The JOBS Act: Did It Accomplish Its Goals?

Skadden

06/28/16

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Michael J. Zeidel
New York
212.735.3259
michael.zeidel@skadden.com

Kathleen A. Negri
New York
212.735.2411
kathleen.negri@skadden.com

Brittany L. Turner
New York
212.735.2198
brittany.turner@skadden.com

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

In the wake of the 2008 financial crisis, Congress created the Jumpstart Our Business Startups Act (JOBS Act) to encourage capital formation in order to grow businesses, create jobs and spur economic activity. Congress and the Securities and Exchange Commission (SEC) continue to monitor and update the JOBS Act rules to further achieve this goal. Since its enactment in 2012, the JOBS Act has succeeded in increasing market activity by easing regulatory requirements for smaller companies going public as well as companies raising capital in the private markets.

The Public Market

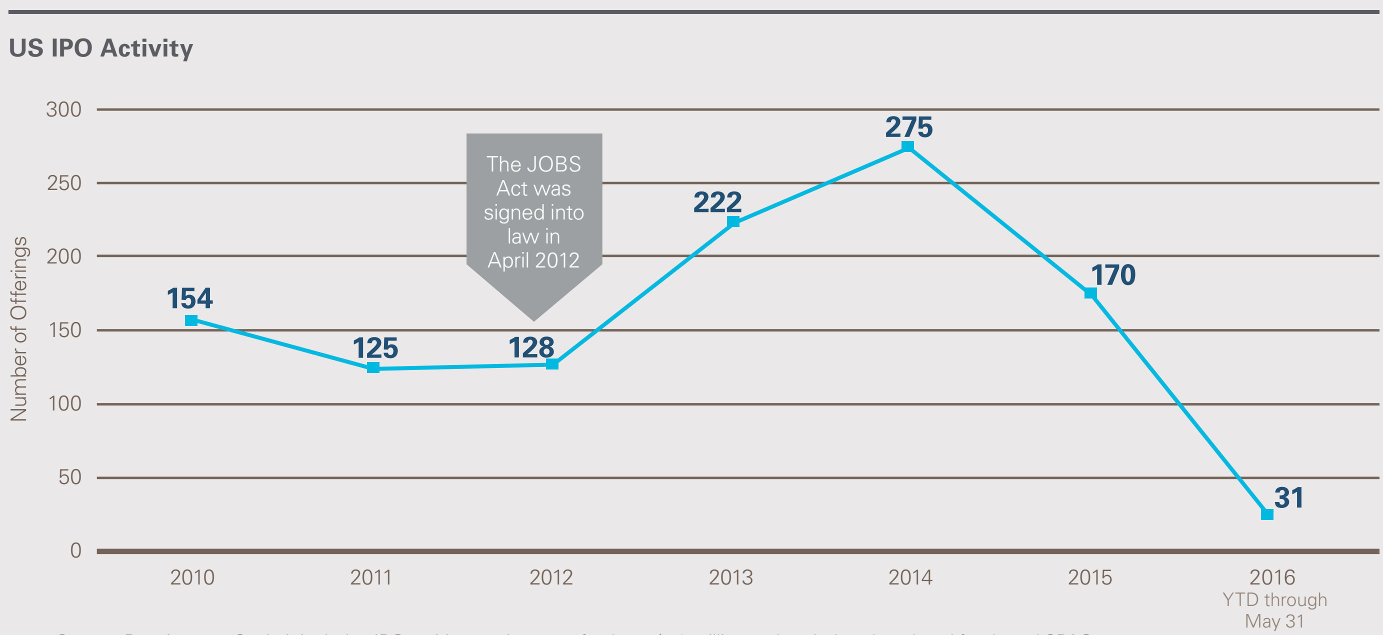
The JOBS Act encouraged economic activity in the public market by incentivizing smaller companies to go public. The "IPO On-Ramp" provisions in Title I of the JOBS Act created a category of emerging growth companies (EGCs), or issuers with less than $1 billion in annual gross revenue during their most recently completed fiscal year. The JOBS Act encourages initial public offerings (IPOs) by reducing various regulatory, disclosure and compliance requirements for EGCs during an IPO and for up to five years thereafter.

During an IPO, for example, EGCs may submit confidential draft registration statements to the SEC. This preserves an EGC's privacy during the SEC review process, protecting the company from its competitors and maintaining confidentiality if the EGC decides not to go public. An EGC's registration statement may omit certain disclosures otherwise required of issuers, particularly with respect to executive compensation and financial data. EGCs are permitted to disclose two (rather than three) years of audited financial statements and two (rather than five) years of selected financial data. EGCs also may "test the waters" or the receptiveness of the market by communicating with investors prior to the launch of the issuer's roadshow. After an EGC goes public, it continues to be subject to fewer regulations during the time it maintains its EGC status. For example, EGCs are exempt from mandatory audit firm rotation and are not subject to auditor attestation under Section 404 of the Sarbanes-Oxley Act of 2002 (SOX 404). Prior to the JOBS Act, SOX 404 was a significant disincentive to going public for smaller companies, as it required significant time, effort and expense.

EGCs have taken advantage of the new rules. Since the JOBS Act was enacted, through mid-2015, approximately 87 percent of EGCs that have gone public have confidentially submitted their registration statements, and 59 percent of EGCs that have gone public have disclosed two years of audited financial statements, according to the Ernst & Young report "The JOBS Act: 2015 Mid-Year Update." EGCs continue to selectively test the waters, allowing issuers and underwriters to better determine the best time to launch an IPO and better predict the potential success of that IPO. Nearly all EGCs take advantage of the reduced compensation disclosure requirements and flexibility of the SOX Section 404 exemption following their IPOs, according to the report. Despite initial concerns that the SOX Section 404 exemption as well as the reduced financial information would provide less investor protection, the exemptions have not scared investors from the market or resulted in any meaningful change in disclosure claims.

EGCs taking advantage of the reduced regulatory requirements notably have contributed to an increase in the number of IPOs. There were 275 IPOs in 2014, a 14-year high, according to Renaissance Capital's 2014 review. EGCs represented 85 percent of IPOs that have gone into effect since the JOBS Act's enactment through mid-2015, according to the Ernst & Young report. Though activity in the IPO market tempered in 2015 and significantly slowed in the first half of 2016, EGCs remain a high proportion of companies pricing IPOs, demonstrating the lasting effect of the JOBS Act on the public market.

The JOBS Act: Did It Accomplish Its Goals?



Source: Renaissance Capital. Includes IPOs with a market cap of at least $50 million and excludes closed-end funds and SPACs.

The Private Market

The JOBS Act also incentivizes capital formation in the private market. Several provisions of the law seek to jump-start the private markets by expanding the potential number of investors that companies may solicit and the amount of capital that may be raised privately, although critics argue that reduced regulation may have limited transparency and resulted in the loss of some investor protection. For example, Title II lifted the ban on general solicitation and advertising for a private placement under Rule 506 of Regulation D. Title III created an exemption for crowdfunding, allowing companies to gain access to large pools of investors who each contribute small amounts of capital. Title IV increased the amount that a small company could raise by selling shares to the public in a general solicitation without complying with registration requirements. Title V raised the number of shareholders of record that would trigger registration and reporting by a company from 500 shareholders of record to 2,000, so long as there are no more than 499 nonaccredited investors.

The goal of these JOBS Act provisions is to streamline companies' ability to raise capital privately. While the JOBS Act has affected the private market in some respects, there is still potential for future growth as issuers take increased advantage of the provisions. For example, private placements under Regulation D have increased in recent years; however, most issuers of unregistered securities did not use general solicitation as permitted by the JOBS Act, according to an SEC analysis. Crowdfunding has changed the way certain real estate platforms raise capital by giving smaller investors greater access to deals; still, real estate crowdfunding remains in its early stages. In addition, though many anticipated that the JOBS Act would encourage trading among institutional and sophisticated investors in a secondary market, this has yet to materialize in a meaningful way.

The JOBS Act has been successful in incentivizing pre-IPO financing rounds and providing companies with more flexibility in timing their IPOs, particularly as a result of the increase in the number of shareholders before a company is required to become a reporting company. The longer-term effects of some provisions are continuing to develop.

The Future of the JOBS Act

The SEC continues to monitor and update the JOBS Act rules. For example, in December 2015, the rules were relaxed to allow an EGC to begin its roadshow 15 calendar days after publicly filing its registration statement with the SEC, rather than the previous 21-calendar day waiting period. The SEC also is reviewing Regulation S-K to modernize certain business and financial disclosure. In June 2016, the SEC approved an interim final rule that allows Form 10-K filers to provide a summary of business and financial information contained in the annual report with links to more detailed disclosure. The SEC will continue to monitor and update the JOBS Act rules as necessary to achieve the goal of streamlining and encouraging capital formation while preserving investor protection.