Portfolio Media. Inc. | 111 West 19th Street, 5th Floor | New York, NY 10011 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

A Less Verbose SEC Means IPOs Are Cleared More Quickly

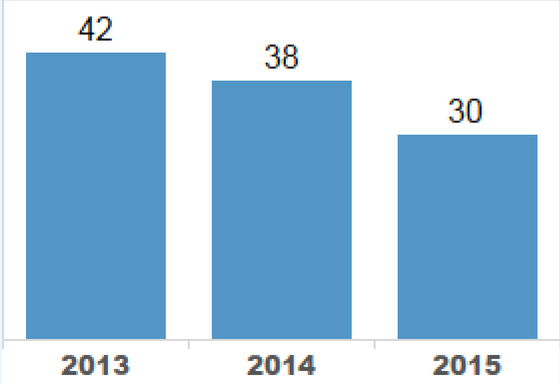
By **Tom Zanki**

Law360, New York (March 18, 2016, 3:44 PM ET) -- As the initial public offerings landscape continues to be wracked by delays amid market volatility, capital markets attorneys say one part of the process is actually quickening — companies are moving through the U.S. Securities and Exchange Commission's review faster as regulators pare down and sharpen the focus of their comments.

Lawyers welcome the shift toward greater economy, a trend that new data shows has been underway for years. Attorneys note that SEC comments have become more focused on substantive matters specific to companies, and, rather than recite standard laundry lists, they take better account of varying dynamics facing different industries.

Less Talk

The past three years have seen a 29 percent decline in the average number of first-round comments by the SEC when reviewing initial public offerings.



Source: Proskauer Rose

"I feel like the comments from the staff have been getting smarter," Kirkland & Ellis LLP partner Joshua Korff said. "They have been focusing in on the real important issues. There's more thought being put into the comments than simply giving us a ton of comments."

A recent analysis by Proskauer Rose LLP shows that the average number of number of first-round comments by SEC staff when reviewing IPOs declined 29 percent over the past three years, falling from 42 in 2013 to 30 in 2015. Attorneys say the figures, based on a survey of 309 IPOs drawn from Proskauer's proprietary database, would reflect a larger drop if measured over a longer time.

"If we had started this study 10 years ago, I think we would have found a dramatic decrease in the number of SEC comments," Proskauer partner Philippa Bond said. "There was a time when 200 SEC comments in the first round of an IPO wasn't that unusual."

Attorneys say the reasons include counsel's becoming savvier in anticipating comments as well as more efficiency — at least with words — from the SEC itself. That's not to suggest the IPO process is a snap, but lawyers say the agency is playing a more constructive role when resolving comments to not drag out offerings.

“The IPO process as a general matter has become more efficient, more focused," Debevoise & Plimpton LLP partner Matthew Kaplan said. "I think the SEC is more attuned to the fact that issuers that come into the SEC may need to take advantage of narrow market windows. The SEC is not going to give an issuer a pass just so they can take advantage of a market window, but I think the SEC recognizes the fact that a more efficient and cooperative process yields a better result for all market participants.”

The SEC declined to comment on the matter.

Kaplan said the general thrust follows Congress' prodding as well as the SEC's own streamlining in response to concerns that regulatory burdens were hindering competitiveness of U.S. capital markets. He noted that the past two directors of the SEC’s Division of Corporation Finance, which oversees disclosures to investors, urged staff to avoid issuing “off the shelf” comments and focus instead on substantive questions targeted to a particular disclosure.

"I think there was a recognition in some quarters, including at the SEC, that we needed to become a leaner and more efficient capital markets destination,” Kaplan said.

At the same time, attorneys say issuers and their counsels are more effectively anticipating SEC comments, which are published on the Edgar database. As technology makes such information available more rapidly, lawyers can better access SEC comment letters for comparable companies when preparing documents for a client.

“It’s very easy for us, when we are drafting these registration statements, to foresee what comments we might receive and deal with them up front,” Korff said.

Comparing Apples and Oranges

Attorneys who advise on public offerings say recent SEC comments tend to better reflect specific characteristics of individual companies and their sectors than in years past. The pattern bears out in the different nature of comments that certain industries receive — whether biotech or telecommunications — during their correspondence with regulators.

“I think this is ultimately a good thing because it means both the regulators and the issuers are focused on the items that are germane to that sector,” Bond said.

Proskauer’s study notes that IPOs most scrutinized for “revenue recognition” — an accounting principle that determines when income is realized as revenue — occur in technology, media and telecommunications, or the TMT sector. The firm attributes that trend to distinct contractual arrangements used by companies in those industries, including nonfinancial metrics to estimate market size, such as website views.

But health care-related companies are more often a magnet for “cheap stock” comments, which relate to the difference in valuation of pre-IPO equity grants and a company’s expected IPO price.

Life sciences companies are more likely to rely on pre-IPO equity grants to recruit employees because many of those businesses, focused on developing costly drugs, have yet to gain approval for their products and achieve recurring revenue. According to Proskauer, 73 percent of health care IPOs in 2015 received cheap stock comments.

But health care companies as a whole received only 24 first-round comments on average, the fewest among six categories measured in the Proskauer study. Health care firms also zipped through the SEC process from first submission or filing to pricing in 118 days, leading all other industries. Financial services companies received the most first-round comments on average with 46 and took 194 days to price.

Attorneys who work on life sciences offerings say the smaller comment total in health care is not a surprise given that many SEC comments focus on financial statements, an area where young biotechs have little history.

“If you pick up a prospectus for an early-stage life sciences company, the piece that would get the bulk of staff comments in other industries, the financials, they’re very basic, not much to comment on,” Covington & Burling LLP partner Donald Murray said.

Less Talk, But Less Action

Despite the fewer SEC comments, initial public offerings are taking longer to price. Proskauer reports that the average time from filing or first submission to pricing increased to 149 days in 2015, compared with 124 days in 2014.

But attorneys aren’t singling out regulators for that delay, noting the increased volatility of capital markets over the past year has made it harder to determine valuations. That trend has carried into 2016, which has seen only seven IPOs price while many companies have delayed or withdrawn plans.

"In at least some cases we would chalk that up to more difficult market conditions as opposed to greater difficulty clearing the SEC,” Bond said.

Kaplan said other factors can also play a role in delaying pricings, including the increased frequency of “dual-track” IPOs, where a company simultaneously auctions itself for sale then chooses the better outcome. If a company isn’t happy with the acquisition bids, it can still pursue the IPO, but the process will likely have taken longer.

The exact impact of dual-track IPOs is unknown since the M&A process is confidential.

--Editing by Jeremy Barker and Edrienne Su.