Reopening American Capital Markets to Emerging Growth Companies Act of 2011

BACKGROUND SUMMARY

Create a new category of "Emerging Growth Companies." The bill would establish a new category of issuers, called "emerging growth companies," who have less than $1 billion in annual revenues at the time they register with the SEC and less than $700 million in public float after the IPO. These companies will have as many as five years (or until they reach $1 billion in annual revenue or $700 million in public float) to comply with certain regulatory requirements. "On-Ramp" status is designed to be temporary and transitional, encouraging small and medium-sized companies to go public but ensuring they transition to full compliance over time or as they grow. Only an estimated 11-13 percent of companies and 3 percent of total market capitalization would qualify for "on ramp" status if these provisions were in effect today.

Provide an "On-Ramp" for Emerging Growth Companies by Leveraging Existing Scaled Regulation Approach. The scaled regulations are limited to those areas of compliance that are high cost and which do not compromise core investor protections or disclosures, and all of them build on existing scaled regulations. These include:

Section 404(b) of Sarbanes-Oxley. This is the requirement that public companies pay an outside auditor, in addition to auditing the financial statements, to attest to the company's internal controls and procedures. SEC studies have shown that compliance with Sarbanes Oxley costs companies more than $2 million per year. All companies with market capitalization of less than $75 million are already exempt, because lawmakers and the SEC recognize the substantial burden this regulation imposes on smaller companies. CEOs and chief financial officers would still be required to personally certify that the internal controls and procedures are adequate, exposing them to personal liability. Others, including the president's Jobs Council, have proposed complete exemption from Section 404(b) for all companies with less than $1 billion of market capitalization – approximately 85 percent of all companies – so this proposal strikes a more balanced middle ground between investor protection and capital formation.

Limited Look-Back for Audited Financials. This bill would only require emerging growth companies to provide audited financial statements for the two years before registration, rather than three years. Full compliance would be phased in each year so a full five years of audited financials are required after three years.

Limited Exemptions from Executive Compensation Votes and Disclosures. The bill would also exempt emerging growth companies from the requirement to hold a stockholder vote on executive compensation arrangements, including so-called "golden parachutes." The SEC already recognized the additional burden these requirements impose on small issuers by giving them an additional year to comply with the new rules. Because the "say-on-pay" and related votes are only required to occur once every three years, this bill effectively only exempts companies from a maximum of two such votes. Furthermore, shareholders in venture-backed companies are likely to be well-protected as a result of the terms negotiated by venture capital investors and the fact that founders and senior executives are often large shareholders themselves, ensuring interests are aligned.

Improve the Availability and Flow of Information for Investors. To increase visibility for emerging growth companies while maintaining transparency and consistency for investors, the bill would improve the flow of information about emerging growth companies to investors before and after an IPO. The proposals would update restrictions on communications to account for advances in modes of communication and the information available to investors. In particular, the bill would:

Close the Information Gap for Smaller Companies. Existing rules allow research on large companies to be provided continuously, but prohibit investment banks participating in the underwriting process from publishing research on emerging growth companies. This bill would allow investors to have access to research reports about emerging growth companies prior to the IPO. However, the bill would maintain other extensive protections in this area, such as Sarbanes Oxley Section 501 (addressing potential conflicts of interest that can arise when analysts recommend equity securities), SEC Regulation AC, the Global Research Analyst Settlement and disclosure requirements regarding potential conflicts of interest. These changes would address the current information shortfall by providing a way for investors to obtain research about IPO candidates in a manner consistent with investor protection.

Permit Emerging Growth Companies to "Test the Waters" Prior to Filing a Registration Statement. The bill would permit emerging growth companies to gauge preliminary interest in a potential offering by expanding the range of permissible pre-filing communications to institutional investors, and filing a registration statement with the SEC on a confidential basis (which non-U.S. companies are currently permitted to do). This would help emerging growth companies determine the likelihood of a successful IPO, but general solicitation would still be prohibited, as would any expanded communications to retail investors. Anti-fraud provisions of the securities laws would still apply, and a prospectus would still be required prior to any sale.

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