Private Securities Offerings post-JOBS Act

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Outline

Landscape of public and private offerings

- Capital raising levels
- Participation by offering method

General economic considerations w.r.t. capital formation

Update of offering activity post JOBS Act implementation

- Title I – Emerging Growth Companies (EGCs) – April 5, 2012
- Title II – General solicitation – September 23, 2013 (effective date)
- Title IV – Regulation A – June 19, 2015 (effective date)
- Title III – Crowdfunding – May 16, 2016 (effective date)
Public vs. Private Capital Raising

* Includes Reg S and other Section 4a(2) offerings
Sources: EDGAR Form D and Form D/A filings for Rule 504, 505, and 506 offerings; Thomson Financial for all others
Number of Issuers During 2015

Sources: EDGAR Form D and Form D/A filings for Regulation D; Thomson Financial for all others
Composition of SEC Reporting Companies

Source: Staff analysis of 10-K filings on EDGAR
Access to capital by small businesses

• While some small firms raise capital through exempt offerings and others undertake registered securities offerings, many small businesses do not raise capital through either method.

• Financed by founders, friends and family, bank loans, alternative lenders etc.

• In 2013, there were more than 5 million firms with fewer than 500 paid employees, according to the latest data from U.S. Census (2013 Business Dynamics Statistics).
Impact of JOBS Act on Capital Formation

Two potential effects of JOBS Act rules on capital formation

• Improve the efficiency with which capital can be raised
  ▪ If offerings in reliance on the JOBS Act rules attract issuers that are otherwise able to raise capital through existing exempt offering methods, this will result in redistribution of capital flow, which may enhance efficiency but have a limited impact on the aggregate level of capital formation.

• Increase overall levels of capital formation in the economy
  ▪ If the JOBS Act rules enable entrepreneurs and small business to raise capital not previously available to them, then the level of capital formation will be enhanced.
Emerging Growth Companies (EGCs)

• Title I introduced a scaled disclosure regime for EGCs - a new category of IPO issuers
  ▪ Based on 10-K filings made in 2014, there are approximately 928 EGCs (12% of reporting companies that filed 10-Ks)
  ▪ Between April 2012 and the end of 2014, close to 85% IPOs have been undertaken by EGCs

• Recent research have shown that eligible issuers are frequently relying on EGC accommodations

• EGC provisions affect capital raising by the largest small firms
  ▪ for many smaller firms, an IPO would still be too costly

Source: Staff analysis of filings on EDGAR
General Solicitation and Rule 506(c)

What we said in the economic analysis of the final rule (July 2013)

- Intended to facilitate capital formation, especially for early stage firms

- Would lower search cost of issuers finding accredited investors, and provide accredited investors with a greater number of investment opportunities.
  
  - Decrease the cost of raising capital; could replace other offering methods

- Reduce uncertainty for issuers as to whether a Rule 506 offering can be completed (e.g., inadvertent release of information).

- Could increase the incidence of fraud; erode investor participation in private offering markets
General Solicitation and Rule 506(c)

What we have observed since enactment

- No measured increase in the incidence of fraud in new Rule 506(c) market
- Rule 506(c) market remains much smaller than the traditional Rule 506(b) market
  - Market may still be learning about what constitutes general solicitation, appropriate verification methods
  - Potential uncertainty about pending regulation
  - Delay in amending regulations by other agencies that restricted use of general solicitation (e.g. CFTC for commodity funds)
General Solicitation and Rule 506(c)

- Used more by operating companies than funds
  - Average age and size of operating companies raising capital through Rule 506(c) is smaller (intention of JOBS Act)
  - Operating companies use intermediaries to a greater extent in Rule 506(c) offerings
  - Intermediation costs reported to be higher under new Rule 506 market than traditional Rule 506(b) market
- Median offer size larger, but median amount raised lower, in 506(c) offerings
  - Issuers that anticipate difficulty raising capital may be self-selecting into advertised offerings
# General Solicitation and Rule 506(c)

<table>
<thead>
<tr>
<th></th>
<th>All 506</th>
<th>506(b) Funds</th>
<th>506(b) Non-Funds</th>
<th>506(c) Funds</th>
<th>506(c) Non-Funds</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Initial offerings filed September 23, 2013 to December 31, 2015</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number</td>
<td>48,773</td>
<td>12,603</td>
<td>32,461</td>
<td>763</td>
<td>2,946</td>
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<tr>
<td>Total amount sold ($millions)</td>
<td>$1,531,132</td>
<td>$1,170,594</td>
<td>$310,109</td>
<td>$23,751</td>
<td>$26,677</td>
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<tr>
<td>Average amount sold ($millions)</td>
<td>$31.4</td>
<td>$92.9</td>
<td>$9.6</td>
<td>$31.1</td>
<td>$9.1</td>
</tr>
<tr>
<td>Median amount sold ($millions)</td>
<td>$1.42</td>
<td>$10.00</td>
<td>$1.10</td>
<td>$1.00</td>
<td>$0.51</td>
</tr>
<tr>
<td>Average investors/offer</td>
<td>13.7</td>
<td>17.0</td>
<td>12.8</td>
<td>17.2</td>
<td>8.1</td>
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<tr>
<td>Used intermediary</td>
<td>18%</td>
<td>20%</td>
<td>16%</td>
<td>17%</td>
<td>28%</td>
</tr>
<tr>
<td>Median years since incorporation</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Median issuer size (of those reporting)</td>
<td>$25-50Mn</td>
<td>&lt; $1Mn</td>
<td>$5-25Mn</td>
<td>&lt; $1Mn</td>
<td></td>
</tr>
</tbody>
</table>

**Amendments to offerings**

|                                |         |              |                  |              |                  |
| Number                         | 23,322  | 20,168       | 2,575            | 392          | 187              |
| Total amount sold ($millions)  | $1,375,310 | $1,315,218   | $39,564          | $18,929      | $1,598           |

**Movers - Rule 506(c) offerings initiated by issuers that had a prior Regulation D offering during 2009-2013**

| Number of Offerings | 626 | n/a | n/a | 75  | 551  |
| Total amount sold ($millions) | $34,277 | n/a | n/a | $21,220 | $13,056 |
Year-over-year 506(c) offerings

- Year 1, beginning Sep 23, 2013
- Year 2, beginning Sep 1, 2014
- Year 3, beginning Sep 1, 2015
- Cumulative Year 1 (Sep 23, 2013- Aug 2014)
- Cumulative Year 2 (Sep 1, 2014- present)
- Cumulative Year 3 (Sep 1, 2015- present)
Exempt Offerings: Regulation A+

• Regulation A has been utilized infrequently in the prior years and amendments were adopted on March 25, 2015 and became effective on June 19, 2015

• The market continues to evolve but the sample is still relatively small
  ▪ Only a subset of filings has been qualified and very few reports of sales have been filed, so it remains to be seen how much capital will be raised through these offerings in the future
  ▪ Between June 19, 2015 and February 15, 2016, about 68 filings made on Form 1-A, 19 qualified, and 3 reports of sales filed for offerings qualified

Source: Staff analysis of filings on EDGAR
Exempt Offerings: Regulation A+

What we said in the economic analysis of the final rule (March 2015)

- Potential use of Reg A (Tier 1 v. Tier 2) offerings will depend on how issuers perceive the trade-off between:
  - the costs of qualification and ongoing disclosure requirements
  - The benefits from access to a broad investor base and preemption of state securities law registration requirements

- will also depend on ability of issuers to use other exemptions
  - e.g., general solicitation permissible under rule 506(c) of Reg D

- and the need for secondary market liquidity
  - Which would require Exchange Act reporting if listed on a national market exchange (i.e., is reg A a viable alternative to an IPO?)
Exempt Offerings: Regulation A+

- Total capital sought: $1.3 billion ($290 million across qualified filings)
  - Tier 1 and Tier 2: 46% vs. 54% (53% vs. 47% across qualified filings)
    - Tier 1: Median amount sought per filing: $13 million ($7.5 million qualified)
    - Tier 2: Median amount sought per filing $24 million ($23 million per qualified filing)

- Most filers are pre-revenue firms, with variation in issuer size, amounts sought, industry, location, and profitability
  - Median assets: $0.1 million ($0.5 million qualified offerings)
    - Issuer assets < $1 million in 72% of filings (58% qualified filings)
    - Issuer assets <$100 million in 95% filings (85% qualified filings)
  - Issuer in a median filing / qualified filing had no revenues, net income, or long-term debt, and no / low cash and PP&E
Exempt Offerings: Regulation A+

• Limited underwriter involvement
  - 90% of all / qualified filings were on a “best efforts” basis
  - 80% of all and of qualified filings were equity offerings

• Industry
  - >50% filings by issuers in business services, real estate, and credit industries

• Geography
  - >50% filings by issuers incorporated in DE or NV
  - Close to 1/3 filings by issuers with a business location in CA
  - Nationwide solicitation more common with Tier 2: Median filer solicited in 50 states, compared to 3 (9) states for the median (qualified) Tier 1 filing
Regulation Crowdfunding

• The final rules implementing Title III were adopted on October 30, 2015 and will be effective May 16, 2016

• Establish a framework for the federal securities-based crowdfunding market

• Intended to help provide small businesses with capital through relatively low dollar investments by the “crowd” of retail investors
Regulation Crowdfunding

• How costly will it be for issuers?
  ▪ Issuers will have to use an intermediary and provide offering and periodic disclosure; could be required to provide audited financials

• What will investors’ exit options be?
  ▪ What types of securities will be used? Will secondary markets develop?
  ▪ The survival rates of CF issuers are expected to be low, may face expropriation risk

• Will CF increase fraud?
  ▪ Limits on capital to be raised, investor limits, disclosure, ability of intermediaries to limit issuers’ access to portals