. I look forward to your questions and discussion on this critical topic.