



# Hard and Soft Information: Firm Disclosure, SEC Letters, and the JOBS Act

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## RESEARCH QUESTION

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- How does the **reduction in disclosure requirements** for IPO firms under the JOBS Act impact:
  1. IPO **firms'** disclosures of hard and soft information
  2. The behavior of the **SEC** in its comment letters to the firms, and
  3. The reaction by **investors** (market) on the IPO date and upon the publication of the comment letters?



**THE JOBS ACT BECAME LAW ON APRIL 5, 2012**

# “Jumpstart Our Business Startups Act”

To increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.

**Emerging Growth Company (EGC): < \$1B revenues in fiscal year**

**Aim to reduce costs of IPOs to EGCs by:**

- **Reducing mandatory financial disclosure requirements:**
  - **2 yrs (vs. 3) of audited financial statements**
  - **3 yrs (vs. 5) of selected financial variables**
- **Reducing mandatory disclosure of executive compensation:**
  - **Compensation of 3 (vs. 5) named executives**
  - **May omit a written discussion of compensation**
- **Extending time to comply with accounting standards**
- **Allowing Confidential Initial Filing**
- **Exempting from some Sarbanes-Oxley requirements**
- **Removing pre-and post-IPO communications restrictions**

## POTENTIAL IMPACT OF THE JOBS ACT

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- Disclosure can reduce information asymmetry and lower the cost of capital (Easley & O'Hara, 2004)
- **Hard** information: verifiable, but costly (Petersen, 2004)
- **Soft** information: not as credible, less costly
  - ➔ Optimal mix of **hard** and **soft** disclosures (tradeoffs) taking reaction of investors into account.
- JOBS Act reduced binding constraint on hard information
- JOBS Act didn't change **soft** info requirements
  - ➔ Reduce disclosures of **hard** information
  - ➔ Change disclosures of **soft** information?

## HARD VS SOFT INFORMATION: GOOGLE

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Before it's IPO, **Google** announced that it would **not provide** earnings guidance as that will induce **short-termism**.

- Google's Founder's letter during IPO (IPO in 2004):
- “We believe that artificially creating **short term** target numbers serves our shareholders poorly.”

“We will not shy away from **high-risk**, high-reward projects because of **short term** earnings pressure. Some of our past bets have gone extraordinarily well, and others have not. ... For example, we would fund projects that have a 10% chance of earning a billion dollars over the long term. Do not be surprised if we place smaller bets in areas that seem **very speculative or even strange** when compared to our current businesses. ... as the ratio of reward to risk increases, we will accept projects further outside our current businesses..”

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# HARD VS SOFT INFORMATION: TWITTER

70,000,000 Shares



**Twitter, Inc.**

Common Stock

This is an initial public offering of shares of common stock of Twitter, Inc.

Prior to this offering, there has been no public market for the common stock. The initial public offering price per share is \$26.00. Our common stock has been approved for listing on the New York Stock Exchange under the symbol "TWTR".

We are an "emerging growth company" as defined under the federal securities laws and, as such, may elect to comply with certain reduced public company reporting requirements for future filings.

We cannot predict if investors will find our common stock less attractive if we choose to rely on these exemptions. If some investors find our common stock less attractive as a result of any choices to reduce future disclosure, there may be a less active trading market for our common stock and the price of our common stock may be more volatile.

## TWITTER, INC. CONSOLIDATED BALANCE SHEETS (In thousands, except par value)

	December 31,	
	2011	2012
	\$218,996	\$203,328
	330,543	221,528

28, \$1,280 and \$1,261 as of December 31, 2011

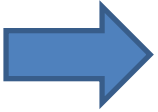
## Summary Compensation Table

The following table provides information regard individual who served as our principal executive officer serving as executive officers as of December 31, 2012

Name and Principal Position	Year	Salary (\$)
Richard Costolo <i>Chief Executive Officer</i>	2012	200,000 <sup>(3)</sup>
Adam Bain <i>President of Global Revenue</i>	2012	200,000
Christopher Fry <i>Senior Vice President of Engineering</i>	2012	145,513

## POTENTIAL IMPACT OF THE JOBS ACT

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- Impact of reduction in **hard** disclosures and change in **soft** disclosures:
  - Easley & O'Hara (2004):
    - Less hard info  More underpricing
  - And/Or
  - Bertomeu & Marinovic (2015):
    - Some risky firms reveal type via soft information to avoid costs of hard disclosures
    - Some hide with low risk firms using soft info, but must also disclose hard info.
    - Soft info related to underpricing.

# PREVIEW OF RESULTS

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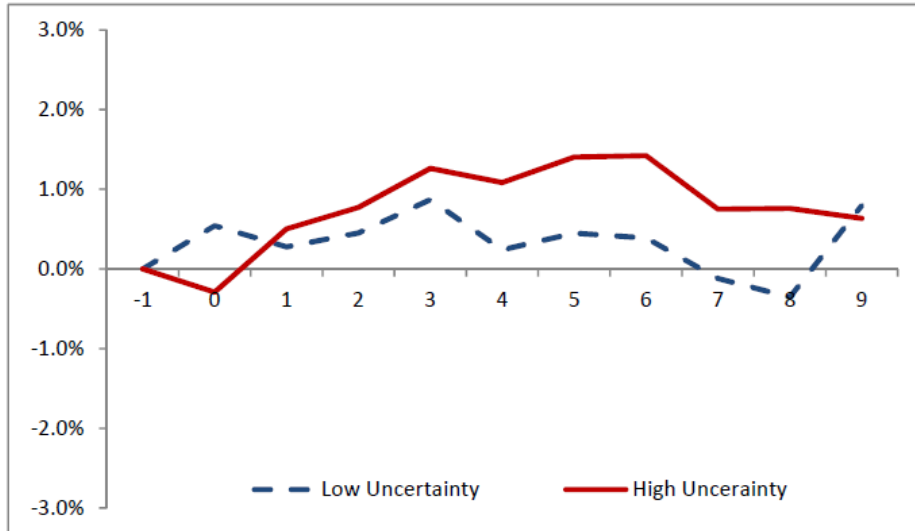
## Under the JOBS Act:

- **JOBS Act IPO Firms:**
  - Reduce disclosures of hard information
  - Change their disclosures of soft information
- **The SEC:**
  - Uses more forceful language in its comment letters
  - Focuses more on quantitative items in its letters
- **Investors:**
  - Focus on soft information when pricing the IPO
  - Place more emphasis on the content of the SEC letters when pricing the stock.

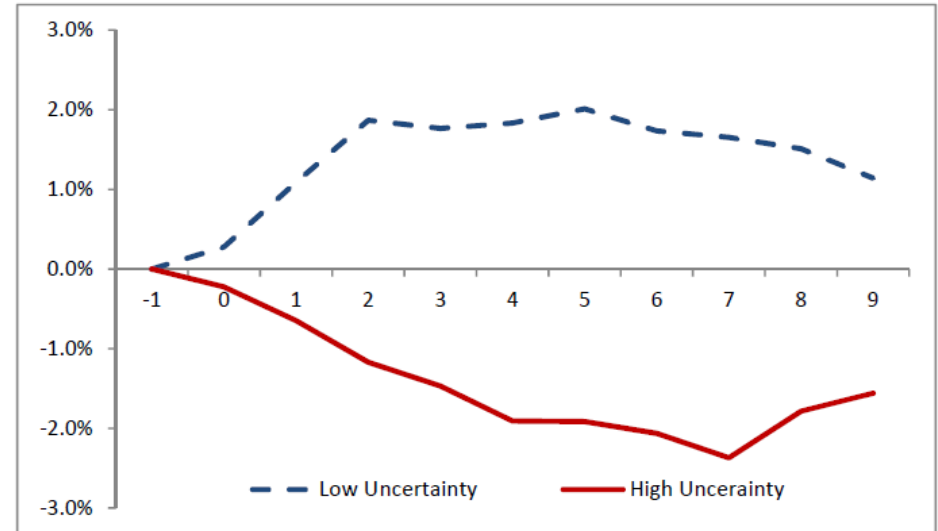


# PREVIEW OF RESULTS

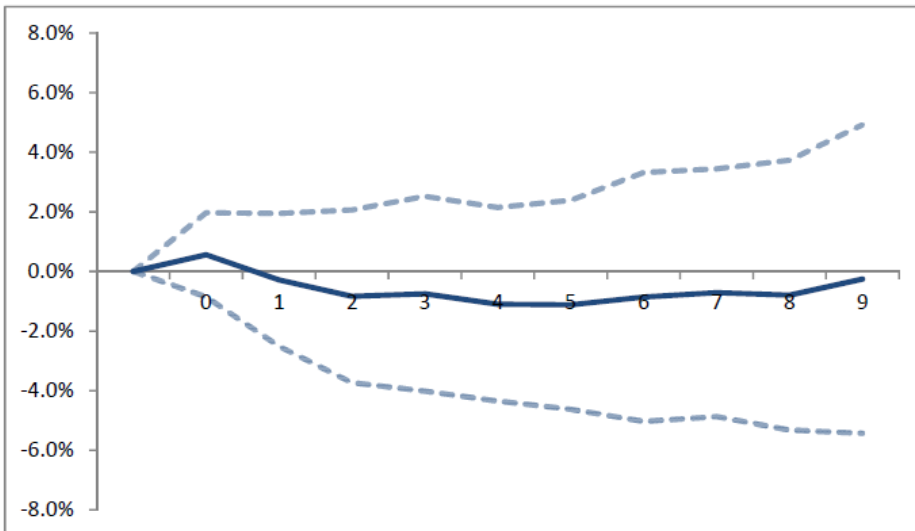
Panel A: Returns to L and H Before JOBS Act



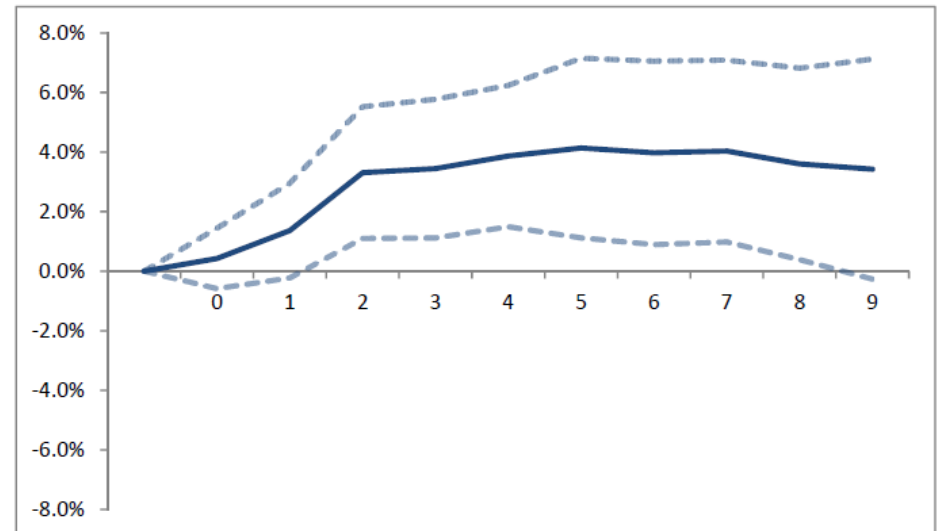
Panel B: Returns to L and H Under JOBS Act



Panel E: Diff. in Abn. Rets Before JOBS Act



Panel F: Diff. in Abn. Rets Under JOBS Act



# HYPOTHESES

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- H1: Optimal Firm Disclosure
  - Change soft information at the firm level
- H2: IPO Underpricing/Cost of Capital
  - Underpricing higher under JOBS Act
  - Non-disclosure of hard information **not priced** by market
  - **Only soft information** is priced
- H3: Change in SEC's behavior/role (comment letters)
  - SEC will change its letter-writing behavior under the JOBS Act
  - Letter content priced by the market **only** under the JOBS Act

# DATA

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## SEC:

- Firm-level variables
- IPO-level variables
- JOBS Act accommodations (Hard disclosures)
- EDGAR hits from server logs
- Text of filings (soft disclosures)
- SEC comment letters

## SDC Platinum:

- Venture capital backing
- Lead underwriter

## CRSP:

- Stock returns, industry codes

## I/B/E/S:

- Analyst coverage/recommendations
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## SUMMARY STATISTICS: IPO- AND FIRM-LEVEL VARIABLES

Variable	Pre JOBS Act	JOBS Act
Offer Size (\$B)	0.13 (0.13)	0.14 (0.19)
StarUnderwriter	0.44 (0.50)	0.43 (0.50)
VCbacked	0.57 (0.50)	0.59 (0.49)
1-day IPO ret	0.16 (0.22)	0.20** (0.31)
Total Assets (\$M)	184 (415)	359** (1154)
Total Liabilities (\$M)	118 (282)	249** (829)
Revenues (\$M)	107 (149)	99 (164)
R&D Expenses (\$M)	17 (15)	17 (85)
Investment in PP&E (\$M)	9 (33)	6 (19)
N	127	271

## DATA: HARD AND SOFT DISCLOSURES

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### Hard disclosures:

- JOBS Act accommodations

### Soft disclosures:

- Text of the prospectus: “Risk Factor” Section
  - Has been shown to affect underpricing
  - Important: makes up large part of filing
- Which risks are disclosed/emphasized?
- We use a topic model (LDA) to identify the set of risks...
  - A comprehensive set of latent (risk factor) topics made up of words that tend to appear together:
    - Probability distribution of words
- ... and to classify the documents using the topics
  - Each risk factor section is drawn from topics:
    - Probability distribution of topics
- Maximize the likelihood of observing the set of documents



# TOPIC MODELS

<i>ProdApproval</i>		<i>ProductDev1</i>		<i>ProductDev2</i>	
word	<i>p</i>	word	<i>p</i>	word	<i>p</i>
product	4.4	product	9.5	product	7.1
approval	3.6	new	4.5	development	4.4
clinical	3.5	technology	4.1	candidate	2.3
trial	2.9	market	2.9	research	2.1
fda	2.7	develop	1.8	develop	1.7
regulatory	2.6	change	1.7	marketing	1.4
drug	1.5	customer	1.5	partner	1.3
obtain	1.4	services	1.4	sales	1.2
candidate	1.4	development	1.4	party	1
require	1.1	software	1.2	commercialize	1
result	1.1	technological	1.1	commercialization	1
delay	1	industry	1.1	collaboration	0.9
study	0.9	acceptance	1	market	0.9
market	0.9	ability	0.9	commercial	0.9
approve	0.8	exist	0.9	license	0.9
use	0.8	competitor	0.9	drug	0.9
include	0.8	competitive	0.8	effort	0.8
patient	0.7	introduce	0.8	revenue	0.8
process	0.7	standard	0.8	collaborator	0.8
safety	0.6	solution	0.8	technology	0.8

# WORD-TOPIC DISTRIBUTIONS

	<i>Accounting</i>		<i>Competition</i>		<i>Contractual</i>		<i>Costs</i>		<i>Credit</i>		<i>Demand</i>		<i>Disclosure</i>		<i>EnviroReg</i>	
rank	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>
1	financial	4.2	company	7.7	agreement	5.9	costs	3.8	credit	3.4	result	3.7	risk	6.5	environmental	3.2
2	control	3.5	customer	2.9	contract	4.9	increase	2.9	debt	3.3	economic	2.4	statement	4.6	regulation	2.6
3	internal	2.5	competitor	2.6	terms	1.6	cost	2.1	facility	2.3	affect	2.4	result	3.4	laws	2
4	reporting	2.3	market	2.3	terminate	1.5	project	2	cash	2	conditions	2.1	forward	2.8	operations	1.6
5	accounting	2.2	competition	2.2	lease	1.3	result	1.9	note	1.9	business	2.1	factor	2.6	costs	1.4
6	result	1.8	services	2.1	plan	1.3	labor	1.7	indebtedness	1.9	customer	2	looking	2.5	material	1.4
7	report	1.7	compete	2	provide	1.2	equipment	1.4	ability	1.8	sales	1.8	financial	2.4	subject	1.2
8	require	1.7	competitive	1.7	obligation	1.1	operations	1.3	capital	1.8	demand	1.4	business	2.4	facility	1.2
9	company	1.5	business	1.6	certain	1.1	employee	1.2	financial	1.4	impact	1.4	operations	1.9	require	1.1
10	impairment	1.5	financial	1.4	enter	1.1	affect	1.1	covenant	1.3	adversely	1.4	uncertainty	1.9	state	1.1
11	assets	1.2	product	1.3	term	1	work	1.1	senior	1.2	market	1.4	include	1.6	hazardous	1.1
12	goodwill	1.2	industry	1.2	termination	1	operate	1	additional	1.1	operations	1.4	information	1.6	use	0.9
13	management	1.2	result	1.1	arrangement	0.9	construction	1	obligation	1.1	product	1.4	condition	1.6	result	0.9
14	material	1.2	greater	1.1	require	0.8	facility	0.9	flow	1.1	operate	1.3	future	1.4	permit	0.9
15	public	0.9	service	0.9	renew	0.8	adversely	0.9	require	1	financial	1.2	materially	1.4	emission	0.9
16	statement	0.9	resource	0.9	purchase	0.8	delay	0.9	financing	1	change	1.2	report	1.2	safety	0.8
17	standard	0.9	price	0.9	franchise	0.8	company	0.9	agreement	1	industry	1.2	prospectus	1.2	federal	0.8
18	intangible	0.8	increase	0.8	party	0.7	contract	0.8	business	1	factor	1.1	actual	1.1	include	0.8
19	independent	0.8	operate	0.7	restaurant	0.7	vessel	0.8	default	1	revenue	1.1	following	1.1	waste	0.8
20	procedure	0.8	offer	0.7	pension	0.6	material	0.8	operations	0.9	consumer	1.1	affect	1.1	water	0.8
	<i>Financing</i>		<i>FinMarket</i>		<i>Growth</i>		<i>HealthCare</i>		<i>HumanCapital</i>		<i>Insurance</i>		<i>IntellProp</i>		<i>International</i>	
rank	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>
1	acquisition	5.1	investment	2.7	growth	3.4	health	2.6	personnel	4.9	insurance	5.1	patent	5.2	foreign	4.4
2	business	4.9	financial	2.6	business	2.5	care	2.2	key	3.8	claim	4.2	right	3.8	currency	3
3	acquire	2.7	market	2.5	new	2.3	healthcare	2.1	retain	3.6	liability	3.1	property	3.4	international	2.6
4	additional	2.4	rates	2	manage	2.2	program	2.1	employee	3.5	result	2.4	intellectual	3.1	operations	2.4
5	capital	2.4	credit	1.7	operations	1.8	reimbursement	2.1	management	2.8	business	1.7	license	2.8	tax	2.2
6	operations	1.9	security	1.5	sales	1.7	product	2	business	2.7	product	1.7	technology	2	country	2
7	company	1.8	loan	1.5	expand	1.7	government	1.6	attract	2.3	coverage	1.6	party	2	exchange	2
8	financing	1.6	rate	1.4	ability	1.7	medical	1.4	officer	2.3	risk	1.6	proprietary	1.8	unite	2
9	future	1.5	affect	1.4	increase	1.5	medicare	1.3	executive	2.1	financial	1.3	product	1.8	risk	1.8
10	result	1.3	bank	1.3	management	1.4	patient	1.2	qualify	2	operations	1.1	protect	1.6	dollar	1.5
11	terms	1.1	increase	1.3	continue	1.4	physician	1.2	ability	1.8	adverse	1.1	claim	1.6	state	1.4
12	need	1	institution	1.2	strategy	1.3	services	1.1	company	1.5	material	1.1	litigation	1.2	china	1.3
13	equity	0.9	deposit	1.2	financial	1.3	state	1.1	depend	1.3	litigation	1	use	1.1	result	1.3
14	raise	0.9	result	1.1	operate	1.2	party	1	loss	1.3	subject	0.9	protection	1	fluctuation	1.2
15	require	0.9	company	1.1	market	1.1	hospital	0.9	services	1.3	condition	0.9	infringement	1	political	1.1
16	available	0.9	risk	1.1	system	1.1	payors	0.9	success	1.2	losses	0.9	infringe	1	sales	1
17	include	0.9	value	1	result	1.1	payment	0.8	senior	1.1	liabilities	0.9	application	1	business	1
18	able	0.9	change	1	effectively	1.1	drug	0.8	chief	1.1	company	0.9	result	1	rates	0.9
19	obtain	0.8	assets	1	maintain	1	medicaid	0.8	continue	1	reinsurance	0.8	trademark	0.9	subject	0.9
20	risk	0.8	rating	1	expansion	1	provider	0.8	hire	0.9	costs	0.8	obtain	0.9	change	0.9



# WORD-TOPIC DISTRIBUTIONS (CONTINUED)

	<i>Internet</i>		<i>Legal</i>		<i>Oil</i>		<i>Payout</i>		<i>ProdApproval</i>		<i>ProductDev1</i>		<i>ProductDev2</i>	
rank	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>
1	internet	3.2	action	1.5	gas	5.1	dividend	4.6	product	4.4	product	9.5	product	7.1
2	services	2.3	state	1.5	oil	4	subsidiary	4	approval	3.6	new	4.5	development	4.4
3	advertising	1.6	court	1.3	natural	3.7	pay	3.6	clinical	3.5	technology	4.1	candidate	2.3
4	brand	1.5	company	1.1	price	3.3	company	3.3	trial	2.9	market	2.9	research	2.1
5	program	1.3	prc	0.9	production	2.3	payment	2	fda	2.7	develop	1.8	develop	1.7
6	online	1.3	law	0.9	reserves	1.8	distribution	1.8	regulatory	2.6	change	1.7	marketing	1.4
7	content	1.3	federal	0.9	drilling	1.4	holding	1.6	drug	1.5	customer	1.5	partner	1.3
8	business	1.2	file	0.8	property	1.2	cash	1.6	obtain	1.4	services	1.4	sales	1.2
9	user	1.1	claim	0.8	fuel	1.2	capital	1.3	candidate	1.4	development	1.4	party	1
10	use	1	laws	0.8	result	1.1	venture	1.2	require	1.1	software	1.2	commercialize	1
11	service	1	investigation	0.7	operations	1	trust	1.1	result	1.1	technological	1.1	commercialization	1
12	consumer	1	certain	0.7	future	0.9	future	1.1	delay	1	industry	1.1	collaboration	0.9
13	increase	0.9	information	0.7	produce	0.9	ability	1.1	study	0.9	acceptance	1	market	0.9
14	revenue	0.9	security	0.7	costs	0.9	joint	1	market	0.9	ability	0.9	commercial	0.9
15	web	0.9	legal	0.7	affect	0.9	receive	0.9	approve	0.8	exist	0.9	license	0.9
16	medium	0.8	lawsuit	0.6	exploration	0.9	obligation	0.8	use	0.8	competitor	0.9	drug	0.9
17	site	0.8	include	0.6	energy	0.9	investment	0.8	include	0.8	competitive	0.8	effort	0.8
18	network	0.8	unite	0.6	commodity	0.8	make	0.8	patient	0.7	introduce	0.8	revenue	0.8
19	provide	0.7	act	0.6	estimate	0.8	funds	0.8	process	0.7	standard	0.8	collaborator	0.8
20	website	0.7	relate	0.6	activity	0.8	bank	0.7	safety	0.6	solution	0.8	technology	0.8
	<i>RealEstate</i>		<i>Regulation</i>		<i>Revenue</i>		<i>Stakeholder</i>		<i>StockPrice</i>		<i>SupplyChain</i>		<i>Systems</i>	
rank	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>	word	<i>p</i>
1	loan	7.0	regulation	5.9	revenue	3.8	stock	5.2	stock	9.0	product	6.2	system	4.6
2	real	2.6	laws	3.5	tax	2.5	share	4.5	price	7.1	customer	2.5	business	2.8
3	estate	2.4	state	3.0	net	2.4	common	3.5	common	6.5	supplier	2.4	information	2.1
4	losses	1.7	business	2.4	result	2.2	stockholder	2.7	market	6.3	manufacturing	2.2	customer	2.1
5	increase	1.4	subject	2.2	future	1.8	director	2.4	security	2.2	supply	1.9	result	2.0
6	power	1.3	regulatory	2.0	income	1.7	board	1.4	trading	2.1	material	1.9	failure	1.8
7	energy	1.3	change	1.9	year	1.6	control	1.3	share	1.8	manufacturer	1.6	operations	1.7
8	property	1.2	federal	1.8	expense	1.6	right	1.2	company	1.7	component	1.5	security	1.4
9	commercial	1.2	requirement	1.5	operate	1.6	company	1.2	result	1.5	result	1.4	services	1.3
10	risk	1.1	government	1.4	losses	1.5	offering	1.2	public	1.2	increase	1.3	client	1.3
11	portfolio	1.1	operations	1.2	period	1.5	provisions	1.1	decline	1.2	manufacture	1.2	data	1.3
12	market	1.1	comply	1.2	estimate	1.3	outstanding	1.1	offering	1.1	production	1.2	party	1.1
13	allowance	1.0	affect	1.2	end	1.3	shareholder	1.0	fluctuation	1.1	price	1.1	service	1.0
14	coal	1.0	compliance	1.1	december	1.2	prefer	1.0	operate	1.0	delay	1.0	interruption	1.0
15	mortgage	0.9	include	1.0	approximately	1.2	price	0.9	future	1.0	purchase	0.9	damage	0.9
16	home	0.9	result	1.0	base	1.1	issue	0.9	factor	1.0	order	0.9	disruption	0.9
17	result	0.8	require	0.9	significant	1.1	option	0.8	investor	0.9	raw	0.9	loss	0.9
18	borrower	0.8	act	0.9	fiscal	1.0	holder	0.8	affect	0.9	source	0.9	financial	0.9
19	construction	0.8	new	0.8	change	1.0	change	0.8	analyst	0.8	costs	0.9	cause	0.8
20	residential	0.8	applicable	0.8	incur	1.0	exercise	0.8	sales	0.8	inventory	0.8	reputation	0.8

## DISCLOSED RISK FACTORS

Risk Factor	Pre JOBS ACT		JOBS ACT		Diff
	Mean	Std. Dev.	Mean	Std. Dev.	
Accounting	4.6	2.1	5.4	2.3	0.8***
Competition	3.0	2.1	2.4	1.7	-0.6***
Contractual	2.3	1.8	2.3	1.7	0.0
Costs	1.2	2.2	0.9	1.5	-0.3
Credit	3.0	3.0	2.5	2.6	-0.5
Demand	4.0	3.3	3.5	3.4	-0.5
Disclosure	2.9	1.1	3.4	3.8	0.5
EnviroReg	1.3	2.3	1.0	1.8	-0.3
Financing	3.3	1.6	3.2	2.0	-0.1
FinMarket	1.2	3.1	2.0	4.9	0.8*
Growth	4.8	2.9	4.5	2.9	-0.3
HealthCare	1.6	2.5	2.3	3.3	0.7**
HumanCapital	2.7	1.3	2.4	0.8	-0.3**
Insurance	2.2	0.9	2.2	1.4	0.0
IntellProp	6.4	3.8	6.0	4.4	-0.4
International	2.0	2.0	1.5	1.5	-0.5***
Internet	3.6	5.6	2.2	4.2	-1.4***
Legal	1.6	1.5	2.2	2.5	0.6***
Oil	2.3	6.7	1.2	5.4	-1.1
Payout	1.2	1.1	1.6	1.7	0.4***
ProdApproval	4.2	9.0	6.4	10.2	2.2*
ProductDev1	4.8	4.1	3.9	4.1	-0.9*
ProductDev2	3.5	5.8	4.4	6.5	0.9
RealEstate	0.7	1.9	1.6	3.7	0.9***
Regulation	4.6	2.5	5.2	2.4	0.6**
Revenue	3.6	1.7	3.9	2.2	0.3
Stakeholder	8.8	2.9	9.2	4.9	0.4
StockPrice	5.4	1.7	5.2	1.9	-0.2
SupplyChain	3.5	4.2	2.5	3.3	-1.0**
Systems	4.7	3.5	4.2	3.4	-0.5

### Increase

Accounting

FinMarket

HealthCare

Legal

Payout

RealEstate

Regulation

### Decrease

Competition

HumanCapital

International

Internet

ProductDev1

SupplyChain



First Principal Component (factor1)

Topic	Standardized Coeff.
Payout	0.150
EnviroReg	0.134
Credit	0.118
Oil	0.117
Contractual	0.082
RealEstate	0.081
Revenue	0.073
Costs	0.071
FinMarket	0.062
Stakeholder	0.042
Insurance	0.039
Financing	0.024
Legal	0.023
Disclosure	-0.003
International	-0.013
Demand	-0.015
Regulation	-0.024
HealthCare	-0.035
StockPrice	-0.044
Accounting	-0.049
ProdApproval	-0.050
SupplyChain	-0.054
ProductDev2	-0.058
Internet	-0.079
HumanCapital	-0.081
Competition	-0.102
Systems	-0.113
Growth	-0.131
ProductDev1	-0.141
IntellProp	-0.144

Second Principal Component (factor2)

Topic	Standardized Coeff.
Demand	0.129
Systems	0.127
Competition	0.122
Growth	0.108
Internet	0.078
Revenue	0.077
ProductDev1	0.076
Regulation	0.075
Contractual	0.074
International	0.069
Accounting	0.067
HumanCapital	0.056
Costs	0.045
Credit	0.045
StockPrice	0.040
FinMarket	0.032
RealEstate	0.031
Stakeholder	0.021
Payout	0.018
Legal	0.017
Insurance	0.010
Financing	0.009
Disclosure	0.006
SupplyChain	-0.004
Oil	-0.012
EnviroReg	-0.016
IntellProp	-0.126
HealthCare	-0.160
ProductDev2	-0.205
ProdApproval	-0.208



## “PAYOUT” RISK EXAMPLES

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“Because **we do not anticipate paying any cash dividends** on our capital stock in the foreseeable future, capital appreciation, if any, will be your sole source of gain. **We have never declared or paid cash dividends** on our capital stock.”

“**We do not currently intend to pay dividends** on our common stock following the offering. We **do not anticipate paying any cash dividends** on our common stock for the foreseeable future. Instead, we intend to retain future earnings to fund our growth.”

“As a result, **we do not expect to pay any cash dividends** in the foreseeable future.”

“We have **never paid cash dividends** on our share capital, and we **do not anticipate paying any cash dividends** in the foreseeable future”

## “CREDIT” RISK EXAMPLES

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“To the extent additional debt is added to our current debt levels, the risks described above could increase. We **may not have cash available** to us in an amount sufficient to enable us **to make interest or principal payments** on our indebtedness when due.”

“We **may be unable to maintain a level of cash flows** from operating activities sufficient to permit us **to pay the principal and interest** on our indebtedness. If our cash flow and capital resources are insufficient to fund our debt service obligations, **we may be forced to reduce or delay** capital expenditures, sell assets, seek to obtain additional equity capital or restructure our indebtedness.”

“We **cannot assure** you that our business **will generate sufficient cash flow** from operations or that future borrowings will be available to us in an amount sufficient to enable **us to service our debt** or to fund our other liquidity needs.”

# JOBS ACT ACCOMMODATIONS AND RISK FACTORS

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<u>JOBS Act Provisions / Factors</u>	<u>Number</u>	<u>Pct</u>
<u>Hard Information</u>		
No Discussion of Exec. Comp.	51	18%
Private Accounting Standards	51	18%
<3 Yrs of Audited Statements	122	45%
<5 Yrs of Selected Fin. Data	74	27%
<5 Executives' Compensation	233	86%
<u>Soft Information</u>		
Confidential Filing	212	78%

<u>JOBS Act Provisions / Factors</u>	<u>ExecComp Discuss</u>	<u>Private Acctg</u>	<u>&lt;3 yrs Audited</u>	<u>&lt;5 yrs Fin Data</u>	<u>&lt;5 ExecComp</u>	<u>Confid. Filing</u>	<u>factor1</u>
<u>Hard Information</u>							
No Discussion of Exec. Comp.							
Private Accounting Standards	-0.18						
<3 Yrs of Audited Statements	-0.47	0.09					
<5 Yrs of Selected Fin. Data	-0.49	0.14	0.62				
<5 Executives' Compensation	-0.50	0.14	0.43	0.48			
<u>Soft Information</u>							
Confidential Filing	-0.68	0.21	0.54	0.58	0.57		
factor1	-0.16	0.09	0.21	0.26	0.17	0.22	
factor2	0.14	-0.07	-0.19	-0.21	-0.11	-0.04	0.10

# JOBS ACT ACCOMMODATIONS AND RISK FACTORS

	Dependent Variable					
	factor1			factor2		
	(1)	(2)	(3)	(4)	(5)	(6)
Treatment	0.308 (4.08)***	0.270 (4.34)***	0.287 (5.24)***	-0.120 (-1.01)	-0.022 (-0.31)	0.146 (1.95)*
StarUnderwriter		0.051 (0.81)	-0.056 (0.99)		-0.112 (-1.43)	-0.052 (-0.65)
VCbacked		-0.352 (5.12)***	-0.345 (5.74)***		0.000 (0.00)	0.010 (-0.11)
Ln(Offer Size in \$Billions)		0.037 (-0.81)	0.053 (-1.30)		-0.039 (-0.76)	0.000 (-0.01)
Log(Offer Size in \$Millions)		0.016 (-0.84)	-0.008 (-1.35)		0.043 (-1.21)	0.025 (1.67)*
Missing Revenues			0.214 (2.31)**			0.658 (2.30)**
Constant	-0.576 (8.87)***			0.019 (-0.19)		
Industry FE	No	Yes	Yes	No	Yes	Yes
Adjusted R-Sq	0.040	0.490	0.490	0.000	0.540	0.520
N	394	328	394	394	328	394

Propensity score matching on:  
 underwriter, venture capital backing,  
 offer size, revenues, R&D expenditures,  
 assets, and industry

Panel B: Disclosed Risk Factors - Matched Sample

	factor1	factor2
SATT	0.27 (3.68)***	0.45 (3.76)***

# SEC COMMENT LETTER EXAMPLE



UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

DIVISION OF  
CORPORATION FINANCE

LETTER DATE

March 28, 2014

Via E-mail

Darryl Rawlings  
Chief Executive Officer  
Trupanion, Inc.  
907 NW Ballard Way  
Seattle, WA 98107

Re: **Trupanion, Inc.**  
**Confidential Draft Registration Statement on Form S-1**  
**Submitted February 28, 2014**  
**CIK No. 0001371285**

ASSOCIATED FILING

Dear Mr. Rawlings:

BOILERPLATE

We have reviewed your draft registration statement and have the following comments. In some of our comments, we **may** ask you to provide us with information so we **may** better understand your disclosure.

Please respond to this letter by providing the requested information and either submitting an amended draft registration statement or publicly filing your registration statement on EDGAR. If you do not **believe** our comments apply to your facts and circumstances or do not **believe** an amendment is appropriate, please tell us why in your response.

After reviewing the information you provide in response to these comments and your amended draft registration statement or filed registration statement, we **may** have additional comments.

General

1. We note that you have yet to submit several of your exhibits. Please be advised that we **may** have further comments upon examination of these exhibits once they have been submitted by amendment.

2. Please provide us proofs of all graphic, visual or photographic information you will provide in the printed prospectus prior to its use, for example in a **preliminary** prospectus. Please note that we **may** have comments regarding this material.

3. Please supplementally provide us with copies of all written communications, as defined in Rule 405 under the Securities Act, that you, or anyone authorized to do

ITEMS

11. Please include in this list your current level of indebtedness and its **possible** impact on your operations and the necessity of generating sufficient cash flow to satisfy your debt service obligations, as described in the **risk** factor on pages 30-31.
12. Please include in this list the **possibility** that litigation or regulatory action **could** negatively impact your business, while citing the **pending** inquiries from Washington State's and California's insurance agencies as described in the **risk** factor on page 31.
13. In your first bullet point, please include the net losses you have experienced over the last three fiscal years as well as your accumulated deficit to date. Please also include your accumulated deficit in the related **risk** factor on page 13.
14. In your sixth bullet point and in the related **risk** factor on page 15, please state the amount of current reserves you have established for claims.
15. In your eighth bullet point, the related **risk** factor on page 33-34 and the relevant disclosure on page 93, please state the minimum amount of **risk**-based capital APIC is required to maintain.

Risk Factors

Risks Related to Our Business and Industry

"If we are unable to maintain high member retention rates, our growth prospects and revenue will be adversely affected." page 14

16. In this **risk** factor, please include information about your cohort retention rate on a year-to-year basis, similar to the disclosure included in your MD&A on page 58.

"We depend on key personnel to operate our business . . ." page 23

CONTEXT

17. Please identify the other key executives or employees whose departure **could** result in a material adverse event.

"Our indebtedness **could** adversely affect our business and limit our ability to expand our business or respond to changes . . ." page 30

18. Please expand this **risk** factor to summarize the financial and non-financial covenants you must comply with in connection with the Square 1 credit facility and note your obligations under both the Square 1 credit facility and the PEPI Capital, L.P. term loan are secured by substantially all of your assets.

"A downgrade in the financial strength rating of our insurance company **may** have an adverse effect on our competitive position . . ." page 33

19. Please **revise** this **risk** factor to include the names of the rating agencies that review APIC and the current financial strength ratings they have assigned to it.

You **may** contact Donald Abbott at (202) 551-3608 or Lisa Vanjoske at (202) 551-3614 if you have questions regarding comments on the financial statements and related matters. Please contact Scot Foley at (202) 551-3383, John Krug at (202) 551-3862 or me at (202) 551-3715 with any other questions.

BOILERPLATE

Sincerely,

/s/ Daniel Greenspan for

Jeffrey P. Riedler  
Assistant Director

LETTER WRITERS

cc: Alan Smith



# JOBS ACT ACCOMMODATIONS AND RISK FACTORS

Panel A: Summary Statistics			
Comment Letter Variable	Pre JOBS Act	Post JOBS Act	Difference
weak/total (× 1,000)	5.20 (2.04)	4.68 (2.23)	-0.52**
strong/total(× 1,000)	3.64 (1.44)	4.38 (2.41)	0.74***
weak/strong	1.84 (2.06)	1.27 (0.85)	-0.57***
negative/positive	3.25 (1.78)	3.76 (2.83)	0.50**
uncertainty/total(× 1,000)	19.04 (5.25)	17.86 (4.79)	-1.18**
items	44.81 (17.94)	36.87 (15.98)	-4.24***
quant. items (%)	32.22 (8.36)	34.27 (10.58)	2.05**
N	126	268	

weak:  
may,  
might,  
could,  
(etc.)

strong:  
will,  
must,  
clearly,  
(etc.)

quant.  
items:  
“how much”,  
“how many”,  
“quantify”,  
“amount”,  
“range”,  
“rate”,  
“value”,  
(etc.)

Panel B: SEC Letters - Matched Sample

	weak/total	strong/total	weak/strong	negative/positive	uncertainty/total	items	quant. items (%)
SATT	-0.74 (2.20)**	0.91 (2.55)**	-0.57 (2.98)***	0.30 -0.83	-0.22 -0.30	-4.37 -1.52	2.80 (2.30)**

# QUANTITATIVE ITEMS

	(1)	(2)	(3)	(4)
Treatment	0.05 (3.36)***	0.04 (2.44)**	0.08 (2.95)***	0.07 (2.67)***
< 3 Yrs of Audited Statements			0.02 (1.11)	0.00 (0.18)
Discussion of Executive Compensation			0.01 (0.54)	0.02 (0.87)
Private Accounting Standards			0.01 (0.54)	0.02 (0.91)
Num Executives' Compensation Reported			0.00 (0.10)	0.00 (-0.62)
Num Yrs of Selected Fin Data			0.01 (1.65)*	0.01 (1.03)
Confidential Filing			-0.04 (-1.72)*	-0.04 (-2.23)**
factor1			0.01 (0.35)	0.01 (0.88)
factor2			-0.01 (-1.30)	-0.02 (-1.31)
StarUnderwriter			-0.01 (-0.75)	-0.01 (-0.57)
VCbacked			0.01 (0.61)	0.01 (0.61)
Ln(Offer Size \$Billions)			0.01 (0.61)	0.01 (1.05)
Constant	0.34 (25.82)***			
Letter Writer FE?	No	Yes	No	Yes
Firm FE?	No	No	Yes	Yes
N	1,509	1,509	1,509	1,509
Adj R-Sq	0.010	0.074	0.025	0.097

# IPO UNDERPRICING AND HARD AND SOFT INFORMATION

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
Treatment	0.06 (2.56)**	0.06 (2.13)**	0.03 (0.72)	0.08 (2.82)***	0.09 (3.06)***	0.06 (2.06)**	0.03 (0.92)	0.07 (1.36)	0.04 (1.35)	0.06 (1.18)
<u>Hard Information :</u>										
<3 Yrs of Audited Statements		0.00 (0.01)						-0.02 (-0.38)		-0.03 (-0.68)
Discussion of Executive Compensation			0.05 (1.09)					0.04 (0.83)		0.03 (0.62)
Private Accounting Standards				-0.04 (-1.09)				-0.04 (-1.09)		-0.04 (1.11)
Num Executives' Compensation Reported					0.02 (2.01)**			0.02 (1.74)*		0.01 (1.23)
Num Yrs of Selected Fin Data						0.00 (0.27)		-0.01 (-0.60)		-0.01 (-0.43)
<u>Soft Information :</u>										
Confidential Filing							0.04 (1.22)		0.05 (1.28)	0.05 (1.19)
factor1									-0.07 (-2.44)**	-0.07 (-2.36)**
factor2									0.03 (1.37)	0.02 (1.26)
<u>Control Variables :</u>										
StarUnderwriter	0.00 (0.03)	0.00 (0.03)	0.00 (0.13)	0.00 (0.07)	0.00 (0.08)	0.00 (0.02)	0.00 (0.11)	-0.01 (-0.30)	0.00 (0.00)	-0.01 (-0.26)
Log Offer Size (\$B)	0.08 (4.01)***	0.08 (3.94)***	0.08 (4.04)***	0.08 (4.16)***	0.07 (3.90)***	0.08 (3.94)***	0.08 (4.01)***	0.08 (4.04)***	0.08 (4.17)***	0.08 (4.22)***
VCbacked	0.08 (2.32)**	0.08 (2.32)**	0.07 (2.25)**	0.08 (2.34)**	0.07 (2.28)**	0.08 (2.34)**	0.08 (2.32)**	0.07 (2.27)**	0.05 (1.55)	0.05 (1.48)
Mkt-RF	0.56 (0.43)	0.56 (0.42)	0.61 (0.47)	0.47 (0.36)	0.53 (0.41)	0.61 (0.45)	0.67 (0.51)	0.54 (0.41)	0.73 (0.55)	0.62 (0.46)
AdjustedR2	0.12	0.12	0.12	0.13	0.12	0.12	0.12	0.13	0.13	0.14
N	398	398	398	397	398	398	398	397	398	397

- Only soft information is priced (partial separation)

## MARKET REACTION TO SEC COMMENT LETTERS

9. We note that following Facebook's acquisition of Instagram, Instagram disabled photo integration with Twitter. Please describe the consequences of Facebook's decision in terms of your service and the user experience. In addition, identify any other material third-party integration that you **believe** is at **risk** for similar elimination and the **potential** consequences.

# THE TONE OF SEC LETTERS AND STOCK RETURNS

Panel A: The Tone of SEC Letters and Stock Returns

Treatment	0.080 (2.11)**	0.008 (0.37)	-0.015 (-0.68)	0.027 (1.02)	0.015 (0.52)
Uncertainty	1.546 (1.01)				
Weak		-1.574 (-0.04)			
Strong			-2.418 (-0.53)		
Positive				6.751 (1.30)	
Negative					2.273 (1.19)
Uncertainty×Treatment	-4.586 (-2.50)**				
Weak×Treatment		-3.295 (-0.90)			
Strong×Treatment			2.575 (0.48)		
Positive×Treatment				-6.512 (-1.16)	
Negative×Treatment					-1.638 (-0.73)
Constant	-0.022 (-0.68)	0.017 (0.92)	0.017 (0.92)	-0.026 (-1.06)	-0.020 (-0.83)
N	389	389	389	389	389
Adj R-Sq	0.020	0.011	0.001	0.008	0.005

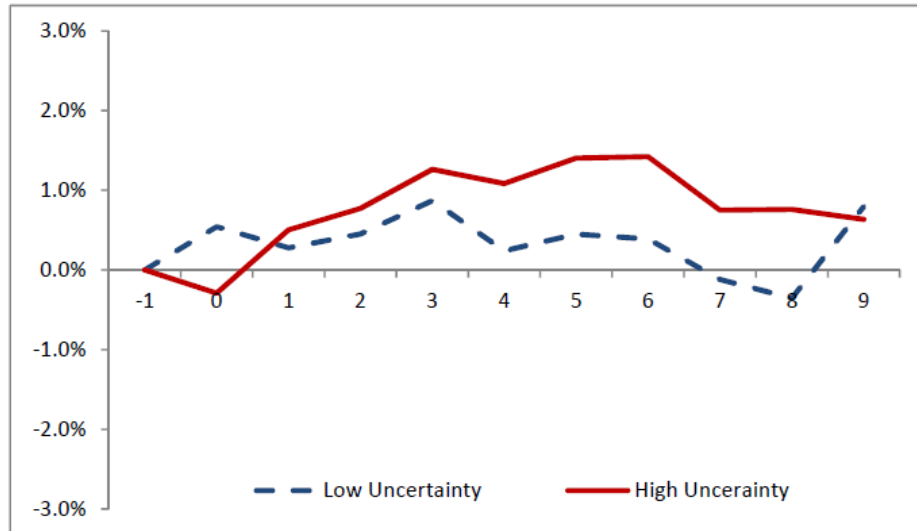
# SEC LETTERS AND STOCK RETURNS

	(1)	(2)	(3)	(4)	(5)	(6)
EDGAR Hits × Uncertainty × Treatment				-0.286 (-2.54)**	-0.315 (-2.97)***	-0.3 (-2.77)***
Uncertainty × Treatment	-4.557 (-2.43)**	-4.472 (-2.38)**	-4.571 (-2.45)**	-1.758 (-0.83)	-1.396 (-0.67)	-1.676 (-0.81)
EDGAR Hits × Treatment				0.005 (3.05)***	0.006 (3.50)***	0.006 (3.27)***
EDGAR Hits × Uncertainty				0.12 (1.39)	0.105 (1.39)	0.112 (1.42)
EDGAR Hits				-0.002 (-1.68)*	-0.002 (-1.66)*	-0.002 (-1.70)*
Uncertainty	1.714 (1.08)	1.794 (1.19)	1.802 (1.20)	0.643 (0.37)	0.857 (0.53)	0.808 (0.49)
Treatment	0.083 (2.15)**	0.083 (2.11)**	0.081 (2.12)**	0.27 (0.65)	0.026 (0.61)	0.028 (0.67)
Num Letters			0.003 (1.08)			0.002 (0.76)
Words per Item			-0.001 (-1.91)*			-0.001 (-1.73)*
Number of Analyst		-0.002 (-1.28)	-0.002 (-1.13)		-0.002 (-1.82)*	-0.002 (-1.58)
Mean Analyst Recommendation		-0.02 (-2.43)**	-0.018 (-2.33)**		-0.022 (-2.86)***	-0.02 (-2.69)***
Controls, Fixed Effects, etc?	Yes	Yes	Yes	Yes	Yes	Yes
N	389	389	389	389	389	389
Adj R-Sq	0.007	0.184	0.199	0.08	0.216	0.228

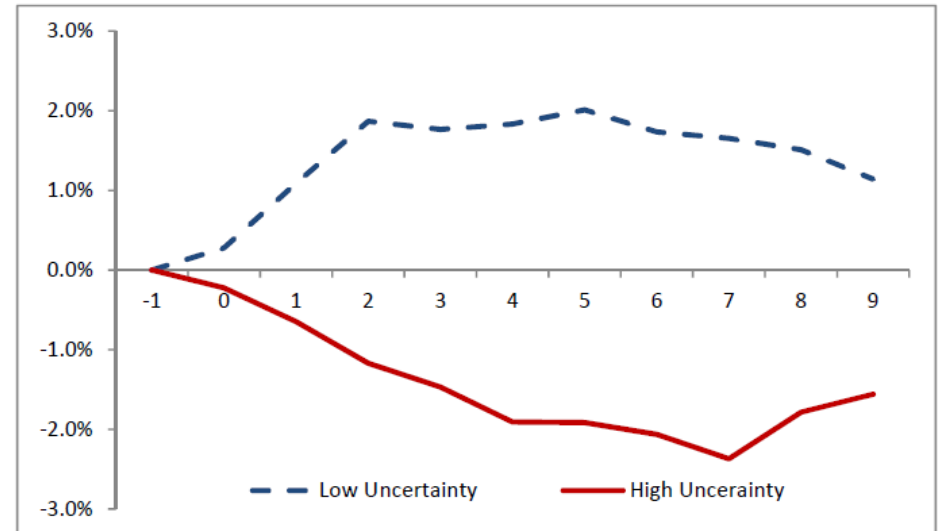


# MARKET REACTION TO SEC COMMENT LETTERS

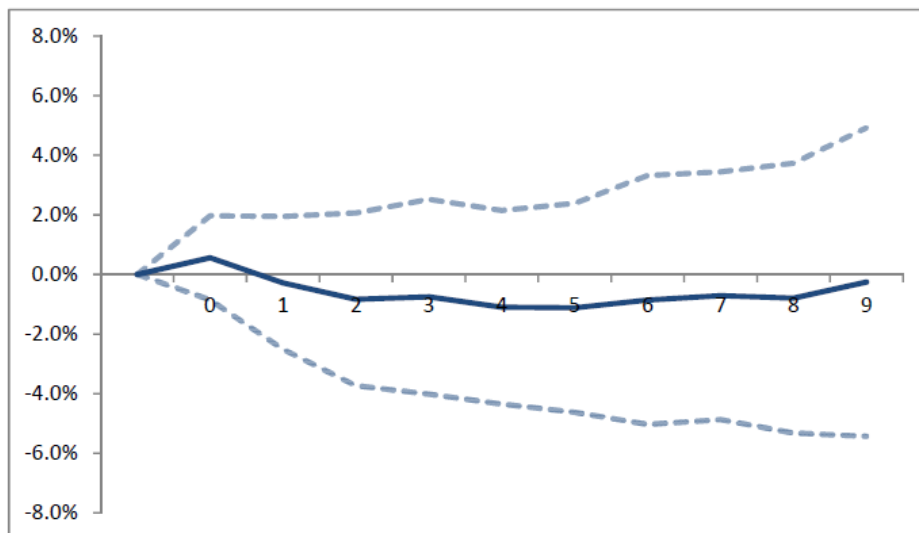
Panel A: Returns to L and H Before JOBS Act



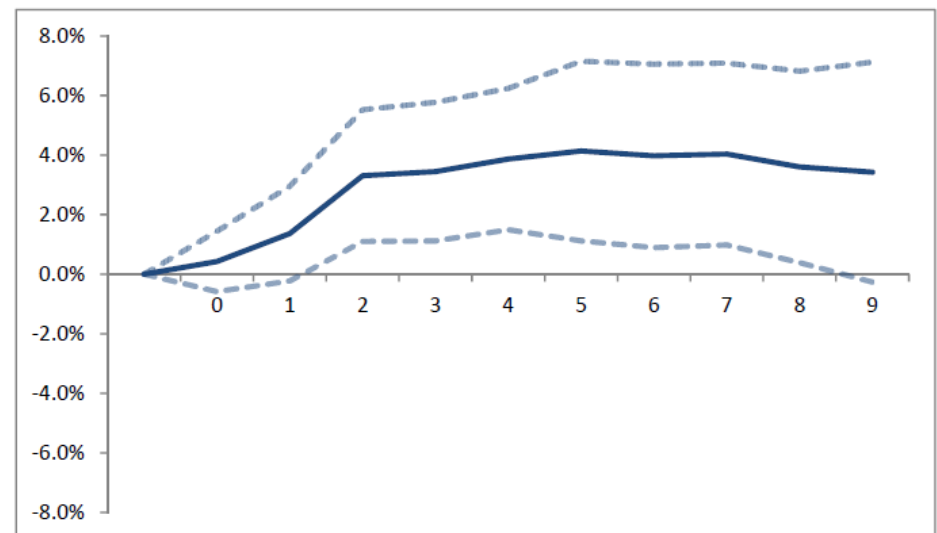
Panel B: Returns to L and H Under JOBS Act



Panel E: Diff. in Abn. Rets Before JOBS Act



Panel F: Diff. in Abn. Rets Under JOBS Act



## CONCLUSION

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- Firm behavior under the JOBS Act:
  - A reduction in the disclosure of hard information
  - A change in the disclosure of soft info (risk factors)
  - Market response:
    - More underpricing
    - Only related to soft information (partial separation)
- SEC behavior under the JOBS Act:
  - SEC uses more forceful language in its comment letters
  - More quantitative related requests
  - Market response:
    - Market prices the content of the SEC's letters upon release
    - Wasn't the case prior to the JOBS Act

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# Thank you!



## HARD VS SOFT INFORMATION: GOOGLE

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Before it's IPO, **Google** announced that it would not provide earnings guidance as that will induce short-termism.

- Google's Founder's letter during IPO (IPO in 2004):
- "We believe that artificially creating short term target numbers serves our shareholders poorly."

"We will not shy away from high-risk, high-reward projects because of short term earnings pressure. Some of our past bets have gone extraordinarily well, and others have not. ... For example, we would fund projects that have a 10% chance of earning a billion dollars over the long term. Do not be surprised if we place smaller bets in areas that seem very speculative or even strange when compared to our current businesses. ... as the ratio of reward to risk increases, we will accept projects further outside our current businesses.."

# IPO PROCESS

