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# Clayton's Bid To Revive Public Markets Off To Modest Start

By **Tom Zanki**

*Law360, New York (January 1, 2018, 3:04 PM EST)* -- U.S. Securities and Exchange Commission Chairman Jay Clayton's efforts to make U.S. public markets more attractive — and reverse a perceived drought in initial public offerings — have produced incremental results so far, attorneys say, likely laying the basis for more gradual reforms ahead.

Clayton, who arrived at the SEC with the stated priority of facilitating capital formation, one of the agency's core functions along with investor protection and maintaining orderly markets, has taken steps toward achieving that goal. Under Clayton's watch, the SEC so far has broadened the privilege of confidential IPO filings to all issuers and made marginal reductions to disclosure requirements.

Capital markets attorneys say the issuer-friendly tone is welcome, albeit unlikely to spur more public companies. Just how much regulation plays a role in deterring companies from going public is debatable, lawyers say, plus the fact that the SEC was shorthanded until recently made it harder to pursue bolder policy shifts.

"There is a new attitude we see, but it hasn't blossomed yet because of the composition of the commission," said Davis Polk & Wardwell LLP partner Joseph Hall, referring to the fact that the five-commissioner SEC operated with only three commissioners for the past two years.

President Donald Trump's nominees to fill two SEC commissioner vacancies, Republican Hester Peirce and Democrat Robert Jackson, were approved on Dec. 21 by the Senate, bringing the SEC back to a full slate for the first time since 2015. With a full deck at hand, deal-makers expect Clayton will push for additional measures that would entice more companies to go public.

"It's no secret that he has capital formation, especially for smaller companies, in the middle of his gun sight," Covington & Burling LLP partner Donald Murray said. "I think that we will see a thoughtful, continuous series of steps in toward lessening the burden, particularly of IPOs."

During confirmation hearings before the Senate Banking Committee in May, Clayton lamented a decadeslong decline in IPOs on grounds that ordinary retail investors are missing opportunities to benefit from the growth of emerging companies, many of which are staying private for longer periods. To that end, Clayton said he wanted to make it less burdensome for companies to go and stay public.

Clayton's SEC in June expanded confidential IPO filings, a right previously limited to smaller so-called "emerging growth companies" that make up the bulk of IPO applicants, to all issuers. Confidential filings allow companies to keep IPO submissions under wraps with regulators until that company is ready to launch a marketing roadshow — the idea being that companies will feel freer to start the IPO process if they know they can shelve plans without divulging information to their competitors or suffering the public embarrassment of a withdrawn offering.

Confidential filings have been widely used by emerging growth companies since the benefit was established by the Jumpstart Our Business Startups Act of 2012, legislation that Clayton has praised. Lawyers say the benefit alone doesn't prompt a company go public, but it can make the IPO process less intimidating.

"That has absolutely given issuers more flexibility," said Simpson Thacher & Bartlett LLP partner Roxane Reardon, adding that the confidentiality benefit is "not a game-changer; it’s much more of a facilitator."

Clayton's SEC has also tweaked policy to allow confidential filers the right to omit certain, interim financial statements that could become outdated by the time a company publicly files its IPO so long as that company’s ultimate public filing is fully up to date.

At the behest of Congress, the SEC has recently proposed streamlining Regulation S-K, a body of rules that lays out reporting requirements for public companies. The agency in October put forth a plan that would trim and modernize certain disclosure requirements, mostly technical adjustments aimed at eliminating paperwork considered duplicative or immaterial.

"All of that is great, but I don't think it moves the needle in terms of somebody's decision whether to remain private or go public," said Hall, a former aide to past Republican SEC Chairman William Donaldson.

Exactly how much regulators can do to prod companies to go public is debated, given larger market dynamics, including the growth of private capital sources, that have resulted in fewer listed companies. Clayton has stated in testimony to Congress that he believes it important to restore vibrancy to public markets on the premise that more investment choices and more available information on U.S. companies benefits the economy.

While regulators can’t control the growth of private capital, the agency has made a priority of making public markets more appealing, said Bill Hinman, picked by Clayton to run the Division of Corporation Finance that oversees public company disclosures.

"From our perspective we can only affect the regulatory framework,” Hinman said. “We can only try to improve that and make the public alternative relatively more attractive and efficient, which is something we are focused on."

Hinman said results are starting to show, noting that the expansion of confidential filings, among other initiatives, has been well received by issuers. Apart from IPOs, newly public companies can also now use the confidential process for additional offerings for one year after going public.

"I think we are off to a fast start,” said Hinman, a former Simpson Thacher partner. “On the policy side, we are doing the things we can be doing and we are being told by companies entering the system that those things are making a difference.”

Stimulating interest for IPOs on the investor side of the equation is a separate challenge.

Rick Fleming, the SEC's investor advocate, has argued that policymakers should worry less about the reduced supply of public companies and instead explore reasons for reduced demand for IPOs, noting that fewer retail investors are buying stocks now but are instead choosing to invest in mutual funds. During a speech in May, Fleming said boosting demand for smaller company shares would accomplish more to invigorate the IPO market than "whittling away at disclosure requirements or shareholder rights."

The drop in IPOs is often blamed on a myriad of factors beyond the booming growth of private capital, including low interest rates that make it cheaper for companies to raise debt, and the desire of founders of startup companies to retain control of their companies. Barbara Roper, a member of the SEC's Investor Advisory Committee and director of investor protection at the Consumer Federation of America, said those causes "don't lend themselves to the kind of policy solutions that are focused on tweaking the rules for going public."

"He's a smart guy, and he knows this issue well, so maybe he has some magic up his sleeves that we haven't seen yet," Roper said of Clayton. "But I don't think streamlined disclosures or confidential filings are going to get us there."

Recent Congressional efforts to ease-capital raising have gained only limited traction, a handful of capital-raising measures were inserted into the Financial Choice Act, part of a larger bill aimed at scaling back Dodd-Frank Act financial regulations, that passed the House of Representatives in June. But the legislation has since stalled in the Senate.

The Public Offerings Act of 2017, a more modest bill that passed the House in November, would codify into law the SEC's recent action to make confidential IPO filings available to all companies. The bill would also expand the JOBS Act's testing-the-waters provision, which allows emerging growth companies to conduct limited communications with accredited investors before an IPO to determine potential interest in the deal, to all issuers regardless of size.

Given the legislation the SEC has to work with, Akerman LLP partner Brian Miller said the agency’s ability to stem the tide of capital formation shifting toward private markets is limited. He said Congress could amend the Investment Company Act of 1940 to make it easier for mutual funds to invest in private companies, and thereby increase the access of public investors to pre-IPO companies.

"There are things Congress could do, but they are not doing them yet," Miller said.

Regulators also have certain ability to move without waiting for Congress. Hall notes that the SEC could use what is known as its general exemptive authority, which allows the agency to exempt any transaction or security from the landmark securities laws of 1933 and 1934 to promote capital formation.

"A real look at the public company disclosure regime is long overdue," Hall said. "And, I think with this leadership, hopefully they would give at least some weight to the views of issuers. Maybe not the point of the view of the company, but at least a more neutral point of view then they have applied in the past."

The SEC also has to contend with investor groups wary of reduced disclosure. Council of Institutional Investors Executive Director Ken Bertsch said he generally agrees with the SEC actions so far under Clayton, although he is concerned that the narrative of there being a problem with capital formation is false, arguing that the U.S. is "awash in capital" when taking into account private funding sources.

Bertsch said the CII opposes efforts backed by some business groups to scale back requirements that companies hire external auditors to certify that their "internal controls" — meaning policies to prevent financial fraud or misstatements — are effective. The measure was put in place by the Sarbanes-Oxley Act after the accounting scandals of the early 2000s, though the Financial Choice Act would give smaller companies more leeway in avoiding that requirement.

"We are worried about where this may head," Bertsch said, but quickly added that he does not see Clayton pushing to scale back Sarbanes-Oxley requirements even though certain **businesses favor it**. "He has a lot of respect, from what I can gather, for financial processes and disclosure."

In terms of the SEC's direction under Clayton, any sweeping changes to regulations governing capital markets seem unlikely. Instead, several lawyers said the agency to move forward with a methodical approach toward relieving burdens on public companies.

"Any expectation that the SEC would become a patsy continues to be mistaken," Linklaters LLP partner Jeff Cohen said. "But, in general, they continue to evolve incrementally toward a more commercial perspective."

--Editing by Rebecca Flanagan and Katherine Rautenberg.