U.S. House of Representatives | Committee on Financial Services | Republican Staff Report

Ten Years of the Jumpstart Our Business Startups (JOBS) Act of 2012:

How the Law Spurred Capital Formation, and How Congress Can Build on its Success

FINANCIAL SERVICES

Republicans

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Executive Summary

Ten years ago, a divided Congress came together to pass bipartisan legislation to help small businesses access capital. The bipartisan *Jumpstart Our Business Startups Act*, or JOBS Act of 2012, reduced regulatory barriers and created new avenues within our securities laws to facilitate capital formation for small businesses. On April 5, 2012, President Obama signed the JOBS Act into law.

JOBS Act of 2012

The JOBS Act consisted of six bills, each intended to ease the capital formation process for small companies and entrepreneurs attempting to raise funds through U.S. capital markets. To encourage more small-cap IPOs, Title I created a new "Emerging Growth Company" (EGC) designation and an IPO "on ramp" for companies to gradually begin complying with public company regulatory requirements. Title II eased the process by which startups market their securities by extending the Rule 506 offering exemption to securities marketed through a general solicitation or advertising if the purchaser is an accredited investor. Title III allowed startups to raise funds through a new equity crowdfunding exemption. Title IV required the SEC to add a class of securities that would be exempt from registration for offerings up to $50 million. Titles V and VI raised the thresholds for mandatory registration as a public company so private companies would not be forced to go public until they were ready.

JOBS Act Impacts

Because Title I was self-effectuating, small companies utilized the IPO on-ramp immediately. The IPO on-ramp's compliance accommodations made a significant difference in attracting young, high-growth companies to raise capital in American public markets. While the new exemptions from Titles II-IV cannot boast similarly outstanding results as Title I, they are still helping small companies and entrepreneurs raise the capital necessary for growing and hiring more workers. The number of offerings and the capital raised each year under these new exemptions has mostly climbed year-over-year since the SEC implemented the respective rules.

Need for Congressional Action

American capital markets are stronger now than they were ten years ago. Because of the JOBS Act, entrepreneurs can raise capital more easily. However, unnecessary and costly regulatory burdens continue to keep businesses and entrepreneurs from growing, hurting the United States' competitiveness both at home and abroad. While Americans have started new businesses at record rates since the COVID-19 pandemic, they still struggle to meet their capital needs. Until 2020, the number of U.S. IPOs hovered around half the number of domestic IPOs 20 years ago, as the costs and regulatory burdens of going public remain high. Additionally, foreign markets like China continue to grow, increasing the urgency with which Congress must act to protect and build on successes of the JOBS Act.

Today's political environment is similar to that of 2012. Yet, ten years ago, a divided Washington proved it could come together to support America's entrepreneurs and job creators to strengthen U.S. capital markets and economic activity. It is time Washington harness that same conviction.

Strengthening U.S. Public Markets

To encourage more companies to go public in the U.S., Congress should consider additional reforms that build on the successes of Title I of the JOBS Act. This includes extending the IPO on-ramp; expanding well-known seasoned issuer (WKSI) eligibility and its advantages like automatic shelf registration to more companies; streamlining and clarifying the EGC public filing condition; updating the IPO on-ramp to include spin-off transactions; clarifying EGC financial statement obligations to prevent aberrational results; permitting the auditor of a private company transitioning to public company status to comply with SEC and PCAOB independence rules; expanding protection for research reports to cover all securities of all issuers; and excluding qualified institutional buyers (QIBs) and institutional accredited investors from the record holder count for mandatory Exchange Act registration.

Expanding Opportunities for Underrepresented Entrepreneurs and Investors

Congress should also do more to enhance the ways in which companies raise capital through our private markets. To that end, Congress should increase investment opportunities for everyday American investors in our private markets as more high-growth companies seek to raise capital privately. This includes making our capital markets inclusive for all entrepreneurs and investors of all backgrounds: modernizing the accredited investor definition; increasing access to investment opportunities for retail investors through closed-end funds; modify the qualifying venture capital fund exemption under Section 3(c)(1) of the Investment Company Act of 1940; expanding the scope of qualifying investments for venture capital funds; and creating a micro-offering exemption.

Ten Years of the Jumpstart Our Business Startups (JOBS) Act of 2012: How the Law Spurred Capital Formation, and How Congress Can Build on its Success

Introduction

Ten years ago, a divided Congress passed legislation that modernized and pared back laws and regulations in a widely bipartisan effort to help small businesses access capital. This legislation, the Jumpstart Our Business Startups Act, or JOBS Act of 2012, reduced regulatory barriers and created new avenues within our securities laws to facilitate capital formation for small businesses. On April 5, 2012, President Obama signed the JOBS Act into law.

This report reviews the problems the JOBS Act intended to address, discusses the effectiveness of the legislation's provisions after ten years of its enactment, and profiles several companies that relied on the JOBS Act to raise capital that was critical to their growth, success, and job creation.

The report also considers ways in which Congress can build on the success of the JOBS Act by further modernizing our securities laws to empower both job creators and investors—particularly underrepresented entrepreneurs and investors. Like ten years ago, it is time to remove unnecessary barriers to capital-raising and make our securities laws more inclusive for entrepreneurs and investors pursuing the American dream.

Section I. Review of the Jumpstart Our Business Startups (JOBS) Act

A. Decline in Small Company IPOs and the IPO Task Force

Throughout most of the Twentieth Century, the majority of young American companies with high-growth potential and innovative products turned to our public markets for their capital needs.[1] At a time when the markets and regulatory environment were more conducive to small- and mid-capitalization stocks, groundbreaking American companies like Apple, Cisco, FedEx, and Starbucks raised capital by going public through small-cap offerings.[2] Through an initial public offering (IPO), these upstart enterprises raised the funding necessary to expand their workforce and operations. Simultaneously, everyday retail investors benefited from the opportunity to buy into high-growth companies to diversify their holdings and build their nest egg.

In October 2011, President Obama's IPO Task Force (the "Task Force") published a report detailing troubling trends for smaller companies in our capital markets.[3] The Task Force found that, from 1996 to 2011, American capital markets witnessed a steep decline in the number

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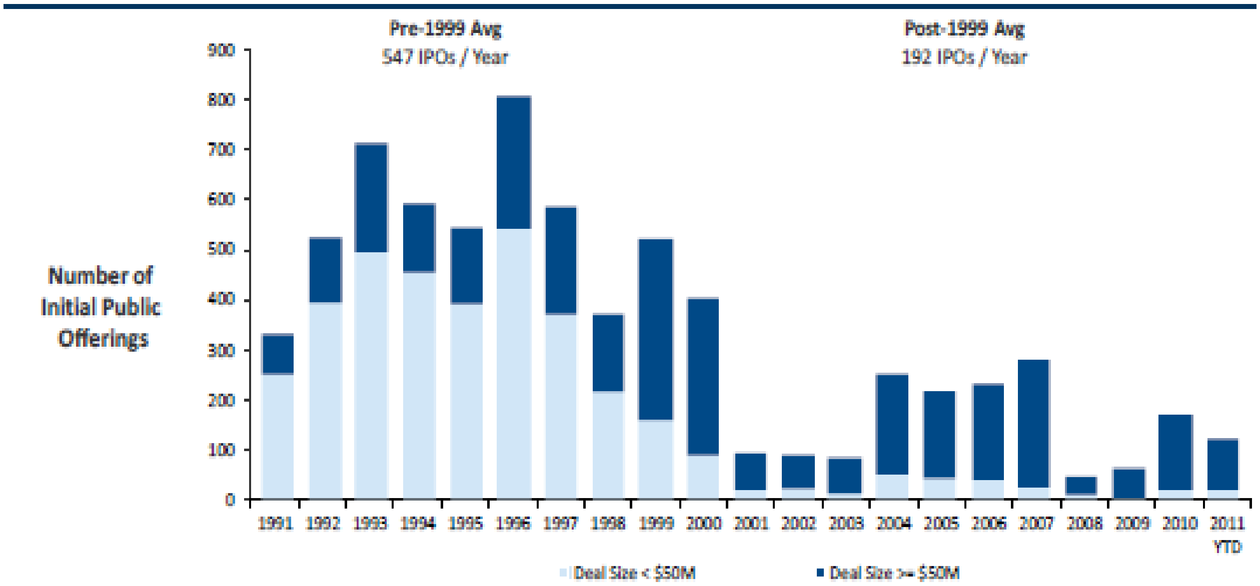
[1] IPO Task Force, *Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth* (the "IPO Task Force Report") (Oct. 20, 2011), *available at* https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.
[2] *Id.* at 5.
[3] *Id.*

of IPOs of what are now known as emerging growth companies (EGCs)—that is, companies with less than $1 billion in annual revenue. After achieving an all-time yearly high of 791 IPOs in 1996, the U.S. capital markets averaged fewer than 157 IPOs per year from 2001 to 2008.[4] Prior to 1999, the U.S. averaged 547 IPOs per year (see Figure 1).[5] Additionally, the Task Force observed that those companies going public in the years leading up to its report were doing so at a later stage in the company life cycle. From 1997 to 2001, the average age of a company at the time of its IPO was around five and a half years, while the average IPO company age between 2006 and 2011 was over nine years.[6]

Figure 1: IPOs Were Down, Particularly Smaller IPOs[7]

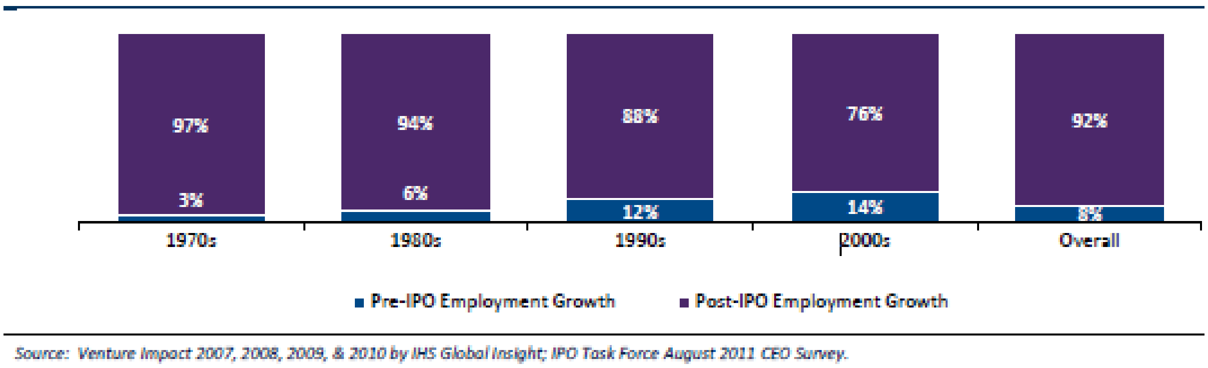


Sources: JMP Securities, Dealogic, Capital Markets Advisory Partners, Grant Thornton

In addition to the concerns over the attractiveness and competitiveness of our capital markets, this significant downturn was troubling given the importance of these small-cap public companies in American job creation. The Task Force report noted the importance of post-IPO job growth, as shown in the graphic below.

[4] *Id.* at 6.
[5] *Id.*
[6] *Id.*
[7] *Id.* at 2.

Figure 2: IPOs Finance Significant Job Creation[8]



In explaining the causes for the decline in small company IPOs from 1996 to 2011, the Task Force pointed to an accumulation of regulatory and market structure changes. These changes drove up costs for emerging growth companies interested in going public and limited the amount of information available to investors about these companies.[9]

To counter these harmful effects on small-cap IPOs, the IPO Task Force Report included a series of recommendations. These recommendations were intended to modernize "the scale of current regulations without changing their spirit."[10]

B. <u>JOBS Act of 2012</u>

Following the release of the IPO Task Force Report in October 2011, Congress incorporated several of the Task Force's recommendations into the JOBS Act of 2012.[11] Signed into law by President Obama on April 5, 2012, the JOBS Act combines six separate bills that originated in the House Financial Services Committee. The bills were intended to help small companies obtain access to U.S. capital markets by right-sizing the burden of certain securities regulations for smaller companies. The JOBS Act pushed the Securities and Exchange Commission (SEC) to rethink its traditional approach to securities regulation. As noted by former SEC Commissioner Mike Piwowar:

> "The JOBS Act requires the Commission to think of capital formation and investor protection in fundamentally different ways than we have in the past. The crowdfunding provision of the JOBS Act forces us to think outside of our historical securities regulation box and to create a different paradigm than the one we have used for the past eight decades."[12]

[8] *Id*. at 1.
[9] *Id*. at 2
[10] *Id*. at 3.
[11] Jumpstart Our Business Startups (JOBS) Act of 2012, Pub. L. No. 112-106, 126 Stat. 306 (2012).
[12] SEC Commissioner Michael S. Piwowar, Statement at Open Meeting Regarding Crowdfunding (Oct. 23, 2013), *available at* https://www.sec.gov/News/PublicStmt/Detail/PublicStmt/1370542558708.

Jonah Crane, former Counsel to Senator Charles Schumer (D-NY) when the bill was being negotiated and during its passage, reflected on the origins of the JOBS Act, stating:

> "The JOBS Act came together due to some unique circumstances: A sense that the economic recovery was lagging a bit, so proposals that might plausibly support job growth were in demand. Partisan tensions had been escalating, and there was a strong desire on the part of many in Congress to pass bipartisan legislation. And along came the JOBS Act, a series of proposals, each with bipartisan support, packaged together by leaders in the House and labeled the 'JOBS Act.' So despite the fact—or perhaps because—it was an election year, a large bipartisan group of Senators and Members of Congress opted for common sense."[13]

Title I: Emerging Growth Companies and the IPO "On-Ramp"

Title I of the JOBS Act established a new category of issuers known as "Emerging Growth Companies" (EGCs). These issuers must have less than $1.07 billion in annual revenues or $700 million in public float when they register with the SEC.[14] These companies are given an "on ramp" of up to five years to comply with certain regulatory requirements prior to, throughout, and immediately after the company's IPO.[15] Title I allows EGCs the ability to pitch a contemplated IPO to institutional investors before filing a registration statement with the SEC (known as "testing the waters"); initiate the SEC IPO registration process confidentially; go public with scaled financial disclosure requirements; and the option to abstain from Sarbanes-Oxley internal control audits and Dodd-Frank executive compensation disclosures.[16] Additionally, Title I authorized research analysts at the underwriter to publish research coverage and reports directly following the earnings release, as opposed to waiting a precise number of days.[17] By granting these issuers a temporary "on-ramp" status, Title I encourages small companies to go public while ensuring that they graduate to full regulatory compliance as they grow large enough to sustain the compliance infrastructure typical of mature companies.

Title II: Private Placements

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[13] Interview by McArn Bennett with Jonah Crane, Former Counsel to Sen. Charles Schumer (D-NY) 2009-13 (March 2, 2022).

[14] JOBS Act §§ 101-108. The JOBS Act Title I text specified an annual revenue cap of $1 billion but also required the SEC to index the cap to inflation every five years. As such, in 2017, the SEC updated the annual revenue cap to $1.07 billion. *See* "Inflation Adjustments and Other Technical Amendments Under Titles I and III of the JOBS Act," Release No. 33-10332, File No. S7-09-16 (April 5, 2017), *available at* https://www.sec.gov/rules/final/2017/33-10332.pdf.

[15] JOBS Act § 101 (adding new Section 2(a)(19) of the Securities Act of 1933 and Section 3(a)(80) of the Securities Exchange Act of 1934). After the initial determination of EGC status, a company will remain an EGC until the earliest of:

- the last day of any fiscal year in which the company earns $1.0 billion or more in revenue;
- the date when the company qualifies as a "large accelerated filer," with at least $700 million in public equity float;
- the last day of the fiscal year ending after the fifth anniversary of the IPO pricing date; or
- the date of issuance, in any three-year period, of more than $1.0 billion in non-convertible debt securities.

[16] JOBS Act §§ 102-107.

[17] JOBS Act § 105.

Title II of the JOBS Act made it easier for startups to market their securities through a general solicitation or advertising. The Securities Act of 1933 ("the Securities Act") requires that offers to sell securities must either be registered with the SEC or specifically exempted from such registration. A company or issuer that fully registers with the SEC may sell its securities to the public and the purchasers of those securities may sell them in the secondary market without restriction.

However, full registration associated with going public and remaining a public company results in increased compliance costs. Prior to an IPO, companies often spend tens of millions of dollars gathering and compiling mandatory specified information to submit to the SEC and make available to the public for the sale of its securities.[18] After its IPO, the company must continue to comply with SEC regulatory requirements, such as audit requirements and disclosure requirements intended to provide investors and potential investors information necessary to make informed investment decisions.

Many companies want to avoid the costs associated with being a publicly traded company, especially smaller companies. The exemptions from the Securities Act registration requirements provide an attractive path to raising capital through the sale of its securities. One such exemption from the Securities Act registration requirements is Rule 506 of Regulation D. Reg D allows companies to offer securities for sale in a private placement or offering if they do not market their securities through general solicitations or advertising.[19]

Title II of the JOBS Act extended this exemption for private placements to securities marketed through a general solicitation or advertising so long as the issuer verifies that purchasers of the securities are "accredited investors."[20] Accredited investors are defined as institutional investors or individual investors who meet specific income or net worth tests. Additionally, Title II directed the SEC to update Rule 144A. Rule 144A is a safe harbor exemption that permits the offering of unregistered securities in the secondary market—with no holding period requirement—to qualified institutional buyers ("QIBs"). QIBs are generally institutional investors and dealers who own and invest on a discretionary basis a minimum of $100 million and $10 million, respectively.[21] Specifically, Title II instructed the SEC to update Rule 144A to allow securities sold under the revised Rule 506 exemption to be offered to non-QIBs. This permits private placements and securities sold through private placements to be offered—practically speaking, advertised—through any means or medium.[22]

[18] Thaya Brook Knight, *A Walk Through the JOBS Act of 2012: Deregulation in the Wake of Financial Crisis*, Cato Institute (May 3, 2016), at 9, *available at* https://www.cato.org/policy-analysis/walk-through-jobs-act-2012-deregulation-wake-financial-crisis.
[19] 17 C.F.R. § 230.506.
[20] JOBS Act § 201(a).
[21] 17 C.F.R. § 230.144A(a).
[22] JOBS Act § 201. *See also* Thaya Brook Knight, *supra* note 18, at 13.

The SEC adopted the final rules implementing the updates required by Title II in 2013, incorporating two variations of Rule 506 offerings.[23] First, the final rule retained the traditional Rule 506 offering, now named a "506(b)" offering, prohibiting general solicitations and limiting the number of non-accredited investors.[24] The other type of offering included in the final rule included a Rule 506(c) offering, allows for general solicitation but restricts issuing companies to sell only to accredited investors.[25]

Title III: Crowdfunding

Title III of the JOBS Act enabled startups to raise capital through crowdfunding. At the time, crowdfunding was a new and innovative way for startups and small businesses to raise capital, typically over the Internet. Entities or individuals that raise funds through crowdfunding typically seek small contributions from a large number of people. Crowdfunding campaigns generally specify a target amount to be raised and identify the purpose for which those funds will be used. Title III exempted securities issued through crowdfunding from SEC registration requirements.[26] To qualify for this exemption, an issuer's offering may not exceed $5 million.[27] A non-accredited investor whose income or net worth is below $107,000 may invest up to either $2,200 or 5 percent of the investor's annual income or net worth, whichever is greater.[28] A non-accredited investor whose income and net worth are equal to or greater than $107,000 may invest up to $107,000 or 10 percent of the investor's annual income or net worth, whichever is greater.[29] These offerings must be conducted through an intermediary, who must register with the SEC as either a broker-dealer or a funding portal.[30]

Title III of the JOBS Act directed the SEC to issue rules implementing the crowdfunding provisions by January 2013. The SEC missed this deadline. In October 2015, the SEC finally completed its Title III rulemaking by adopting Regulation Crowdfunding.[31] When the SEC

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[23] *See* SEC Press Release 2013-124, *SEC Approves JOBS Act Requirement to Lift General Solicitation Ban* (July 13, 2013) *available at* https://www.sec.gov/news/press-release/2013-124-sec-approves-jobs-act-requirement-lift-general-solic.

[24] *See* "Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings," Release No. 33-9415; File No. S7-07-12 (July 13, 2021), *available at* https://www.sec.gov/rules/final/2013/33-9415.pdf.

[25] *Id*.

[26] JOBS Act § 302.

[27] The JOBS Act Title III text specified an offering limit of $1 million but also required the SEC to index the offering limit to inflation every five years. As such, in April 2017, the SEC updated the offering limit to $1.07 million. *See* "Inflation Adjustments and Other Technical Amendments Under Titles I and III of the JOBS Act," Release No. 33-10332, File No. S7-09-16 (April 5, 2017), *available at* https://www.sec.gov/rules/final/2017/33-10332.pdf. In 2020, the SEC adopted amendments raising the offering limit to $5 million and adjusting certain investment limits, notably eliminating the investment limit for accredited investors. *See* SEC Press Release 2020-273, *SEC Harmonizes and Improves "Patchwork" Exempt Offering Framework* (Nov. 2, 2020), *available at* https://www.sec.gov/news/press-release/2020-273.

[28] 17 C.F.R. § 227.100(a)(2)(i).

[29] 17 C.F.R. § 227.100(a)(2)(ii).

[30] JOBS Act § 302.

[31] *See* SEC Press Release 2015-249, *SEC Adopts Rules to Permit Crowdfunding* (Oct. 30, 2015) *available at* https://www.sec.gov/news/pressrelease/2015-249.html. *See* "Crowdfunding," Release Nos. 33-9974; 34-76324; File No. S7-09-13 (Oct. 30, 2015), *available at* https://www.sec.gov/rules/final/2015/33-9974.pdf..

adopted its final rules, Republican SEC Commissioner Michael Piwowar dissented. In his dissenting statement, he noted several important issues and concerns:

> While crowdfunding was intended to be a treat for the smallest and least sophisticated companies seeking to raise capital, today's rules are full of tricks. The rules will spin a complex web of provisions and requirements for compliance. I fear that many traps for the unwary are hidden in the regulations, creating potential nightmares for small business owners that fail to place regulatory compliance at the top of their business plans. Such burdens will spook many small businesses from pursuing crowdfunding as a viable path to raising capital….
>
> [T]he Commission has exercised discretion to make capital raising using crowdfunding even more difficult…. Because the majority of the Commission cannot trust ordinary Americans—the non-accredited investors—to be able to exercise appropriate judgment in how to spend or invest their resources, our rules will now place smaller limits on the amounts that can be invested. Rather than actually protecting investors, these smaller limits will discourage legitimate companies from engaging in crowdfunding….[32]

Title IV: Regulation A

Title IV directed the SEC to adopt rules to add a class of securities that would be exempt from the Securities Act registration requirements for offerings of securities of up to $50 million within a twelve-month period.[33] These rules, commonly referred to as Regulation A+, increased the number of small companies that can access the capital markets under the existing Regulation A's registration exemption available only to offerings under $5 million. Title IV also required the SEC to review and increase the new $50 million offering threshold within two years of enactment and every two years thereafter. Decisions to keep the offering threshold at existing levels must be reported to Congress.[34]

In March 2015, the SEC approved the final rule to implement Title IV of the JOBS Act.[35] The final rule provided for two tiers of Regulation A offerings: Tier 1, for offerings of securities of up to $20 million in a 12-month period, with not more than $6 million in offers by selling security-holders that are affiliates of the issuer; and Tier 2, for offerings of securities of up to $50 million in a 12-month period, with not more than $15 million in offers by selling security-holders that are affiliates of the issuer.[36] Both tiers are subject to certain basic requirements while Tier 2 offerings are also subject to additional disclosure and ongoing reporting requirements.[37] The final rule also provided for the preemption of state securities law registration and qualification

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[32] *See* Commissioner Michael Piwowar, Dissenting Statement at Open Meeting on Crowdfunding and Small Business Capital Formation (Oct. 30, 2015), *available at* https://www.sec.gov/news/statement/piwowar-regulation-crowdfunding-147-504.html.
[33] JOBS Act § 401.
[34] *Id*.
[35] *See* SEC Press Release 2015-49, *SEC Adopts Rules to Facilitate Smaller Companies' Access to Capital* (March 25, 2015), *available at* http://www.sec.gov/news/pressrelease/2015-49.html.
[36] *Id*.
[37] *Id*.

requirements for securities offered or sold to "qualified purchasers" in Tier 2 offerings.[38] In 2020, the SEC adopted amendments raising the offering cap for Tier 2 offerings from $50 million to $75 million and raised the offering cap for secondary sales under Tier 2 from $15 million to $22.5 million.[39]

Titles V and VI: Thresholds for Mandatory Registration as a Public Company

Title V raised the thresholds for mandatory registration under the Securities Exchange Act of 1934 ("the Exchange Act") from $1 million in total assets to $10 million and from 500 shareholders to 2,000 shareholders for all companies, of which a maximum of 500 can be non-accredited investors.[40] Title V provided that persons who received securities under employee compensation plans will not be counted against the shareholder threshold cap.[41] Title V also required the SEC to revise the definition of "held of record" and to adopt safe harbor provisions that issuers can rely on in determining whether holders of their securities received those securities under an employee compensation plan.[42] Additionally, Title V required the SEC to study whether it has adequate authority to enforce the anti-evasion provisions associated with the shareholder threshold.[43]

Title VI raised the Exchange Act registration threshold from 500 to 2,000 record holders of equity securities for banks or bank holding companies with total assets over $10 million.[44] Title VI also raised the threshold for deregistration for banks and bank holding companies from 300 to 1,200 shareholders.[45] Additionally, it required the SEC to issue final regulations to implement the amendments made by Title VI no later than one year after the date of enactment.[46]

Title VII: Small Business Outreach

Title VII required the SEC to provide online information and conduct outreach to inform small and medium-sized businesses, women-owned businesses, veteran-owned businesses, and minority-owned businesses of the changes made by the JOBS Act.[47] To meet this requirement, the SEC partnered with the Small Business Administration to inform the public about the new options for raising capital established by the JOBS Act.[48]

[38] *Id*.
[39] *See* SEC Press Release 2020-273, *supra* note 27.
[40] JOBS Act § 501.
[41] JOBS Act § 502.
[42] JOBS Act § 503.
[43] JOBS Act § 504.
[44] JOBS Act § 601.
[45] *Id*.
[46] *Id*.
[47] JOBS Act § 701.
[48] *See* SEC Press Release 2014-196, *SEC and SBA to Partner on Events on Small Business Capital Raising Under the Jumpstart Our Business Startups (JOBS) Act* (Sept. 16, 2014), *available at* https://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542964443.

C. JOBS Act Impacts

The IPO On-Ramp at Work

Unlike many other provisions in the JOBS Act, Title I's changes to securities law were self-effectuating. The ability of companies to classify as EGCs immediately after enactment translated to prompt and noticeable impacts in American IPO trends.

Within one year of enactment, just under 75 percent of companies that priced an IPO in the U.S. were designated as EGCs.[49] Of those EGCs that publicly filed their first registration statement in the first year following enactment, over 90 percent of them utilized at least one of the scaled regulatory requirements provided by the JOBS Act.[50] Title I's confidential filing accommodation was particularly popular among EGCs in the law's first year. In that first year, roughly 65 percent of EGCs that publicly filed their initial registration statement after April 5, 2012, confidentially filed at least one draft registration statement before publicly filing.[51] Likewise, almost all EGCs that priced an IPO in the first year after enactment signaled their intent to utilize the delayed phase-in of the internal controls audit requirement.[52] Moreover, issuers disclosing their EGC status became standard practice within that first year.[53]

The popularity and usage of EGC status and the IPO on-ramp continued to increase after the first year. By April 2014, EGCs represented roughly 85 percent of all IPOs in U.S. capital markets, up from 75 percent a year earlier (see Table 1).[54] In the second year following enactment, confidential filing had become a nearly universal practice, with around 90 percent of EGCs that priced an IPO in that second year confidentially filing at least one draft registration statement before publicly filing.[55] Other Title I accommodations increased in popularity, including "testing the waters." For industries like life sciences, issuers reported testing the waters in almost every deal.[56] Within those first two years after enactment, the JOBS Act changed how companies went public, and the evidence indicated that Title I's IPO on-ramp was functioning as designed. In 2014, one group of researchers estimated that "the JOBS Act has led to 21 additional IPOs annually, a 25 percent increase over pre-JOBS levels."[57]

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[49] Latham & Watkins LLP, *The JOBS Act After One Year: A Review of the New IPO Playbook* (April 5, 2013), *available at* https://www.sec.gov/info/smallbus/acsec/acsec-091713-lathamreport-slides.pdf.
[50] *Id*.
[51] *Id*.
[52] *Id*.
[53] *Id*.
[54] Latham & Watkins LLP, *The JOBS Act, Two Years Later: An Updated Look at the IPO Landscape* (April 5, 2014), at 4, *available at* https://www.lw.com/thoughtleadership/lw-jobs-act-ipos-second-year.
[55] *Id*.
[56] *Id*.
[57] Michael Dambra, Laura Field, and Matthew Gustafson, "*The JOBS Act and IPO Volume: Evidence that Disclosure Costs Affect the IPO Decision*," (June 28, 2014), *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2459591.

Table 1: EGC Trends Within the First Two Years of the JOBS Act[58]

Trend	Year One	Year Two
Percentage of total US IPOs completed by EGCs	75%	85%
Percentage of EGCs that are also foreign private issuers	10%	15%
EGCs that submitted at least one registration statement confidentially	65%	90%
EGCs that provided only two years of audited financial statements	50%	65%
EGCs that indicated an intention to use the extended phase-in for Section 404(b) of Sarbanes-Oxley or reserved the right to do so in the future	97%	98%
EGCs providing scaled executive compensation disclosure	75%	85%
EGCs opting out of the extended phase-in for new accounting standards	80%	77%

In 2014, CFO Magazine profiled several companies that went public in the first two years of the JOBS Act using Title I's new EGC designation.[59] The magazine highlighted the successful experiences of CFOs of those companies and their perspectives on how Title I's IPO on-ramp eased the path to going public.

- **TrueCar**

  Michael Guthrie, CFO of car buying and selling platform TrueCar, explained that his company began the IPO process in October 2013, yet they were "not in a position to file our registration statement until the middle of February."

  In February 2014, TrueCar filed its Form S-1 confidentially over two months before the company's IPO. In describing the impact of confidential filing, Guthrie noted the significance of initiating the SEC's review process "without exposing our filing to the market or competitors or anyone else." He added that filing confidentially "gave us a lot of confidence to move forward and get a huge amount of work done," crediting confidential filing as the "biggest benefit for us of doing a JOBS Act filing." According to Guthrie, the JOBS Act's IPO on-ramp is not about lowering standards. Instead, he expressed that the JOBS Act is about making it simpler for growth companies to navigate the IPO process.

- **Zoës Kitchen**

  Zoës Kitchen, a fast-casual restaurant chain, was founded in 1995. By 2014, the company had expanded to over 120 restaurants over 15 states. In April

[58] *See* Latham, *supra* note 54, at 4.
[59] *See* Edward Teach, *On the IPO On-Ramp: How the JOBS Act helped five CFOs take their companies public*, CFO Magazine (Sept. 15, 2014), *available at* https://www.cfo.com/accounting-2/2014/09/ipo-ramp/.

2014, the company went public with a $87 million offering, and investor enthusiasm drove the stock price up 65 percent on the first day of trading.

While preparing for the IPO, CFO Jason Morgan noted that the company was in the process of adding up to 30 new restaurant locations in 2014. According to Morgan, this aggressive growth made filing its S-1 confidentially so helpful. He explained that filing confidentially "allowed for only a limited number of our team to be involved in the IPO process" and did not distract the other employees from executing their objective of growing the company.

- **GlycoMimetics**

  Biotechnology company GlycoMimetics, which raised $64.4 million in to fund clinical research in its January 2014 IPO, benefited from the JOBS Act provisions for "testing the waters," confidential filing, and the Sarbanes-Oxley 404(b) internal control audit 5-year abatement.

  In 2013, the company's lead product, a compound for treating sickle cell disease, demonstrated a strong performance in Phase II clinical trials by drastically reducing hospitalization times and the amount of pain medication required by patients. These results moved the company one step away from marketing its drug to the public. As a result, the company was finally ready to go public after relying on venture capital funding in the ten years since its founding in 2003.

  However, from April to June of 2013, "the biotech IPO market was heating up," company CFO Brian Hahn noted. After confidentially filing the S-1 with the SEC in August 2013, the company began meeting with investors. According to Hahn, Title I's testing-the-waters provision was particularly helpful to biotech firms because it provided them time to sufficiently educate investors on the companies' unique commercial stories, opaque regulatory pathways, and complicated technologies.

  According to Hahn, testing the waters with investors was critical to the success of the company's IPO, and the deferred internal control audit compliance served as a major advantage as well.

By 2017, Title I's IPO on-ramp had proved to be noticeably helpful for emerging biotech companies. Biotech startups have commercial characteristics and operational issues that are quite distinct from most other industries. Perhaps the most distinguished aspect of biotech startups is the many years spent operating without a revenue-generating product. The firms traverse the years-long road developing their product through the clinal trials and phases of the Federal Drug Administration (FDA) approval process. However, these firms must rely on venture capital or a public offering to fund the process of getting their product to market.[60] Yet, without a marketable revenue-generating product, biotech founders can only sell the potential of a later breakthrough treatment to investors.[61] Meanwhile, going public becomes more of a necessity in the later stages of drug and treatment development as funding human clinical trials can cost hundreds of millions of dollars.[62]

By the fifth anniversary of the JOBS Act, more than 212 biotech companies used provisions in the JOBS Act to go public.[63] This compared to a mere 55 biotech companies in the five years preceding the JOBS Act.[64] Those 212 companies were at the time responsible for employing 27,000 people.[65] The JOBS Act also facilitated a significant increase in financing for these firms' early-stage research. Through five years of IPOs, these biotech firms raised $17 billion and an additional $16 billion in follow-on offerings.[66] Additionally, in those five years, the FDA had already approved 18 new treatments from these companies, with hundreds more in the pipeline.[67]

The SEC recognized the importance of EGCs' ability to confidentially file draft registration statements ahead of an IPO. In June 2017, the SEC announced that its Division of Corporate Finance would expand this accommodation to all issuers.[68] As a large majority of EGCs depended on confidential filing, Chairman Clayton noted he hoped extending the benefits of confidential filing to larger companies would "encourage them to find the prospect of selling their shares in the U.S. public markets more attractive generally and at an earlier stage in their development."[69] Likewise, after observing the critical role that "testing-the-waters" played in attracting EGCs to IPO, the SEC adopted a new rule to allow all issuers to "test-the-waters" in September 2019.[70] By expanding this JOBS Act provision beyond EGCs, issuers could assess the appetite of institutional investors ahead of a potential IPO before sustaining the high costs accompanying an IPO. The evaluation of market interest prior to an IPO also benefits retail investors. The feedback received from "testing-the-waters" enables issuers to pinpoint important

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[60] Former Rep. Jim Greenwood (R-PA), *Rare policy sanity in Washington with JOBS Act ignites biotech boom*, The Hill (April 5, 2017), *available at* https://thehill.com/blogs/pundits-blog/economy-budget/327311-rare-policy-sanity-in-washington-with-jobs-act-ignites?rl=1.
[61] *Id*.
[62] *Id*.
[63] *See* Biotechnology Innovation Organization (BIO), "*JOBS Act @ 5 [2012-2017]*" (April 5, 2017), *available at* https://www.bio.org/sites/default/files/legacy/bioorg/docs/JOB-Act-at-5-FINAL.pdf.
[64] *Id.*.
[65] *Id*.
[66] *Id*.
[67] *Id*.
[68] *See* SEC Press Release 2017-121, *SEC's Division of Corporation Finance Expands Popular JOBS Act Benefit to All Companies* (June 29, 2017), *available at* https://www.sec.gov/news/press-release/2017-121. *See also* SEC Division of Corporation Finance, "Voluntary Submission of Draft Registration Statements – FAQs" (last modified June 24, 2020), https://www.sec.gov/corpfin/voluntary-submission-draft-registration-statements-faqs.
[69] SEC Chairman Jay Clayton, "Remarks at the Economic Club of New York" (July 12, 2017), *available at* https://www.sec.gov/news/speech/remarks-economic-club-new-york.
[70] *See* SEC Press Release 2019-188, *SEC Adopts New Rule to Allow All Issuers to "Test-the-Waters"* (Sept. 26, 2019), *available at* https://www.sec.gov/news/press-release/2019-188.

information from the investors' perspective, putting the issuers in a better position for conducting a successful IPO.

A separate 2021 report provides further evidence that the JOBS Act's IPO on-ramp provided a significant and sustained boost for emerging biotech firms wanting to raise capital through U.S. public markets. That study found that biotech startups using the IPO on-ramp made up almost 40 percent of all U.S. IPOs from 2012 to 2018, compared to 10 percent prior to the JOBS Act.[71] The report also found three common trends among these biotech firms attributable to the JOBS Act: an uptick in product development, higher capital formation, and increased job growth.[72] The paper further notes that, since the JOBS Act, biotech startups began IPOs 1.42 years earlier during the FDA approval process. This is nearly 20 percent sooner in the lifecycle of their products.[73] On top of that, post-JOBS Act biotech startups raise about 30 percent more money when they IPO compared to companies that completed an IPO prior to the JOBS Act.[74] From this, the researchers concluded that the lower compliance burdens established by the JOBS Act likely attract these startups with early-stage potential products. These products enter U.S. public markets earlier and can raise capital notwithstanding the heightened uncertainty about that product's approval or success.[75]

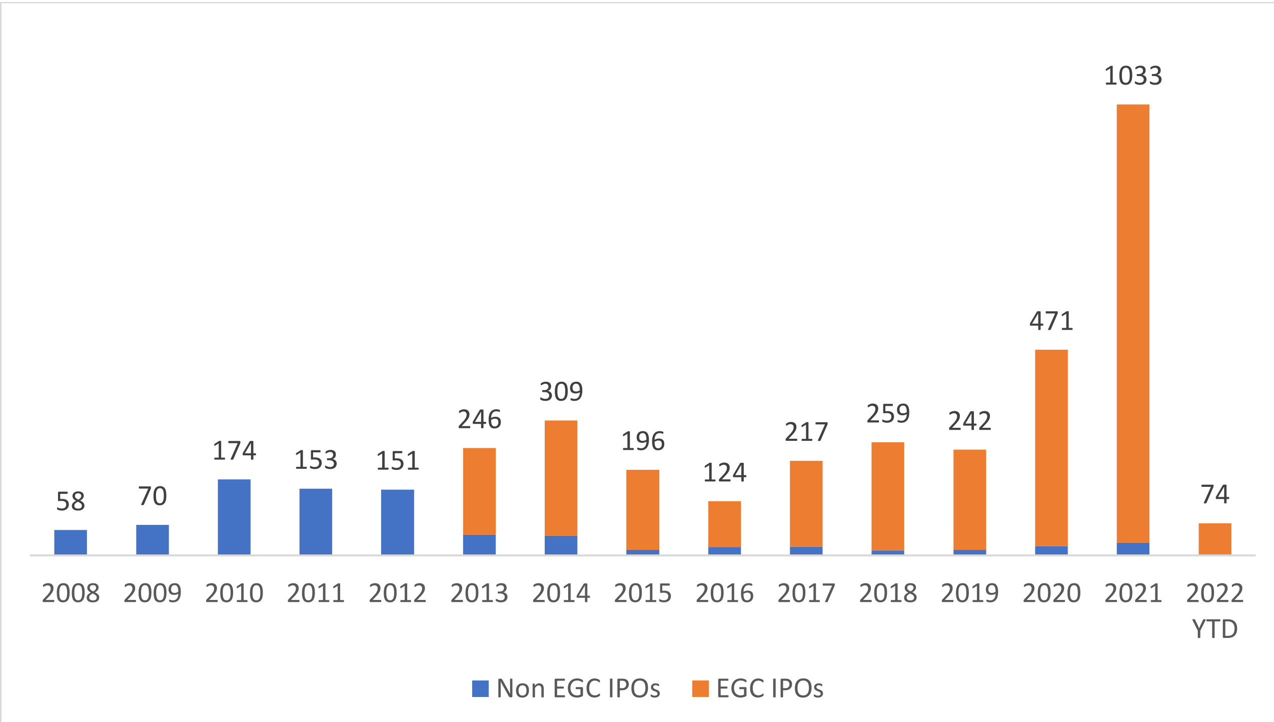
This 2021 study also found that biotech startups expand their workforces by an average of 150 percent in the first three years following their IPO under the JOBS Act's provisions. This is a significant increase in the job growth rate compared to biotech firms that went public prior to the JOBS Act and non-biotech firms that went public after the JOBS Act.[76] According to the researchers, this indicates that emerging biotech companies turn investment dollars into job creation at higher rates when scaling and tailoring regulatory compliance burdens to the companies that need capital access.[77]

Since enactment of the JOBS Act in 2012, Title I's IPO on-ramp has provided an attractive path to capital raising in U.S. public markets for companies in sectors beyond biotechnology. Since 2013, 93 percent (2,951 out of 3,171) of U.S. IPOs were completed by EGCs under Title I's provisions, based on a review of company filings (see Figure 3).[78] Likewise, EGC IPO's were responsible for 78 percent of capital raised through U.S. IPOs since 2013 ($633B of $816B) (see Figure 4).[79] The overwhelming popularity of Title I's IPO on-ramp also correlates with an increase in the average number of U.S. IPOs annually, growing from an annual average of 121 IPOs from 2008-2012 to an annual average of 344 IPOs from 2013-

[71] Craig M. Lewis and Joshua T. White, *Deregulating Innovation Capital: The Effects of the JOBS Act on Biotech Startups*, Vanderbilt Owen Graduate School of Management Research Paper (December 7, 2021), *available at* https://ssrn.com/abstract=3640852.
[72] *Id*.
[73] *Id.* at 4.
[74] *Id*.
[75] *Id*.
[76] *Id*.
[77] *Id*.
[78] Nasdaq economic research, www.Nasdaq.com.
[79] *Id*.

2021.[80] This increase is not solely driven by IPOs with record-breaking capital raises. In fact, the average number of yearly IPOs in every offer amount range has increased from 2013-2021 compared to 2008-2012 (see Table 2).[81] Similarly, a variety of sectors have seen an increase in the average number of IPOs per year since 2013 compared to 2008-2012 averages.[82]

Figure 3: U.S. IPO Count, 2008-2022 YTD[83]



[80] *Id.*
[81] *Id.*
[82] *Id.*
[83] *Id.*

Figure 4: U.S. IPO Raise ($B), 2008-2022 YTD[84]

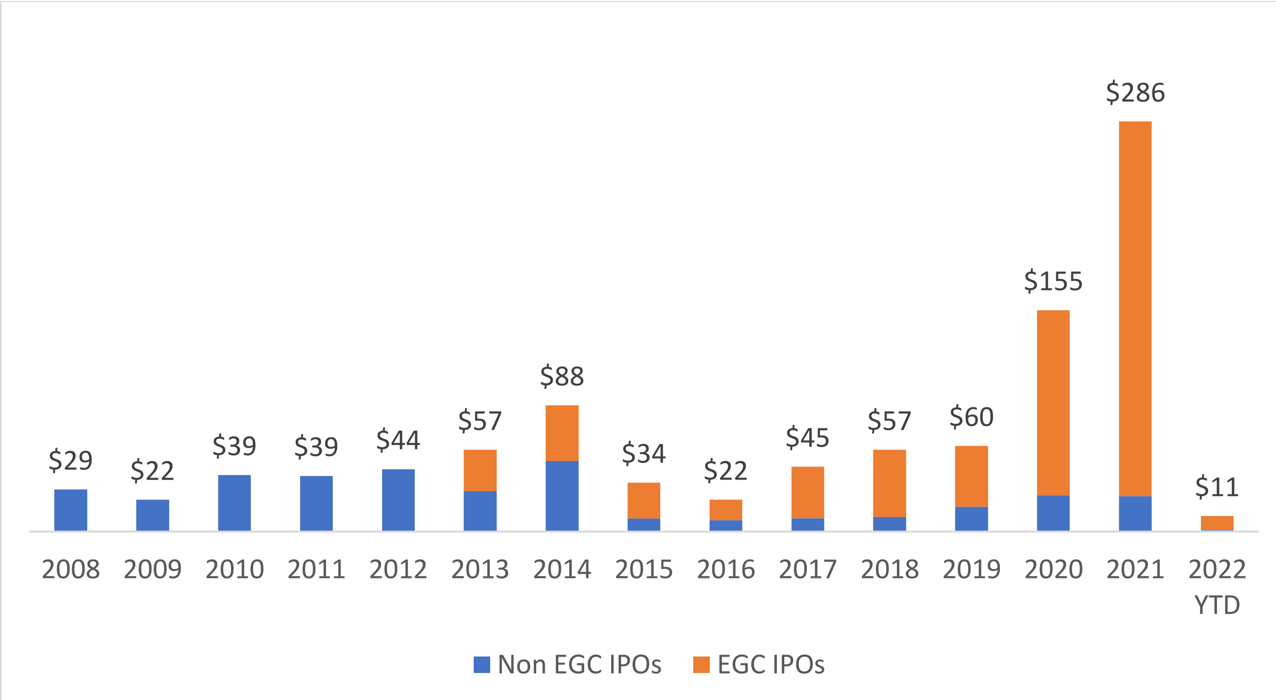


Table 2: Offer Amount Range[85]

Offer Amount Range	Avg. Yearly IPO Count 2008 - 2012	Avg. Yearly IPO Count 2013 - 2021
$1B+	3	11
$500M-$1B	7	24
$250M-$500M	15	69
$100M-$250M	43	128
<$100M	53	112

After just ten years, the success and impact of Title I's IPO on-ramp is undeniable and significant. While the resulting impacts and sizable shifts in how companies go public in the U.S. might be remarkable, Title I's concept and its provisions are common sense: attracting emerging companies to tap into U.S. public markets by rightsizing regulatory requirements and cutting compliance costs to focus on growing the company in the near-term. Small companies and startups took advantage of these provisions immediately and now the IPO on-ramp is basically

[84] *Id.*
[85] *Id.*

the universally preferred approach for going public in American capital markets. Thanks to Title I of the JOBS Act, these emerging companies now have a viable path forward for meeting their capital-raising needs, expanding their workforce, and offering investment opportunities to everyday American investors saving for their future.

Raising Capital Under Rule 506(b) and Rule 506(c)

Titles II and IV of the JOBS Act made several reforms to longstanding exemptions for securities offerings, while Title III created a new equity crowdfunding exemption. Like Title I, these titles were intended to enhance the variety of options available to small companies for raising capital. Titles II, III, and IV focus on exempt offerings instead of registered public offerings—based on the unique circumstances and needs of the individual company. Unlike Title I, these three titles were not self-executing. Instead, these provisions required the SEC to adopt final rules to implement the reforms established by these titles.

Since enactment of the JOBS Act, capital raised in exempt offerings grew from around \$1.7 trillion in 2012 to \$2.9 trillion in 2018.[86] From July 1, 2020 to June 30, 2021, the total raised in exempt offerings rose to \$3.3 trillion.[87] Exempt offerings have long been an attractive path for companies raising money through U.S. capital markets, with some exemptions proving more popular than others even before the JOBS Act. Title II of the JOBS Act required the SEC to update one of the most used exemptions, Rule 506 of Regulation D for private placements. Prior to the JOBS Act, the yearly total of Regulation D offerings far exceeded the number of offerings using other exemptions (See Table 3).[88] Moreover, from 2009-2017, Rule 506 offerings (including 506(b) and 506(c) offerings following the SEC's adoption of rules implementing Title II of the JOBS Act in 2013) made up almost 100 percent of the amounts reportedly sold under Regulation D offerings.[89] This includes 93 percent of capital raised through offerings with an offering limit of \$1 million and 98 percent of capital raised below the \$5 million offering limit in Rule 504 of Regulation D. This indicates companies find Rule 506 exemptions' preempting state securities laws—an element unavailable for Rule 504 offerings—of significant value.[90]

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[86] *See* "Concept Release on Harmonization of Securities Offering Exemptions," Release. No. 33-10649 (June 18, 2019) at 18, available at https://www.sec.gov/rules/concept/2019/33-10649.pdf. ("SEC Concept Release")
[87] *See* Office of the Advocate for Small Business Capital Formation Annual Report for Fiscal Year 2021 (Dec. 2021), *available at* https://www.sec.gov/files/2021-OASB-Annual-Report.pdf.
[88] *See* SEC Concept Release, supra note 86. *See* Scott Bauguess, Rachita Gullapalli, & Vladimir Ivanov, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings*, 2009–2017 (U.S. Sec. and Exch. Comm'n, Division of Economic and Risk Analysis White Paper, Aug. 1, 2018), *available at* https://www.sec.gov/dera/staff-papers/white-papers/dera_white_paper_regulation_d_082018.
[89] *Id*.
[90] *Id*.

Table 3: Number of offerings by type of offering and year[91]

	Public Offerings		Private Offerings		
Year	Public equity	Public Debt	Regulation D	Rule 144A	Other private*
2009	942	1,445	18,295	1,661	942
2010	1,072	1,930	25,993	1,958	930
2011	863	1,465	27,336	1,388	960
2012	954	1,473	28,184	1,558	531
2013	1,250	1,510	30,429	1,896	841
2014	1,176	1,576	33,429	1,813	674
2015	985	1,565	34,877	1,761	287
2016	821	1,636	35,793	1,500	450
2017	976	1,846	37,785	2,099	1,217

**Includes offerings conducted under Regulation S, qualified Regulation A, Regulation Crowdfunding, and Section 4(a)(2).*

However, following the SEC's adoption of Rule 506(c) in 2013, in which the ban on general solicitation was eliminated pursuant to the JOBS Act, only four percent (or $255 billion) of the capital raised under Rule 506 offerings from 2013 to 2017 was raised in Rule 506(c) offerings (See Table 4).[92] Even though Rule 506(c) offerings made up four percent of total capital raised under Rule 506 during this span, 6,690 issuers pursued 7,110 Rule 506(c) offerings.[93] From a narrow perspective, that nearly 7,000 companies used this new exemption created by the JOBS Act Title II to raise capital seemed to be an encouraging sign that the exemption provided utility to certain companies. On the other hand, this same period saw 87,890 new Rule 506(b) offerings that reportedly raised $5.8 trillion.[94] This made for a highly unfavorable comparison and a troubling indication early on that the newly created Rule 506(c) exemption was of relatively little use to the broader population of companies pursuing a capital raise.[95]

The cause of the significant disparity between Rule 506(b) and Rule 506(c) usage may be attributable to the sudden elimination of the ban on general solicitations, particularly after so many years in which general solicitation was prohibited.[96] Given the traditional Rule 506(b)'s long existence, companies likely had pre-existing sources of financing and investment and optimized utilizing Rule 506(b). Thus, the need for general solicitations allowed by Rule 506(c) was eliminated.[97] Another issue potentially limiting widespread use of Rule 506(c) is confusion regarding what constitutes general solicitation and reasonable steps to verify accredited investor status.[98]

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[91] See Bauguess, *supra* note 88, at 9.
[92] *Id*. at 16.
[93] *Id*. at 15.
[94] *Id* at 16.
[95] *Id*.
[96] *Id*.
[97] *Id*. at 15.
[98] *Id*. *See also*, Keith Higgins, Director of the Division of Corporation Finance, U.S. Securities and Exchange Commission, Remarks before the 2014 Angel Capital Association Conference, (Mar 28, 2014) *available at* http://www.sec.gov/News/Speech/Detail/Speech/1370541320533.

Table 4: Capital Raising Activity in Rule 506(b) and Rule 506(c) Markets during 2013-2017[99]

Year	Number of New Offerings			Amounts Raised ($ million)		
	Rule 506(b)	Rule 506(c)	Proportion Rule 506(c)	Rule 506(b)	Rule 506(c)	Proportion Rule 506(c)
2013*	4,940	506	9.3%	$214,826	$8,748	3.9%
2014	19,560	1,611	7.6%	$1,323,146	$23,837	1.8%
2015	20,563	1,592	7.2%	$1,321,417	$39,370	2.9%
2016	20,707	1,665	7.4%	$1,285,853	$35,952	2.7%
2017	22,120	1,736	7.3%	$1,700,045	$147,310	8.0%
2013-17	87,890	7,110	8.1%	$5,845,288	$255,216	4.4%

**September 23, 2013 – December 31, 2013*

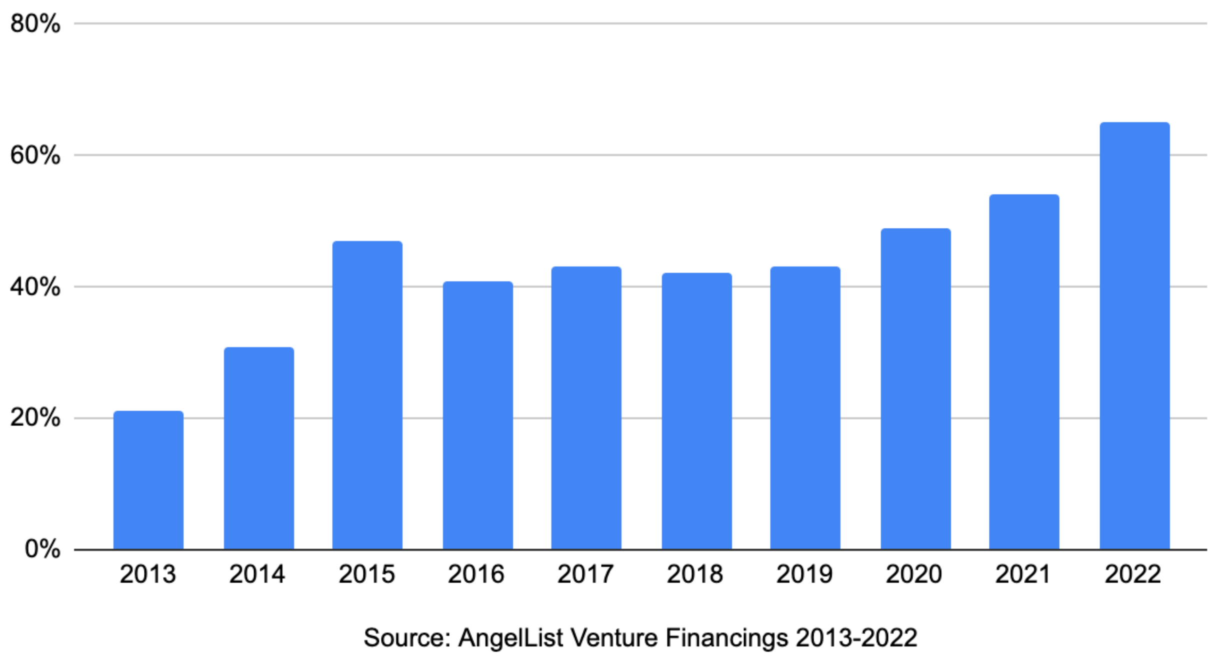
While Title II is most noteworthy for its elimination of the prohibition on general solicitation under Rule 506(c), it also established a framework for online platforms for both Rule 506(b) and Rule 506(c) offerings. This change has had a major impact on capital formation. Online venture platforms like AngelList can work with accredited investors and companies seeking financing without having to register as a broker-dealer with FINRA. Since the JOBS Act, AngelList-facilitated funds have invested over $4 billion into over 12,000 new companies.[100] In 2021 alone, approximately $2 billion in funds reached 6,000 new companies, mostly through Rule 506(b) offerings.[101] Likewise, AngelList Talent runs the largest hiring platform for startups globally.[102] Following the JOBS Act, startups have hired almost 100,000 new employees using this platform alone.[103]

As the hold on capital formation eased, the proportion of technology startups outside of the historical venture hubs of California and New York increased. Many such companies have raised money through online venture platforms like AngelList (See Figure 5):

- Colorado-based Crusoe Energy Systems, a firm specializing in technology to reduce oil and gas flaring, first raised on AngelList in 2018. In 2021, the company raised $128 million to expand its operations.[104]
- Boom Supersonic raised in 2014 and is now planning on opening a facility in North Carolina to build and test ultra-fast planes. The North Carolina facility is expected to employ 1,750 workers by 2030.[105]

[99] *See* Bauguess, *supra* note 88, at 16.
[100] AngelList Analytics (March 17, 2022).
[101] *Id.*
[102] *Id.*
[103] *Id.*
[104] *Crusoe Achieves Operational Milestones and Closes $128 Million Series B Financing to Expand Patented Digital Flare Mitigation Technology*, Business Wire (April 26, 2021), *available at* https://www.businesswire.com/news/home/20210426005202/en/Crusoe-Achieves-Operational-Milestones-and-Closes-128-Million-Series-B-Financing-to-Expand-Patented-Digital-Flare-Mitigation%C2%AE-Technology.
[105] Phil LeBeau, *Boom Supersonic picks North Carolina to build and test ultra-fast planes*, CNBC (Jan. 26, 2022), *available at* https://www.cnbc.com/2022/01/26/boom-supersonic-picks-north-carolina-to-build-and-test-ultra-fast-planes.html.

Figure 5: Proportion of Investment Dollars Outside CA/NY[106]



By unleashing capital formation, the JOBS Act has provided access to many founders that were outside of traditional networks. As former-AngelList CEO Kevin Laws stated, "by clarifying regulations for online platforms, the JOBS Act enabled thousands of new companies to get off the ground and made financing accessible to a much broader array of founders than ever before."[107]

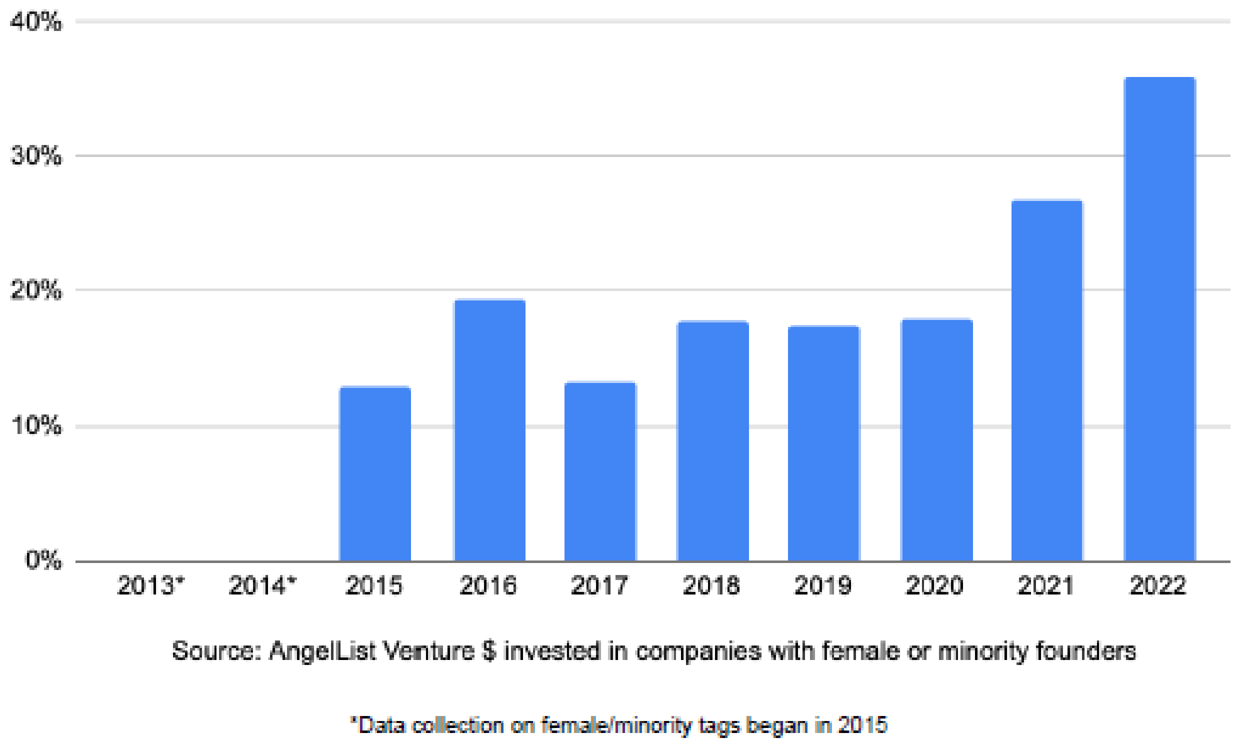
This has led to a rapid rise of financing dollars flowing to founders from historically underrepresented backgrounds, such as (see Figure 6):

- Bitwise provides training for employees in underrepresented groups and geographies and places those workers in jobs at tech companies. In 2021, the company raised $50 million as it endeavors to diversify the workforce, with AngelList participating in that financing.[108]
- Wonderschool is one of the fastest growing childcare management platforms. After raising several million dollars on AngelList in its early stages, the company

[106] *See* AngelList, *supra* note 100100.
[107] Interview by McArn Bennett with Kevin Laws, Former CEO of AngelList (March 18, 2022).
[108] Kristin Stoller, *California Tech Hub Bitwise Industries Raises $50 Million In Quest To Diversify The Workforce*, Forbes (Feb. 24, 2021), *available at* https://www.forbes.com/sites/kristinstoller/2021/02/24/california-tech-hub-bitwise-industries-raises-50-million-in-quest-to-diversify-the-workforce/?sh=fd4c34b582de.

has grown to over 100 employees and completed a financing round led by Goldman Sachs.[109]

Figure 6—Proportion of Dollars Invested in Underrepresented Founders[110]



<u>Impacts of New Regulation A</u>

Historically, Regulation A offerings have also been utilized in low numbers compared to other exempt offerings. In 2011, before the JOBS Act was enacted, only one company pursued an offering under Regulation A. This compared to over 8,000 Regulation D offerings under $5 million.[111] By exempting companies from registration, Regulation A was intended to provide a simpler and less expensive means of capital-raising than a fully registered public offering. However, even then there were only 312 registered public offerings for less than $5 million that year.[112] One of the strongest years for Regulation A before the JOBS Act was 1997, and that year saw only 56 Regulation A offerings.[113]

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[109] *Goldman Sachs Leads $25 Million Investment in Tech Platform Taking on the National Childcare Crisis*, PR Newswire (Jan. 11, 2022), available at https://www.prnewswire.com/news-releases/goldman-sachs-leads-25-million-investment-in-tech-platform-taking-on-the-national-childcare-crisis-301457980.html.
[110] *See* AngelList, *supra* note 100.
[111] *See* Thaya Brook Knight, *supra* note 18, at 23.
[112] *Id*.
[113] "Factors That May Affect Trends in Regulation A Offerings," GAO Report to Congressional Committees, (July 2012) at ii, *available at* http://www.gao.gov/assets/600/592113.pdf.

Before Regulation A was updated, observers identified the exemption's key flaws as the $5 million limit and lack of federal preemption.[114] The lack of federal preemption triggered costly legal and compliance requirements, at both the federal and state levels, that swallowed much of the $5 million a company was permitted to raise under Regulation A.[115] As such, more companies found a fully registered IPO to be more cost effective.

Following the SEC's adoption of the rules implementing the JOBS Act's modifications to Regulation A in 2015, interest in using the new Regulation A exemption increased. From June 2015 through December 2019, SEC staff estimated 382 issuers conducted 382 Regulation A offerings (see Table 5).[116] Over the four-year period, the number of qualified Tier 1 offerings both increased and decreased year-over-year, while the number of Tier 2 offerings mostly increased each year (see Table 6).[117] During this timeframe, reported proceeds for Tier 2 offerings sharply increased—especially compared to the more gradual increase in Tier 1 proceeds—within the first two years of the rule and leveled off thereafter (see Figure 7).[118] Likewise, in this four-year period, Tier 2 offerings represented the majority of Regulation A offerings (73 percent of qualified offerings), dollar amounts sought (92 percent of amounts sought in qualified offerings), and reported proceeds (91 percent).[119] In addition during this period, 41 percent of qualified Tier 2 offerings sought amounts under Tier 1's $20 million offering limit. At the same time, Tier 2's higher offering limit did not appear to be the only characteristic attracting issuers to Tier 2 over Tier 1.[120] SEC staff posited that the federal preemption of state securities laws under Tier 2, which permits nationwide solicitation and solicitation on the Internet, could explain the higher usage rates of Tier 2 offerings among issuers seeking to raise amounts within the lower Tier 1 threshold.[121]

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[114] See Thaya Brook Knight, supra note 18.
[115] *Id.*
[116] *See* Staff Report to the U.S. Sec. and Exch. Comm'n, *Regulation A Lookback Study and Offering Limit Review Analysis* (March 4, 2020), at 7, *available at* https://www.sec.gov/smallbusiness/exemptofferings/rega/2020Report.
[117] *Id.*
[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] *Id. See, e.g.*, Commentary at the 38th Annual SEC Government-Business Forum on Small Business Capital Formation (Aug. 14, 2019), *available* at https://www.sec.gov/files/2019-sec-government-business-forum-small-business-capital-formation-transcript.pdf, transcript at 132–135.

Table 5—Capital Sought under Regulation A during June 19, 2015 – December 31, 2019.[122]

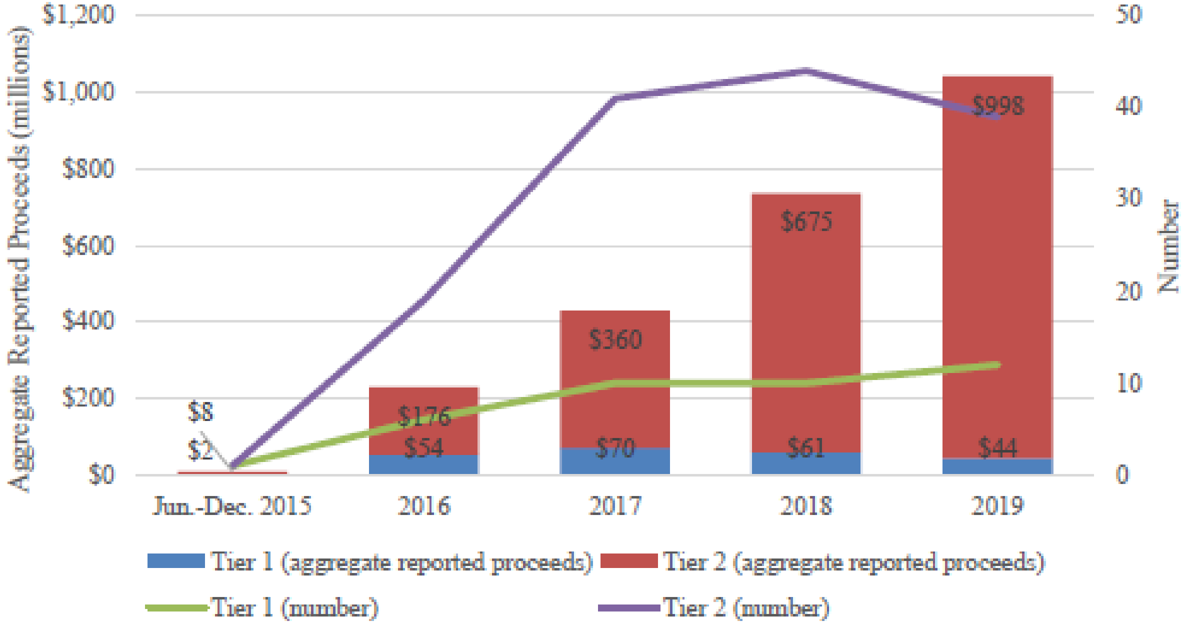
Offerings Qualified by Commission Staff (*Dollar amounts in millions*)	**Tiers 1 & 2**	**Tier 1**	**Tier 2**
Aggregate dollar amounts sought	$9,094.8	$759.0	$8,335.8
Number of offerings	382	105	277
Average dollar amount sought	$23.8	$7.2	$30.1

Table 6—Trends in Financing under Regulation A since 2015[123]

	All		**Tier 1**		**Tier 2**	
Qualified Offerings June 2015 to Dec. 2019	Aggregate amount sought (*Dollar amounts in millions*)	Number of offerings	Aggregate amount sought (*Dollar amounts in millions*)	Number of offerings	Aggregate amount sought (*Dollar amounts in millions*)	Number of offerings
Dec. 2015	181.9	15	68.8	10	113.1	5
Dec. 2016	1,892.1	100	305.7	42	1,586.4	58
Change in 2016	*1,710.2*	*85*	*236.9*	*32*	*1,473.4*	*53*
Dec. 2017	4,153.1	185	488.1	57	3,665.1	128
Change in 2017	*2,261*	*85*	*182.4*	*15*	*2,078.6*	*70*
Dec. 2018	6,332.1	280	724.5	86	5,607.6	194
Change in 2018	*2,179*	*95*	*236.4*	*29*	*1,942.5*	*66*
Dec. 2019	9,094.8	382	759	105	8,335.8	277
Change in 2019	*2,762.7*	*102*	*34.5*	*19*	*2,728.2*	*83*

[122] *See* Staff Report, *supra* note 116, at 8.
[123] *Id.* at 10.

Figure 7—Trends in Regulation A – Reported Proceeds[124]



Knightscope, a California company that designs and builds – exclusively in the U.S. – autonomous security robots that deter, detect, and report for 24/7/365 protection found the JOBS Act's updates to Regulation A particularly helpful.[125] Founded in 2013, Knightscope has used the new Tier 2 offering under Regulation A four times since 2016.[126] In May 2021, the company raised $21.91 million in its most recent Tier 2 offering, marking the cumulative amount Knightscope raised under Regulation A at over $90 million from more than 28,000 investors.[127] In January 2021, Knightscope went public on the Nasdaq exchange, making the company a true success story of the JOBS Act's Regulation A reforms.[128] According to CEO William Li, the impact of the JOBS Act's updates to Regulation A extend beyond raising capital:

> "I'm proud to say that Knightscope has a 100 percent diverse Board of Directors. It's very important to me that my company leadership is diverse, and that's why we decided to raise capital through Regulation A. Doing so allowed me to keep my diverse Board

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[124] *Id*. at 12.
[125] https://www.knightscope.com/.
[126] Interview by McArn Bennett with William Li, CEO, Knightscope (March 3, 2022).
[127] *Knightscope Closes Second Funding Round on StartEngine, Now Responsible for Two Largest Raises in Platform History*, GlobeNewsWire (May 14, 2021), *available at* https://www.globenewswire.com/en/news-release/2021/05/14/2229921/0/en/Knightscope-Closes-Second-Funding-Round-on-StartEngine-Now-Responsible-for-Two-Largest-Raises-in-Platform-s-History.html.
[128] Eddie Pan, *Knightscope Stock IPO: 8 Things to Know as KSCP Starts Trading Today* (Jan. 27, 2022), *available at* https://www.nasdaq.com/articles/knightscope-stock-ipo%3A-8-things-to-know-as-kscp-starts-trading-today.

> members. Without the ability to raise money under Regulation A, I would've had to rely on VC funding. By not relying on VC money, I didn't have to sell a Board seat."[129]

Crowdfunding

The SEC adopted Regulation Crowdfunding ("Reg CF") as directed in Title III of the JOBS Act in October 2015.[130] After its adoption, capital-hungry companies increased their use of the new exemption. Effective May 2016, the new Reg CF was utilized in only 292 offerings in its first year, 557 offerings in its second full year, and roughly 500 offerings in the first part of the third year (May 2018 to December 2018).[131] During the first three years of Reg CF, the SEC found that Reg CF offerings usually raised well below the then-12-month offering limit of $1.07 million.[132] Specifically, the SEC reported that the average Reg CF offering sought a target amount of approximately $52,428, with a maximum amount of approximately $577,385.[133] In this three-year span, Reg CF issuers raised around $208,000 per offering and roughly $107.9 million in total.[134]

When comparing Reg CF offerings to Regulation D offerings below $1 million from May 2016 through December 2017, SEC staff found that Regulation D offerings greatly outnumbered Reg CF offerings (11,646 offerings to 848 offerings) and raised much more capital ($3.49 billion to $53.2 million).[135] Likewise, in this span, Regulation D issuers were typically younger. Roughly 55 percent were under a year old at the time of offering.[136] This comparison to Regulation D offerings under $1 million demonstrated that Reg CF, intended to be a simple and cost-effective alternative for small companies to raise small dollar amounts, was still viewed as a much less attractive option than Regulation D for small dollar issuers. However, 2020 Reg CF data suggests use of the exemption is increasing. The SEC Office of the Advocate for Small Business Capital Formation found that 2020 was a record year for Reg CF in terms of both the number of offerings and in capital commitments. In 2020, issuers completed 1,511 offerings (an increase of 61 percent from 2019) with $232.9 million in capital commitments (an 86 percent increase from 2019).[137]

SEC Harmonizes Exempt Offerings Framework

Companies now have more options for raising capital thanks to reforms to Securities Act registration exemptions included in the JOBS Act and Commission rules. However, the revisions exacerbated the already complicated patchwork of exemption requirements and stipulations.

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[129] *See* Interview, *supra* note 126.
[130] *See* SEC Press Release 2015-249, *supra* note 31.
[131] *See* Report to the U.S. Sec. and Exch. Comm'n, Regulation Crowdfunding (Jun. 18, 2019) *available at* www.sec.gov/smallbusiness/exemptofferings/regcrowdfunding/2019Report.
[132] *Id*. *See* SEC Press Release 2020-273, *supra* note 27. In 2020, the SEC adopted amendments raising the offering cap limit from $1.07 million to $5 million.
[133] *Id*.
[134] *Id*.
[135] *See* Bauguess, *supra* note 88.
[136] *Id*.
[137] *See* Office of the Advocate for Small Business Capital Formation, *supra* note 87.

These complications presented challenges to market participants, especially smaller companies with limited resources, for navigating the resulting exempt offering framework.

In November 2020, the SEC addressed these complexities by adopting rules to harmonize this patchwork of exemptions.[138] For Regulation A, the amendments raised the offering cap for Tier 2 offerings from $50 million to $75 million and raised the offering cap for secondary sales under Tier 2 from $15 million to $22.5 million.[139] For Reg CF, the amendments raised the offering cap from $1.07 million to $5 million, updated the investment limits, and established rules permitting the use of special purpose vehicles as an instrument for investors to facilitate investing in Reg CF issuers.[140] The adopted rules also establish more clearly the ability of issuers to move from one exemption to another. It also harmonized certain disclosure and eligibility requirements.[141]

One company that plans on taking advantage of the revisions under the SEC's 2020 harmonization rulemaking is 20/20 GeneSystems, a Maryland-based clinical lab-testing company. Founded in 2001, 20/20 GeneSystems manufactures a multi-cancer screening blood test and offers a comprehensive menu of COVID-19 testing services.[142] The company was already a success story for both Regulation A and Reg CF prior to the SEC's 2020 rulemaking, raising over $10 million using both Regulation A and Reg CF since 2018.[143] According to President and CEO, Jonathan Cohen, the capital raised through those offerings enabled the company to "grow from 10 employees to over 35, grow revenues exponentially, and we became profitable."[144] He added, "[t]his year, we will rank in the top 150 companies on the Inc.5000 list of the fastest growing companies in America; we were 770 in 2021."[145] Cohen plans on conducting another Reg CF offering now that they can raise up to $5 million with the increased threshold adopted by the SEC in 2020.[146] The company is looking forward to secondary trading of its shares, but Cohen believes rules and regulations need to be further reformed to make this successful.[147]

There is optimism that the enhancements and simplifications under the 2020 harmonization rulemakings will support a larger number of entrepreneurs and companies with their capital-raising efforts. Congress should continue to closely monitor the data on exempt offerings to gauge the effectiveness of these reforms. In the meantime, Congress can do more to empower America's job creators and investors.

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[138] *See* SEC Press Release 2020-273, supra note 27.
[139] *Id.*
[140] *Id.*
[141] *Id.*
[142] https://2020gene.com/.
[143] Interview by McArn Bennett with Jonathan Cohen, President & CEO, 20/20 GeneSystems (March 25, 2022).
[144] *Id.*
[145] *Id.*
[146] *Id.*
[147] *Id.*

Section II. Building on the JOBS Act's Success

A. The Need for Congressional Action

"A second Act would lead to more startups and more jobs. As Matt Ridley, the historian of innovation said, 'innovation is the child of freedom and the parent of prosperity.'"

-Naval Ravikant, co-founder of AngelList, on the need for Congress to take up new reforms that build on the success of the JOBS Act.[148]

The JOBS Act has succeeded in strengthening our capital markets and increasing access to capital for small companies. Unfortunately, remaining regulatory burdens and bureaucracy prevent businesses and job creators from thriving and hinder the United States' ability to compete globally.

These burdens negatively impact smaller businesses, which make up 99 percent of all enterprises in the U.S. and employ almost half of our workforce.[149] Prior to the COVID-19 pandemic, small businesses were more successful at obtaining loans, lines of credits, and cash advances with 81% of small-business applicants being approved for at least some of the funds for which they applied.[150] However, after March 1, 2020, only 70 percent of small businesses received partial approval for funds.[151] In 2021, that approval number dropped to 68 percent.[152] The percentage of small businesses that experienced financial hardships increased from 66 percent to 80 percent between 2019 and 2020.[153]

In 2020, Americans started 4.3 million new businesses, a 24 percent uptick from 2019 and a record-breaking amount since the Census Bureau began tracking such data fifteen years ago.[154] However, most of the new businesses formed in 2020 were made up of non-employer firms.[155] On the other hand, "high propensity businesses," meaning those businesses likely to hire employees, were formed at higher levels in 2021 than in 2020 (almost 1.8 million).[156] Congress and regulators must adopt forward-thinking approaches to increase access and options for American entrepreneurs to raise capital.

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148 Interview by McArn Bennett with Naval Ravikant, Co-Founder of AngelList (March 18, 2022).
149 *See* Frequently Asked Questions, SBA Office of Advocacy, *available at* https://cdn.advocacy.sba.gov/wp-content/uploads/2020/11/05122043/Small-Business-FAQ-2020.pdf.
150 Federal Reserve System, Small Business Credit Survey: 2021 Report on Employer Firms (Feb. 3, 2021), *available at* https://www.fedsmallbusiness.org/medialibrary/FedSmallBusiness/files/2021/2021-sbcs-employer-firms-report.
151 *Id.*
152 Federal Reserve System, Small Business Credit Survey: 2022 Report on Employer Firms (Feb. 22, 2022), *available at* https://www.fedsmallbusiness.org/survey/2022/report-on-employer-firms.
153 *See* Federal Reserve System, *supra* note 150.
154 Ben Casselman, *Start-up Boom in the Pandemic Is Growing Stronger*, The New York Times (Aug. 19, 2021) *available at* https://www.nytimes.com/2021/08/19/business/startup-business-creation-pandemic.html.
155 *See* U.S. Census Bureau, "Business Formation Statistics," (March 9, 2022) *available at* https://www.census.gov/econ/bfs/data.html.
156 *Id.*

Additionally, until a surge in 2020, the U.S. had been steadily witnessing half the number of domestic IPOs than it had 20 years ago. At the same time, the U.S. doubled the regulatory compliance costs a business incurs.[157] One reason for the prior decline in traditional IPOs is the cost. Costs associated with going public are high: "Investment bankers, lawyers, and auditors collectively charge millions of dollars to prepare the lengthy registration statement that must be filed with the SEC before shares can be sold."[158]

Additionally, a series of regulatory burdens on public companies—regulations that do not apply to private companies—impose significant costs to these companies.[159] The SEC estimates the average cost of initial regulatory compliance for going public in a traditional IPO is $2.5 million, with annual compliance costs averaging $1.5 million thereafter. These costs are prohibitive for small and other emerging companies focused on growing their business.

As a result, more companies opt for private fundraising over the costly hassle of entering our public markets. In 1997, 8,884 companies were listed on exchanges in the U.S., namely Nasdaq and the New York Stock Exchange (NYSE). Since then, the number of companies on the exchanges has decreased by more than half. This means fewer investment choices for everyday investors.[160] In the U.S. there were 242 "unicorns," startups with valuations of more than $1 billion that were privately financed as of November of 2020.[161] A decline in IPOs only hurts every day American consumers because it means fewer opportunities for them to get in early with tomorrow's success stories.

While the U.S. IPO market has steadily decreased until 2020, foreign markets, particularly in China, are growing. In 2020, China was the only major economy to achieve positive economic growth.[162] Likewise, for the first three quarters of 2021, China experienced a higher than predicted year-over-year GDP increase of almost ten percent.[163] In 2020, Asia-

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[157] Tom Simpson, *Changes brewing in DC could make it easier for companies to go public and beef up the economy*, INLANDER (Aug. 2, 2018), *available at* https://www.inlander.com/spokane/changes-brewing-in-washington-dc-could-make-it-easier-for-new-companies-to-go-public-and-beef-up-the-economy/Content?oid=11195585; *see* Jay R. Ritter, *Initial Public Offerings: Updated Statistics* (Feb. 1, 2021), *available at* https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf?elqTrackId=aad710c20b5b472fbb1ae8383f6a301b&elq=929af67dfea74fdca3eed3e0b70b886c&elqaid=10789&elqat=1&elqCampaignId=6718.

[158] Frank Partnoy, *The Death of the IPO*, The Atlantic (Nov. 2018), *available at* https://www.theatlantic.com/magazine/archive/2018/11/private-inequity/570808/

[159] President Obama's IPO Task Force reported that "the cumulative effect of a sequence of regulatory actions [beginning in 1996] . . . lies at the heart of the crisis." That of these "one-size-fits all" "regulations … intended to address market issues created exclusively by the behavior of, and risks presented by, the largest companies" "almost all of them have created unintended adverse effects on [EGCs] looing to access public capital." *See* IPO Task Force Report, https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

[160] *See* Frank Partnoy, *supra* note 158.

[161] Kazuyuki Okudaira, Unicorns surge to 500 in number as US and China account for 70%, Nikkei Asia (Nov. 26, 2020), *available at* https://asia.nikkei.com/Business/Startups/Unicorns-surge-to-500-in-number-as-US-and-China-account-for-70.

[162] Ernst and Young Report: Global IPO Trends: Q1 2021 (April 2021), *available at* https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/ipo/ey-global-ipo-trends-2021-q1-v1.pdf.

[163] Ernst and Young Report: Global IPO Trends 2021 (Dec. 16, 2021), *available at* https://www.ey.com/en_gl/ipo/trends.

Pacific markets IPOs accounted for 60 percent of all global IPO activity with 822 IPOs.[164] While that figure declined to approximately 48 percent in 2021, the number of Asian-Pacific IPOs in 2021 climbed to 1,136.[165] Specifically, China's IPO market produced 485 IPOs in 2021, approximately twenty percent of all global IPOs.[166] With the launch of the Beijing Stock Exchange in 2021 and tighter regulatory restrictions on Chinese issuers on U.S. exchanges, China already had 201 companies in the China Securities Regulatory Commission IPO pipeline for a 2022 IPO as of December 2021.[167] In general, Asia-Pacific markets are expected to experience continuously high IPO activity in 2022.[168] Beijing's "Made in China 2025" agenda lays out its plan to dominate the high-tech, biotech, and artificial intelligence industries within the next ten years.[169] Additionally, experts predict more IPO activity due to China's 14th Five-Year Plan, which is designed to boost IPOs in specific sectors through direct financing.[170] This increased pressure from foreign markets only heightens the necessity for immediate action and reform.

Given that upswing in international competition, Congress should pass reforms that will make our public markets more attractive. More attractive public markets ensure a more viable means of capital formation for growing companies, generates more IPOs of all types, and increases investment opportunities for everyday investors.

B. Strengthening U.S. Public Markets

Given the success of Title I's IPO on-ramp and data on post-IPO job growth, Congress should consider additional policy changes to encourage more companies to go public in the United States.

- <u>Extend the IPO On-Ramp</u>

Congress should update the EGC definition to extend the IPO on-ramp by:

(1) Increasing the $1.07 billion revenue test;
(2) Extending EGC status for a guaranteed minimum number of years;
(3) Securing a minimum period for any company that qualifies as an EGC when beginning the IPO process but loses EGC status before completing the IPO;
(4) Eliminating the disqualification based on large accelerated filer status; and/or
(5) Increasing the current maximum five-year IPO on-ramp period to ten years.

The JOBS Act's IPO on-ramp succeeded by providing accommodations that streamlined the IPO process and promoted efficiency without compromising investor protection. The IPO on-ramp accommodations are limited, measured, and based on

[164] Ernst and Young Report: Global IPO Trends: Q4 2020 (January 2020), *available at* https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/growth/ey-global-ipo-trends-2020-q4.pdf.
[165] *See* Ernst and Young, *supra* note 163.
[166] *Id*.
[167] *Id*.
[168] *Id*.
[169] Council on Foreign Relations: https://www.cfr.org/backgrounder/made-china-2025-threat-global-trade.
[170] *See* Ernst and Young, *supra* note 162, at 18.

analogous pre-existing principles or practices in federal securities regulation (e.g., antifraud protections).

The proposed enhancements to the IPO on-ramp similarly represent a balanced approach to promote IPO activity without compromising investor protections, including all of the disclosure and liability requirements that continue to remain in place for all companies.

- Expand Well-Known Seasoned Issuer (WKSI) Eligibility

Congress should expand the availability of WKSI status by updating to the WKSI definition to apply to companies with a public float of $75 million, rather than the current public float threshold of $700 million.

Shelf registration statements typically offer issuers an efficient and flexible avenue for raising capital, including during instances of market volatility.[171] Since the introduction of the WKSI definition nearly two decades ago,[172] the automatic shelf registration process and other benefits available to WKSI issuers have improved capital formation and market efficiency without compromising investor protection. The benefit of the automatically effective registration statement is that it is not exposed to the risk of delay due to potential SEC review or the process of requesting acceleration of the effective date. During times of market volatility, opportunities to access the capital markets are typically brief. As such, it is prudent for companies to have an effective shelf registration statement on file with the SEC.[173] This underscores the advantages of automatically effective shelf registration statements reserved for WKSIs.[174] Additionally, for the last three decades, companies with a public float of $75 million have been able to engage in short-form registration of securities using the integrated disclosure system based on those companies' period reporting. The WKSI status—and its advantages like automatic shelf registration—should be extended to all companies that otherwise satisfy the WKSI definition and have a public float of $75 million, rather than maintaining the current, arbitrarily high requirement of $700 million.

- Streamline and Clarify the EGC Public Filing Condition to Require Public Filing Ten Days Before the Effective Date of the IPO Registration Statement and Conform Confidential Review Process to that Timeline

Congress should update the public filing condition to require that an EGC must publicly file its registration statement, the nonpublic draft registration statement, and all

[171] Craig Scheer, *Insight: SEC Shelf Registration Gives Public Companies a Leg Up*, Bloomberg Law (April 13, 2020), *available at* https://news.bloomberglaw.com/securities-law/insight-sec-shelf-registration-gives-public-companies-a-leg-up.
[172] *See* Securities Offering Reform, Securities Act Release No. 33-8591 (August 3, 2005)[70 FR 44721], *available at* https://www.govinfo.gov/content/pkg/FR-2005-08-03/pdf/FR-2005-08-03.pdf.
[173] *See* Scheer, *supra* note 171.
[174] *Id.*

draft amendments to at least ten days before the effective date of the registration statement.

An EGC is permitted to begin SEC registration on a confidential basis if the EGC publicly files its previously confidential registration statement at least 15 days before conducting a road show. This provision is intended to facilitate public review of the registration statement between the first public filing and the IPO pricing. However, experience has shown that 15 days is more than ample time for that purpose. Moreover, the application of the current requirement can sometimes be unclear based on uncertainty surrounding the definition of a road show. This proposed change would enhance efficiency by reducing the minimum time before pricing and provide greater predictability by referring to the date of effectiveness, which is more precise than conducting a road show, benefitting investor certainty.

Congress should also update the confidential registration process to require that any issuer must publicly file its registration statement, the nonpublic draft registration statement, and all draft amendments for (i) an IPO or an initial listing, at least ten days before the effective date of the registration statement; and (ii) a follow-on offering (before the end of the twelfth month after the effective date of its IPO), at least 48 hours before the effective date of the registration. This change would facilitate capital formation and conform practice for non-EGCs to maintain consistency in the registration process if the changes to the EGC process listed in the previous bullet are made.

- Update the IPO On-Ramp to Include Spin-Off Transactions

Congress should update the EGC financial statement requirements to clarify that an EGC may present two years, rather than three years, of audited financial statements in either an IPO or a spin-off.

Currently, the spin-off of an EGC does not benefit from the two-year financial statement accommodation, which applies only to IPO registration. The EGC financial statement requirements should be comparable for both an IPO and a spin-off. Equalizing the requirements in both scenarios will promote efficiency and capital formation by reducing regulatory compliance costs for companies engaging in spin-offs without sacrificing significant investor protection.

- Clarify EGC Financial Statement Obligations to Prevent Aberrational Results

In some instances, misinterpretations have arisen concerning the accommodation allowing an EGC to provide only two years of audited financial statements in its IPO registration statement, and not for any earlier period. This has occurred occasionally, for example, in the case of acquired company financial statements and for follow-on offerings involving an EGC that lots its EGC status during IPO registration.

Congress should update the EGC financial statement accommodation to clarify that an EGC need not provide financial statements for a period earlier than the two years of audited financial statements required in its IPO registration statement. This update would increase efficiency by ensuring that EGCs can consistently rely on the scaled disclosure accommodation by eliminating aberrational results that have sometimes required burdensome and unnecessary financial statement obligations. Absent this clarification, in some scenarios EGC issuers have needed to provide audited financial statements for financial periods preceding the earliest period in their IPO registration statements. The proposed update would clearly establish that an EGC need not, under any circumstances, provide financial statements for any period preceding the earliest period required to be presented in the IPO registration statement.

- <u>For Any Private Company Transitioning to Public Company Status, Permit the Auditor to Comply with SEC and PCAOB Independence Rules for the Most Recent Year and AICPA or Home-Country Independence for Prior Periods</u>

Congress should permit the auditor of a private company transitioning to public company status (via IPO, spin-off, or otherwise) to comply with SEC and PCAOB independence rules for only the latest fiscal year, as long as the auditor is independent under AICPA or home-country standards for earlier periods.

Requiring a private company's auditor to comply with SEC and PCAOB auditor independence rules for all prior years, rather than only the most recent year, can unnecessarily require hiring a different auditor to re-audit earlier periods even though the original auditor was independent under then-applicable standards, an unnecessary cost of compliance. Under this balanced approach, the auditor must still satisfy SEC and PCAOB independence requirements for the most recent audited year while AICPA or home-country independence standards would suffice for all earlier years.

- <u>Expand the Protection for Research Reports to Cover All Securities of All Issuers</u>

Title I's provision designed to promote publication of research reports about EGCs by deeming the reports a non-offer should be expanded. Congress should update the provision to cover all securities of an EGC or any other issuer.

The current provision offers limited protection of research reports in the context of an EGC's proposed offering of its common equity securities. After a decade of marketplace experience, the provision governing EGC research reports has proved wholly successful. Research analysts remain subject to robust regulation, including SEC Regulation AC certification and conflict disclosure requirements, FINRA conduct and communications rules, and antifraud requirements. Based on this success, the research report provision warrants expansion, especially considering the importance of research reports to small issuers trying to increase stock liquidity or gain investors' recognition.

- <u>Exclude Qualified Institutional Buyers (QIBs) and Institutional Accredited Investors from the Record Holder Count for Mandatory Exchange Act Registration</u>

Congress should update the mandatory Exchange Act registration threshold to exclude qualified institutional buyers (QIBs) and institutional accredited investors.

The provision in the JOBS Act to increase the record holder threshold should not include large institutional investors, such as QIBs or institutional accredited investors. Section 12(g) of the Exchange Act requires every issuer with more than $10 million in total assets and a class of equity security held of record by 2,000 or more persons (or 500 or more unaccredited investors) to register that class of equity security under the Exchange Act. In the decade since the JOBS Act raised this threshold, experience has shown that institutional investors can be excluded from the record holder count without harming the public or private markets. Furthermore, the current threshold is under attack by the current Commission.[175] Congress should make clear that the intent of the regulation, consistent with the original JOBS Act, is not to force companies to go public before they are ready.

C. Expanding Opportunities for Underrepresented Entrepreneurs and Investors

The JOBS Act's updates to offering exemptions and the new crowdfunding exemption opened more opportunities for companies and entrepreneurs to raise capital, and companies are taking advantage of these enhancements. From July 1, 2020 to June 30, 2021, private offerings raised a total of $3.3 trillion, compared to the $317 billion raised in IPOs in the same period.[176] This disparity between capital raised in private markets compared to public markets underscores the importance of the private markets as a source of capital for the roughly 31.7 million American small businesses, almost all of which are not publicly traded companies.[177] This significant gap in capital raised in private versus public markets also highlights the vast wealth-generating investment opportunities accessible in most part only to wealthy accredited investors.

Congress should take up policy changes that strengthen our public markets and make them more attractive as a place to raise capital. However, Congress should also work to ensure that entrepreneurs and founders can continue to raise money with as little friction as possible in our private markets. Congress should work to increase investment opportunities for everyday Americans in our private markets. By adopting policies that make our capital markets as inclusive as possible, Congress can empower entrepreneurs and investors of all backgrounds to pursue the American dream.

- Modernize the Outdated Accredited Investor Definition

Investments in American private markets are largely reserved for accredited investors, mostly institutional investors or individual investors who met specific income or net worth tests. For an individual, the minimum qualifying income for each of the previous two years must be at least $200,000 (or $300,000 together with a spouse) or the individual must have a net worth over $1 million (either alone or together with a

[175] *See* SEC Agency Rule List – Fall 2021, "Revisions to the Definition of Securities Held of Record" (Fall 2021), *available at* https://www.reginfo.gov/public/do/eAgendaViewRule?pubId=202110&RIN=3235-AN05.
[176] *See* Office of the Advocate for Small Business Capital Formation, *supra* note 87.
[177] *See* Frequently Asked Questions, *supra* note 149. *See also* Vartika Gupta, Tim Koller, and Peter Stumpner, *Reports of corporates' demise have been greatly exaggerated*, McKinsey (Oct. 21, 2021), *available at* https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/reports-of-corporates-demise-have-been-greatly-exaggerated.

spouse).[178] In August 2020, the SEC adopted amendments to expand the "accredited investor" definition.[179] The amendments allow investors to qualify additionally based on certain professional certifications or other credentials issued by an accredited educational institution.[180] These amendments were a step in the right direction for expanding opportunities for individual investors to participate in our private markets. However, Congress should further expand the accredited investor definition to increase the pool of potential investors that would enhance a company's ability to raise capital and grow.

According to SEC estimates, about 13 percent of U.S. households qualified as accredited investors in 2016.[181] Additionally, only about 1.3 percent and 2.8 percent of accredited investors are Black and Latino, respectively.[182] Starting a successful company depends so much on the founder's network in the early stages. However, the makeup of a founder's network or community, including whether wealthy accredited investors are involved, should not determine the fate of the enterprise.[183] That so few minorities qualify as accredited investors makes it harder for minority entrepreneurs to get their startups off the ground.

The low number of accredited investors in these underrepresented communities also means that most of these populations are left out of investment opportunities in the private markets, which are often the most high-growth investments. From 2009 to 2017, the SEC estimated that only nine percent of all Regulation D offerings included non-accredited investors,[184] making investing in private companies even more challenging for minorities who are not accredited investors.

The accredited investor definition is meant to limit investments in private companies only to investors who are "sophisticated."[185] However, as Omi Bell, founder of Black Girl Ventures, noted at an SEC Small Business Capital Formation Advisory Committee Meeting, "[f]inancial sophistication needs to be questioned if the current rule

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[178] 17 C.F.R. § 230.501.
[179] *See* SEC Press Release 2020-191, *SEC Modernizes the Accredited Investor Definition* (Aug. 26, 2019), *available at* https://www.sec.gov/news/press-release/2020-191.
[180] *Id*.
[181] Lydia Beyoud, *SEC 'Accredited Investor' Definition Tweak Faces Equity Concerns*, Bloomberg Law (Feb. 23, 2022), *available at* https://news.bloomberglaw.com/securities-law/sec-accredited-investor-definition-tweak-faces-equity-concerns.
[182] Mariah Lichtenstein, *Investors still engage in racist redlining. Why haven't we done something about it?*, Fortune (Jan.6, 2021), *available at* https://fortune.com/2021/01/06/redlining-black-latinx-entrepreneurship-investment-sec/.
[183] *See* SEC Commissioner Hester Peirce, "Remarks at SEC Small Business Capital Formation Advisory Committee Meeting" (Feb. 10, 2022), *available at* https://www.sec.gov/news/statement/peirce-sbcfac-statement-021022. [Commissioner Peirce stated: "Starting a business if you're an Ivy Leaguer living in New York City with a wealthy network might not run into any difficulties from the current thresholds, or whatever they might be raised to in connection with the rulemaking on the Chair's agenda. It's a whole different story for a founder with a good idea and a community that believes in her, but who doesn't have generational wealth or high income. That story too often ends with the founder giving up her dream."]
[184] *See* Bauguess, *supra* note 88.
[185] SEC, Accredited Investors – Updated Investor Bulletin (April 14, 2021), *available at* https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins/updated-3.

that describes that level of financial sophistication makes sense only for a small pool of people."[186] Steve Case, Co-Founder of AOL and Chairman and CEO of Revolution, put it this way:

> "It seemed crazy to me that you have to be an accredited investor to invest in a company, but you can go to Las Vegas and lose $10,000 at the table in an hour but you don't have to be an accredited gambler to do that."[187]

Congress should update the accredited investor definition to include more investors who have historically been relegated to the investing sidelines. According to Bell, "[t]he inclusion of more people also pushes economic development, ingenuity, returns for a group of people who've been historically financially locked out of the ability to buy homes, locked out to levels of loans and access to capital."[188]

Members of the House Financial Services Committee have introduced several bills in recent years to modernize the accredited investor definition, including:

- Codifying an expanded statutory definition of "accredited investor" to include certain licenses or possessing qualifying education or experience as determined by the SEC;
- Directing the SEC to create an examination that individuals can take to be certified as an accredited investor;
- Requiring the SEC to incorporate additional "certifications, designations or credentials that further the purpose of the accredited investor definition" within 18 months and continuously reassessing every five years. This bill also codifies the final rule so that the SEC cannot dial it back.
- Requiring the SEC to create a form that would allow for individuals to certify that they are sophisticated and understand the risks of investment in private offerings.

- <u>Increase Access to Investment Opportunities for Retail Investors Through Closed-End Funds</u>

Approximately three million retail investors rely on closed-end funds (CEFs) as important retirement savings and investment vehicles. These funds are strictly regulated and professionally managed investment vehicles. As such, CEFs are treated as sophisticated investors and may invest freely in privately offered investments that retail investors typically cannot access. These funds regularly invest in privately offered assets, which may be illiquid, such as repurchase agreements, derivatives, certain municipal securities, and institutional debt. The funds can also invest in private funds. However, the SEC staff limits those investments to 15 percent of the fund's net assets, unless the fund

[186] *See* Lichtenstein, *supra* note 182.
[187] Erick Schonfeld, *Steve Case: It's Crazy You Have To Be An Accredited Investor, But Don't Have To Be An "Accredited Gambler*," TechCrunch (Nov. 15, 2011), *available at* https://techcrunch.com/2011/11/15/steve-case-accredited-investor-gambler/.
[188] *See* Lichtenstein, *supra* note 182.

only offers its shares to accredited investors with minimum initial purchases of at least $25,000.

Congress should require SEC staff to allow publicly offered CEFs to invest up to all its assets in private securities. This would increase retail investor exposure to private companies while maintaining investor protections.

- Modify the Qualifying Venture Capital Fund Exemption under Section 3(c)(1)

Venture capital (VC) plays a critical role in the American startup ecosystem. Once growth startups reach a certain size or level of maturity and need larger sums of capital to continue scaling or to prepare for going public, venture capital often provides an attractive path forward. Companies in well-known technology and venture hubs are generally successful in raising capital. However, entrepreneurs outside of these hubs in other parts of country face more difficulties raising capital necessary for scaling.[189] In particular, founders outside of traditional VC locales specifically struggle raising Series A capital, usually $3 million to $10 million, which then propels them to more easily secure Series B funding from investors focused on growth.[190]

Underscoring these geographic barriers, three-quarters of venture capital goes to founders in just three states: California, Massachusetts, and New York.[191] Additionally, personal and network relationships remain the dominant source of VC deal flow.[192] For example, nearly 30 percent of founders who secured venture funding in 2019 had Ivy League degrees.[193] Despite record highs for total VC investments in 2020 and 2021, only 2.3 percent of venture dollars went to women-only founding teams in 2020 (down from 3.3 percent in 2019).[194]

To make matters worse, first-time fund managers and small funds have declined in both number and size, further reducing access to early-stage capital necessary for young companies, especially those outside of primary VC and tech hubs.[195] For upstart and smaller regional funds, taking on additional investors in a fund would pave the way to raise a more meaningful fund with more reach, while simultaneously encouraging diversification that reduces portfolio risk.[196] However, the current qualified venture capital fund size limit of $10 million under Section 3(c)(1) of the Investment Company

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189 *See* Letter from the SEC Small Business Capital Formation Advisory Committee to Chair Gensler (May 21, 2021), *available at* https://www.sec.gov/spotlight/sbcfac/encouraging-small-regional-funds-043021.pdf.
190 *Id*.
191 Start Us Up, *America's New Business Plan* (Dec. 3, 2021), *available at* https://www.startusupnow.org/wp-content/uploads/sites/12/2021/03/AmericasNewBusinessPlan.pdf.
192 *See* Office of the Advocate for Small Business Capital Formation, *supra* note 8787.
193 *Id*.
194 *See* Office of the Advocate for Small Business Capital Formation, *supra* note 87.
195 *See* Letter from the SEC Small Business Capital Formation Advisory Committee, *supra* note 189189.
196 *Id*.

Act of 1940 is prohibitively low. This prevents a fund from covering its operational costs without levying an immense fee on its investors.[197]

As recommended by the SEC Small Business Capital Formation Advisory Committee, Congress should increase the cap for qualified venture funds from $10 million to $150 million and increase the allowable number of investors from 250 to 600 under Section 3(c)(1).[198] Making it easier for VC funds to qualify for the exemption will support small and regional VC funds located outside of established VC hubs, thereby enabling these funds to invest in more entrepreneurs in their own communities, many of whom may be minorities or women. This important policy change would undo the harmful effects of pattern matching, the practice of making investment decisions that mirror patterns of what a successful entrepreneur has looked like in the past.

- <u>Expand the Scope of Qualifying Investments for Venture Capital Funds</u>

Founders of portfolio companies often rely on early-stage investors for hands-on support, participation in board meetings, and developing customer acquisition strategies.[199] Location and proximity to portfolio companies are key factors for early-stage investors when assessing investment opportunities.[200] Likewise, the number of companies the investor can reasonably and actively advise constrains the number of their investments. As such, larger venture capital (VC) funds typically invest larger amounts in several later-stage companies, whereas smaller funds generally invest smaller amounts in a proportionate number of early-stage companies.[201]

A "fund of funds" model, in which a larger fund invests in smaller, regional funds, would mobilize capital previously reserved for late-stage investments and support smaller companies in aspiring startup hubs. The current limitations on exempt reporting advisers' qualifying investments render this model unworkable due to the competing demands on the 20 percent non-qualifying basket. This includes public offering obligations and secondary liquidity for founders.[202]

Congress should amend the "venture capital fund" definition under Rule 203(l)-1 of the Investment Advisers Act of 1940 to allow VC "fund of funds" investments by treating an investment in another VC fund—which meets the Rule 203(l)-1 requirements itself—as a "qualifying investment."[203] By allowing large VC funds deploying more capital to smaller funds, this change will facilitate a more diverse pool of VC funds providing capital to a more diverse pool of founders located outside of the usual VC and tech destinations.

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[197] *Id*.
[198] *Id*.
[199] *Id*.
[200] *Id*.
[201] *Id*.
[202] *Id*.
[203] *Id*.

- <u>Create a Micro-Offering Exemption</u>

  Micro-lending has a demonstrated track record around the world for providing much-needed capital to entrepreneurs—often women and minorities—in underbanked communities, helping them start and grow their businesses. Congress should use the micro-lending model to create a new micro-offering exemption free of mandated disclosures or offering filings to allow broader access to capital for emerging entrepreneurs and small businesses.[204] Moreover, small businesses should be permitted to raise up to a certain small-dollar threshold each year (e.g., $250,000 or $500,000). At same time any new exemption should subject applicants to the antifraud provisions of the Federal securities laws and disqualify bad actors to ensure investor protections.

  This exemption will be especially helpful for those small businesses hit particularly hard by the coronavirus and any shortage in bank lending. In 2020, minority entrepreneurs faced more pronounced difficulties in accessing debt financing, including loans, lines of credit, and cash advances.[205] Specifically, 49 percent of Black entrepreneurs were denied debt financing.[206] A simple and streamlined micro-offering exemption will reduce barriers to capital formation for underrepresented small businesses and entrepreneurs, many of which need different financing options than what is provided by traditional banks.[207]

- <u>Allow Equity Compensation for Gig Workers</u>

  Gig workers are the backbone of our technology-driven 21st century economy. Today, more than a quarter of the U.S. workforce participate in the gig economy or non-traditional work—whether that's as a rideshare driver, food delivery courier, or sharing their property through a platform like Airbnb—in some capacity. Additionally, about 5 percent of workers rely on alternative work arrangements, like gig work, for their primary source of income.[208] These workers represent an increasing number of Americans that do not want to be bound by constraints like an office, set hours, or a traditional employer-employee relationship.

  Congress should direct the SEC to expand Securities Act Rule 701 to include gig workers in the category of workers who are able to benefit from equity compensation, helping them share in our economic resurgence, while preserving the flexibility and independence that is so critical to Americans working in the gig economy. By giving these non-traditional workers access to equity compensation—just like traditional

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[204] Public Statement, Commissioner Hester M. Peirce, "40th Annual Government-Business Forum on Small Business Capital Formation," (May 24, 2021) *available at* https://www.sec.gov/news/public-statement/peirce-small-business-forum-20210524.
[205] *See* Office of the Advocate for Small Business Capital Formation, *supra* note 87.
[206] *Id.*
[207] Letter from Daniel B. Ravicher, Director, Startup Practicum, University of Miami School of Law, to File No. S7-08-19, at 2 (Sept. 24, 2019), https://www.sec.gov/comments/s7-08-19/s70819-6193336-192499.pdf.
[208] Katharine G. Abraham and Susan N. Houseman, *What Do We Know About Alternative Work Arrangements in the United States?*, W.E. Upjohn Institute for Employment Research (Jan. 5, 2022) at 42, *available at* https://research.upjohn.org/cgi/viewcontent.cgi?article=1275&context=reports.

employees—we can ensure they benefit from the growth of the companies they are making successful.

D. Additional Policies to Consider

- Exempt Finders Assisting Small Businesses with Capital Raising

Congress should direct the SEC to finalize its 2020 proposed exemption from broker registration requirements for "finders" who help issuers raise capital in private markets from accredited investors.[209] Finders help introduce investors to small businesses searching for capital. Finalizing this proposed exemption would set clear parameters around this activity that is crucial to small businesses.[210]

- Simplify the Registration Requirements for Small M&A Brokers

Congress should exempt merger and acquisition (M&A) brokers from registration under Section 15(b) of the Exchange Act, unless they fall into established disqualifying categories. M&A brokers provide crucial services to small businesses whose owners want to sell their businesses or merge with others so that their enterprises can continue to operate and grow; thus, preserving existing jobs and creating new jobs. This exemption would simplify the registration requirements for M&A brokers who otherwise pass these costs onto their small business clients.

- Business Development Company Enhancements

Congress should permit funds that invest 10 percent or less their total assets in acquired funds to omit the "acquired fees, funds, and expenses" (AFFE) line item in the fee table and instead disclose the amount of the fund's AFFE in a footnote to the fee table and fee summary. Cleaning up the AFFE table in Business Development Company (BDC) prospectuses would make the actual costs of investing clearer. This change would make BDCs—which invest in smaller and sometimes private companies—more attractive.

- Regulatory Impacts on Small Businesses

Congress should direct the SEC to update its definitions of "small entities" under the Regulatory Flexibility Act to ensure that the SEC more carefully accounts for impacts on small businesses when pursuing rulemakings.

- Crowdfunding Reforms

In implementing the Reg CF rulemaking, the SEC turned what had been few pages of legislative text into 685 pages of complicated rule release.[211] To simplify the

[209] *See* SEC Press Release 2020-248, *SEC Proposes Conditional Exemption for Finders Assisting Small Businesses with Capital Raising* (Oct. 7, 2020), *available at* https://www.sec.gov/news/press-release/2020-248. *See* also Public Statement, *supra* note 204.
[210] *See* Public Statement, *supra* note 204.
[211] *See* SEC Press Release 2015-249, *supra* note 31.

crowdfunding exemption and increase its usefulness, Congress should revise the crowdfunding statute to (1) preempt state securities law registration for secondary transactions; (2) clarify that crowdfunding portals are not to be treated as issuers for liability purposes (e.g., when a company raises money on the portal's platform and makes a misstatement); (3) clarify that crowdfunding portals do not have to comply with anti-money laundering (AML) requirements provided that they do not handle funds; and (4) permit crowdfunding portals to provide impersonal investment advice.