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“Spurring Job Growth Through Capital Formation While Protecting Investors”

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Chairman Johnson, Ranking Member Shelby, Members of the Committee: My name is Scott Cutler, Executive Vice President of NYSE Euronext – the world's leading and most diverse exchange group with equities, futures and options markets throughout the United States and Europe. I appreciate the opportunity to testify today regarding ways to stimulate job growth and innovation through capital formation while protecting investors.

Young, innovative, emerging growth companies are the engines of job creation, and access to capital through initial public offerings is key to allowing these innovative companies to grow and hire new employees. From 1980 to 2005, firms less than five years old accounted for all net job growth in the U.S. For those companies that "go public," 92% of job growth occurs after the company's IPO, and most of that within the first five years after the IPO.[1] Clearly, an IPO provides these young and growing companies an opportunity to expand their business and hire more workers.

Our public markets provide significant benefits for issuers, investors and our economy. Public companies obtain permanent access to capital, the ability to reach the deepest pool of both institutional and retail investors, and the power to use their stock as currency for future acquisitions. Founders, employees and public shareholders obtain liquidity for their investments and the opportunity to transact in real-time, in a transparent and well-regulated market that provides extensive issuer disclosures while protecting both buyers and sellers. It is this symbiotic relationship between issuers and investors that make our markets function so well.

However, over the past decade, the number of young companies going public has declined significantly, and the age of companies at the point of their IPO has increased. While in 1996, there were 761 companies that underwent an IPO, an average of fewer than 157 companies went public per year between 2001 and 2008, and the number remains well below historical norms. At the same time, the average age of a company at the time of its IPO has increased from five and a half years during the period from 1997 to 2001, to nine years from 2006 to 2011.[2]

Rather than pursue an IPO, early investors have shifted toward gaining liquidity for their investment by selling their young companies to larger enterprises. While in 1991, about 90% of venture investor

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[1] Venture Impact Study 2010 by IHS Global Insight. http://www.nvca.org/index.php?option=com_content&view=article&id=255&Itemid=103.

[2] Rebuilding the IPO On-Ramp: Putting Emerging Companies and the Job Market Back on the Road to Growth, page 6. http://www.nvca.org/index.php?option=com_docman&task=doc_download&gid=805&Itemid=93.

exits occurred through an IPO and about 10% through a merger and acquisition (M&A) event, this trend has completely reversed in recent years: in 2010, about 80% of exits were through M&A compared to 20% through an IPO.[3] This shift is critically important because an M&A event does not generally produce the same job rapid growth as an IPO, and often results in job losses over the short term as the acquirer eliminates redundant positions.

The movement away from IPOs has been driven in large part by burdensome regulatory hurdles. In particular, extensive regulatory reporting requirements in order to go public and remain a public company have increased the cost of going public. This is a significant barrier that every CEO we meet highlights as an obstacle to pursuing an IPO.

At the same time, regulatory requirements have also limited the amount of research about these emerging companies available to investors, constraining investor interest. We believe that additional research enhances investors' understanding of emerging companies and facilitates the demand side of the equation.

Removing these barriers to going public is critical to unlocking emerging growth companies' job creation potential.

Several members of this Committee have taken the lead on a bill, the Reopening American Capital Markets to Emerging Growth Companies Act of 2011, which would significantly reduce the obstacles that prevent emerging growth companies from going public—and accessing the capital to hire more employees—while maintaining important investor protections. The bill would tackle both sides of the equation: addressing companies' reduced interest in an IPO due to the costs of going public, while facilitating the sharing of information with investors to stimulate awareness and demand.

The bill would create a transitional category of companies pursuing an IPO called "emerging growth companies." This category would generally include those companies pursuing an IPO that have less than $1 billion in annual revenue and less than $700 million in public float (common equity held by non-affiliates) and would not affect any company that has already completed its IPO. For this small number of emerging growth companies, certain disclosure and other public company regulatory requirements would be reduced or phased-in, thus lowering the costs associated with an IPO and complying with public company requirements. The maximum phase-in period would be five years

[3] Ibid at 7.

from the IPO date (with the phase-in being eliminated earlier if a company reached the $1 billion in revenue or $700 million in public float levels). In particular:

- Emerging growth companies would have scaled-back financial information requirements and scaled-back requirements in their “Management’s Discussion and Analysis” and “Executive Compensation” disclosures. Many of these scaled-back requirements are already permitted for microcap companies with less than $75 million of public float.

- One of the largest expenses associated with becoming a public company is the cost of complying with the requirement to obtain an auditor attestation of a company’s internal controls over financial reporting, under Section 404(b) of the Sarbanes-Oxley Act. The bill would phase-in this requirement, giving emerging growth companies the chance to go public, expand and hire before incurring this expense.

At the same time, emerging growth companies would be able to “test the waters” to gauge investor interest and provide more research information to prospective investors:

- Many emerging growth companies may consider an IPO, but are unsure of whether there is sufficient investor interest. Because current law makes it difficult for companies to test the waters and gauge interest before actually undergoing the expense of preparing an IPO registration statement, companies may forgo an IPO altogether. The bill would allow these pre-IPO companies to communicate with sophisticated investors about a potential IPO, and consider the probability of an IPO’s success, before undergoing the expense of preparing a registration statement.

- On the other side of the equation, restrictions on investment banks providing research coverage on emerging growth companies undergoing an IPO have limited investors’ ability to obtain information—and thus their ability to assess whether to invest in an emerging growth company. The bill would improve the availability and flow of research coverage by scaling back regulatory restrictions that prevent such coverage.

By phasing-in some of the more expensive regulatory requirements of being a public company, and scaling back restrictions on research coverage, the bill will allow more emerging growth companies to access the public capital markets, finance their growth and create more American jobs. Our system of securities regulation, including the robust disclosures required of large or seasoned public companies, would be maintained—while the largest obstacles preventing our most promising young companies from growing and hiring would be removed.

While this bill would remove roadblocks from accessing the public markets for emerging growth companies, the extensive process of SEC registration may still be overly burdensome and expensive for some smaller companies and start-ups, who need a method of raising smaller amounts of capital through a less restrictive and less expensive process. I would therefore also like to comment on a number of other legislative proposals.

I applaud the House for passing H.R. 1070, the Small Company Capital Formation Act of 2011, and commend Senators Tester and Toomey for their leadership on this issue in the Senate. I encourage the Committee to pass S. 1544 as well. This bill would expand the size of offerings eligible to use the scaled-back process for publicly offering securities under Regulation A for small public offerings, from $5 million to $50 million. This would help small companies access public capital and grow their businesses without the more extensive undertaking and expense of full registration under the Securities Act. At the same time, investors are protected as Regulation A securities are traded in the light of the public markets and investors are provided with significant disclosure regarding each issuer.

In contrast to the well-regulated and transparent public markets, private markets provide investors with much less protection, with reduced or no disclosure about the private issuers in which they invest, and low levels of liquidity. These private markets have an appropriate role in addressing capital and liquidity needs for certain issuers and shareholders, and we support methods of private capital formation that facilitate growth while, importantly, protecting investors. In particular, existing law appropriately balances the interest in fostering these transactions with investor protection concerns. For example, the Regulation D private placement safe harbor permits sales to accredited investors without the need to provide information, but prohibits general solicitation, limits the number of non-accredited investors and requires that specified information be provided to non-accredited investors. Because not all accredited investors are necessarily sophisticated, the prohibition on general solicitation ensures that investors who do not have any relationship with the issuer or its placement agent are not drawn in through public advertisements.

While technological advancements have caused a proliferation of private platforms to match buyers and sellers of private stock, investor protection concerns such as the lack of transparency, disclosure and liquidity in these markets should be addressed as these markets expand to a larger set of investors. Investments in private companies are highly risky, with significantly greater risk than investing in the public markets, and historically have been limited to investors that can understand, evaluate, and financially bear these additional risks. I therefore have concerns about legislative proposals that could open up these markets in private companies to a larger set of investors without additional investor protection measures. Any proposal to greatly expand the role of private markets must require either: (1) a high level of investor sophistication and a relationship with the issuer or its placement agent such that the investor can consider and understand the risks of the company in which he or she invests, or (2) a sufficient and uniform amount of disclosure so less sophisticated investors understand what they are investing in.

Two recent legislative proposals need to be considered against these threshold criteria. H.R. 2940, the Access to Capital for Job Creators Act, would remove the requirement under Section 4(2) of the Securities Act and Rule 506 of Regulation D that, in order to qualify for an exemption from registration as a private placement (a transaction "not involving any public offering"), there be no general solicitation. The restriction on general solicitation has been a core feature of the private placement exemption since the first court interpretations of Section 4(2), and is an important safeguard to avoid fraud against investors. The restriction on general solicitation is the key limitation which protects the general public from being drawn into the private markets—a market that by its very nature has a high level of risk not suitable for most investors, and does not provide the real-time liquidity of public markets. In fact, in connection with another exemption under Regulation D, Rule 504 (which permits certain offerings of $1 million or less in reliance on state "blue sky" laws), the SEC found that instances of fraud greatly increased when it relaxed the prohibition on general solicitation. As a result, the SEC found it needed to reinstate into Rule 504 elements of the prohibition on general solicitation to prevent the abuses which it can cause.[4]

Additionally, any proposed exemption from registration for "crowdfunding" offerings also needs careful consideration. Allowing entrepreneurs to raise capital through crowdfunding is an important step to encourage new business and growth, however, important investor protections are needed. These types of investments are very risky, and because they may be offered through a general solicitation, less sophisticated investors may be drawn in. Any crowdfunding exemption should therefore include a low limit on total offering size, a low limit on the amount any individual can invest (such as $1,000), and require that issuers disclose sufficient information to ensure that investors understand what they are purchasing.

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[4] SEC Release No. 33-7644 (Feb. 25, 1999).

The Committee also asked me to comment on pending legislative proposals to increase the number of shareholders a private company may have before being required to publicly disclose information. We support a measured increase from the current 500 shareholder level, but believe that public policy concerns regarding shareholder access to information should limit the size of the increase. In particular, we support H.R. 2167, the Private Company Flexibility and Growth Act, which would increase the level to 1,000 shareholders while excluding from the count current or former employees that were issued shares as compensation.

In closing, I applaud the Committee’s focus on finding ways to encourage job creation through facilitating capital formation. The reforms contained in the Reopening American Capital Markets to Emerging Growth Companies Act of 2011 reflect a measured approach that would remove the major roadblocks preventing emerging growth companies from raising capital in the public, transparent markets, while avoiding the potential for fraud and investor abuse that may arise from opening up the illiquid and private markets to average investors.

I appreciate the opportunity to testify before the Committee today and am happy to answer any questions you may have.