

# The SEC (Sort of) Extends EGC Benefits to All Issuers

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On June 29, 2017, the Securities and Exchange Commission (“SEC”) extended to all issuers some of the benefits that Congress granted to emerging growth companies (“EGCs”)<sup>1</sup> in 2012 under the Jumpstart Our Business Startups Act (the “JOBS Act”).<sup>2</sup>

By way of background, the JOBS Act effectively created a two-tiered system for US IPOs, easing the path for EGCs to become public companies while maintaining restrictions for non-EGCs. A portion of the relief involved relaxing disclosure requirements that required investments of time and resources that were arguably not commensurate with the related benefits to investors in smaller companies. However, other areas of relief—notably those related to the IPO process itself—had no clear rationale based on the size of the issuer. The SEC’s June 29, 2017 announcement goes some way towards addressing this disparity with respect to the offering process. However, as outlined below, additional work for the SEC remains in order to finish the job of levelling the playing field between EGCs and non-EGCs with respect to the IPO process.

## SEC Relief for IPOs of non-EGCs

### Confidential Submission

The SEC is allowing two new groups of companies to submit their initial registration statements confidentially in draft form and maintain that confidentiality until 15 days before a roadshow or, if there is no roadshow, 15 days prior to the effective date of the registration statement. The first group is non-EGCs. This effectively permits all issuers to submit IPO registration statements confidentially. The second group is companies filing a registration statement under the Securities Exchange Act of 1934 (the “Exchange Act”). This would include, for example, foreign private issuers traded overseas and seeking to list on the New York Stock Exchange or Nasdaq in a non-capital-raising transaction by means of a direct listing or a Level II ADR program.

The SEC clarified in FAQs that the confidentiality provisions of Section 6(e)(2) of the Securities Act of 1933 (the “Securities Act”) are specifically limited to draft registration statements of EGCs.<sup>3</sup> Accordingly, the SEC has reminded non-EGCs using this method of submission that they should consider the use of SEC Rule 83 when submitting registration statements and related correspondence confidentially. This rule requires the SEC to notify the filer if it receives a Freedom of Information Act (“FOIA”) request with respect to the registration

<sup>1</sup> An “emerging growth company” is defined as an issuer with “total annual gross revenues” of less than US\$1.07 billion (after recent upward adjustment for inflation) during its most recently completed fiscal year.

<sup>2</sup> See Draft Registration Statement Processing Procedures Expanded, dated June 29, 2017 available at <https://www.sec.gov/corpfin/announcement/draft-registration-statement-processing-procedures-expanded>.

<sup>3</sup> See Question 2, Voluntary Submission of Draft Registration Statements – FAQs, issued June 30, 2017, Question 4, Jumpstart Our Business Startups Act Frequently Asked Questions, Confidential Submission Process for Emerging Growth Companies, issued December 21, 2015 (revised) and Question 26, Jumpstart Our Business Startups Act Frequently Asked Questions, Generally Applicable Questions on Title I of the JOBS Act, issued December 21, 2015 (revised).

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statement and provides the filer with an opportunity to seek confidential treatment for relevant portions of the filing and related correspondence.

A non-EGC seeking to submit confidentially should include a legend at the top of each page of the electronically submitted draft registration statement indicating that it has requested confidentiality. In addition, in its responses to SEC comments, an issuer should identify any information in the registration statement for which it intends to seek confidential treatment upon public filing to ensure that the SEC does not include such information in its comment letters. The SEC reiterated in FAQs that, consistent with its practice in all filing reviews, the staff will publicly release its comment letters and issuer responses to staff comment letters on EDGAR no earlier than 20 business days following the effective date of a registration statement.<sup>4</sup>

The SEC also clarified in FAQs that a filing fee is still due only when the registration statement is first publicly filed on EDGAR.<sup>5</sup> The voluntary submission of a draft registration statement is not considered a “filing” so no fee is due at that time. Furthermore, a submission of a draft registration statement is not required to be signed by the registrant or by any of its officers or directors, nor is it required to include the consent of auditors and other experts, as it is not filed with the SEC.<sup>6</sup> In addition, an issuer submitting a draft registration statement for non-public review may not make a public announcement about its offering in reliance on the Rule 134 safe harbor but may use the Rule 135 safe harbor instead.<sup>7</sup>

### Non-Required Financial Statements

The SEC will accept and review a registration statement that omits financial statements and related information that the issuer reasonably believes will not be required *at the time the registration statement is publicly filed*. This is similar—but not identical—to the relief provided under the December 2015 Fixing America’s Surface Transportation Act (the “Fast Act”) which allowed EGCs to omit financial information that relates to a historical period that the issuer reasonably believes will not be required to be included *at the time of the contemplated offering*. The reason for the slight difference is unclear, but is potentially meaningful for non-EGCs that decide to make an early public filing of their registration statement in order to be able to test the waters with investors (see discussion below).

## SEC Relief for All Companies in 12 Months Following IPOs

The SEC is allowing all companies to submit a registration statement confidentially during the 12 months following effectiveness of an IPO registration statement or the initial Exchange Act registration statement. Such confidentiality can be maintained until 48 hours before the requested effective time of the registration statement at which time the registration statement must be filed publicly on EDGAR. However, the ability of such companies to submit a registration statement confidentiality applies only to the first filing while any second filing—for example to make amendments to respond to SEC comments—must be public.

The ability to submit a registration statement confidentiality for the 12 months following effectiveness of an initial registration statement is a welcome development for issuers, but the limitation to only the first submission of a registration statement may result in issuers seeking to avoid filing an amendment to a registration statement selected for review and, instead, they may try to respond to SEC comments via correspondence filings only. Moreover, the SEC relief results in disparate treatment for a company whose registration statement is selected for review and one that is not—something that is not within an issuer’s control. For this reason, it is hoped that the SEC will extend its relief to all filings until, for example, 48 hours before the effective date.

It is also hoped that the SEC will extend the ability to file confidentially beyond 12 months. The 12-month period is roughly coterminous with the date on which an issuer would presumptively become eligible to file a

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<sup>4</sup> See Question 11, Voluntary Submission of Draft Registration Statements – FAQs, issued June 30, 2017.

<sup>5</sup> See Question 10, Voluntary Submission of Draft Registration Statements – FAQs, issued June 30, 2017.

<sup>6</sup> See Question 8 and Question 9, Voluntary Submission of Draft Registration Statements – FAQs, issued June 30, 2017.

<sup>7</sup> See Question 17 and Question 18, Voluntary Submission of Draft Registration Statements – FAQs, issued June 30, 2017.

Form S-3 or F-3.<sup>8</sup> An issuer that has more than US\$700 million in unaffiliated public float at that time would likely be a well-known seasoned issuer (“WKSI”), and such Form S-3 or F-3 would be automatically effective, thereby removing the potential market impact of filing a registration statement and having to wait to learn whether the SEC intends to review it or not. However, for Form S-3 or F-3 issuers that are not WKSI, the ability to file confidentially initially while learning whether the SEC intends to review the filing, as well as during any review process, could meaningfully reduce any adverse market impact. This challenge is even more pronounced for issuers that are eligible to use a Form S-3 or F-3, but are subject to the “baby shelf” rules (i.e., Form S-3 or F-3 eligibility rules applicable to issuers with an unaffiliated public float of less than US\$75 million undertaking a primary capital raise), and may therefore have to use a Form S-1 or F-1 to achieve their desired offering size. A broader extension of the ability to submit confidentially would likely be appreciated by issuers as it would aid capital formation without adversely impacting investors.

## Outcome of SEC Relief

The following chart sets out the interplay between various offering-related requirements and relief therefrom in light of the recently announced SEC relief:

|  | Securities Act Registration |                               | Exchange Act Registration <sup>9</sup> |
|--|-----------------------------|-------------------------------|--|
|  | EGC                         | Non-EGC                       |  |
| <b>Confidential filing</b>   | ✓<br>(pursuant to JOBS Act) | ✓<br>(pursuant to SEC relief) | ✓<br>(pursuant to SEC relief)          |
| <b>Two (not three) years of financial statements</b>   | ✓<br>(pursuant to JOBS Act) | ✗                             | ✗                                      |
| <b>Omission of financial statements not reasonably expected to be necessary at the time of public filing</b> | ✓<br>(pursuant to FAST Act) | ✓<br>(pursuant to SEC relief) | ✓<br>(pursuant to SEC relief)          |
| <b>Ability to “test the waters” with investors</b>   | ✓<br>(pursuant to JOBS Act) | ✗                             | n/a                                    |
| <b>Ability of syndicate members to publish pre-IPO research</b>  | ✓<br>(pursuant to JOBS Act) | ✗                             | n/a                                    |
| <b>Ability of a research analyst to attend a pitch meeting for an IPO</b>                                    | ✓<br>(pursuant to JOBS Act) | ✗                             | n/a                                    |

As indicated in the chart, the SEC relief with respect to Exchange Act registration statements only extends to filing confidentially and does not reduce the number of years of financial statements required for filers that would technically qualify as an EGC if they filed a Securities Act registration statement.<sup>10</sup> US filers of Exchange Act registration statements must still include three years of audited financial statements even if they are an EGC and foreign private issuers are permitted to include only two years if they are US GAAP and not IFRS reporting companies.<sup>11</sup> This highlights an incongruity in extending the benefit of confidential filing to filers

<sup>8</sup> Form S-3 and F-3 eligibility commences at the end of the 12th complete calendar month after a company becomes subject to Exchange Act reporting obligations subject to the company being current with its filings and having filed required filings during that period.

<sup>9</sup> No distinction is drawn between EGCs and non-EGCs in connection with the filing of an Exchange Act registration statement since JOBS Act benefits are expressly tied to filing a registration statement under the Securities Act.

<sup>10</sup> Section 7(a)(2)(A) of the Securities Act mandating only two years of financial statements for EGCs, which was added by the JOBS Act, does not make a parallel change to the Exchange Act.

<sup>11</sup> See paragraph 3 of Instructions to Item 8.A.2 of Form 20-F.

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of Exchange Act registration statements while still requiring three years of audited financial statements. It is hoped that this difference and the different treatment of US GAAP and IFRS could be addressed by the SEC in subsequent initiatives.

## Time to Level the Playing Field Entirely

Given the SEC's efforts to level the playing field, there remains a fundamental question as to why the United States has meaningfully different restrictions applicable to IPOs by EGCs compared to those by other issuers. It is important to note that since the beginning of 2016 through the date of the SEC relief, there were 206 IPOs in the United States of which 180 were by EGCs and only 26 were by non-EGCs. Those non-EGCs did not have the benefit, for example, of being able to test the waters through early interactions with investors and, instead, had to wait until the first public filing of their registration statement. The challenges faced by non-EGCs are potentially exacerbated because of the SEC's new relief allowing non-EGCs to delay publicly filing their registration statement in the same manner as EGCs. There does not appear to be a strong policy reason why a non-EGC taking advantage of that relief should not be able to test the waters like an EGC.

One might argue that disparate treatment of EGCs and non-EGCs is unimportant since non-EGCs appear to be able to raise capital irrespective of these limitations. However, other leading IPO jurisdictions—London and Hong Kong in particular—have no meaningful restrictions on early engagement with investors. This affords large issuers the ability to enhance deal certainty through early investor interactions. These jurisdictions also permit early publication of research by analysts in order to facilitate investor education. First, such a regime enables the investment bank to reach a larger number of potential investors than individual analysts can reach in a US IPO. This is because, in the absence of published research, sell-side analysts from the IPO syndicate have to call potential investors and discuss their views one-on-one. Second, because research in these jurisdictions can be published before the roadshow, the issuer and underwriters are able to better assess the appropriate price range with greater certainty.

The JOBS Act sought to facilitate the publication of pre-IPO research solely with respect to EGCs in an effort to achieve the goals of enhanced investor education and price certainty. However, in the United States, where 8.4% of the companies comprising the S&P 500 became subject to a securities class action claim during 2016<sup>12</sup> and where issuers and underwriters seek to avoid inclusion of projections in IPO prospectuses, it is easy to understand why investment banks are not willing to take the risk of liability that they may face in the US through publication of pre-deal research. Encouraging the publication of pre-deal research will likely require securities class action liability reforms that go beyond what the SEC can achieve through rulemaking and probably what Congress can achieve politically.<sup>13</sup> That being said, the other areas of the JOBS Act related to the IPO offerings process, particularly testing the waters with investors, could be addressed through SEC rulemaking. Accordingly, the SEC will have to do additional work to the extent its goal is to ease capital formation by non-EGCs as well as EGCs.

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<sup>12</sup> See Securities Class Action Filings, 2016 Year in Review, Cornerstone Research, available at <http://securities.stanford.edu/research-reports/1996-2016/Cornerstone-Research-Securities-Class-Action-Filings-2016-YIR.pdf>.

<sup>13</sup> Underwriters have also sought to avoid distribution of research for 25 days after an IPO in order to avoid any conflict with prospectus delivery requirements during that period.