BETTER MARKETS

– FACT SHEET –

The SEC Must Stop Bleeding Public Markets Dry

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Introduction & Summary

- Over the last several decades, Congress and the SEC have steadily expanded exemptions from the laws governing public securities offerings. This trend has diminished the vital role of the public markets, which offer a number of key benefits: mandatory public disclosure of material information by issuers; public trading venues such as exchanges that provide liquidity; and strong legal obligations and remedies for investors.
- Without corrective action by the SEC, this growth in private markets at the expense of public markets will continue, and it will irreparably harm investors, market confidence, capital formation, and, ultimately, the economy as a whole.

Public markets evolved for good reason: the painful lessons of the 1929 stock market crash.

- The federal securities laws were adopted as a response to the ruinous crash in the U.S. stock markets in 1929, ultimately leading to a Great Depression and an ensuing global economic downturn.
- The silver lining was that many were forced to acknowledge the consequences of the U.S.'s reliance on privately ordered financial markets riddled with self-dealing and conflicts of interest, not to mention outright fraud. The resulting reforms created market conditions that allowed our economy to flourish and permitted countless companies to rely upon liquid, transparent, and stable capital markets, widely viewed as the envy of the world.

The expansion of private markets has come at the expense of the public markets.

- The present imbalance between private and public markets is clear. More than two-thirds of new capital raising in the U.S. securities markets occurs in private markets that are largely unregulated, opaque, and inaccessible to the public. The SEC estimates that in 2019, "registered offerings accounted for $1.2 trillion (30.8 percent) of new capital, compared to approximately $2.7 trillion (69.2 percent) . . . raised through exempt offerings." Over the past decade, there has been a steady increase in Regulation D offerings," the most relied upon exemption under the Securities Act. And state regulatory authorities have sounded similar alarms, emphasizing their experience with fraud and misconduct in the growing private markets.

The private offering exemptions rest on false notions that they are "private" or "limited."

- The growth of private offerings, which dispense with the registration process, has rested largely on Securities Act section 4(a)(2), which provides that section 5's registration requirements do not apply to "transactions by an issuer not involving any public offering." Under this provision, the SEC instituted the Regulation D exemptive framework in 1982, which now represents the majority of private securities offerings. Securities Act section 3(b)(1) created another exemption, applicable to certain securities offerings of a "limited character" or having a "small amount involved."
- Remarkably, Regulation D is only one element of a much broader (and still expanding) exemptive framework. The SEC now has an entire page on its website dedicated to summarizing the multiplicity of current exemptions. These other exemptions include Regulation A, Regulation Crowdfunding, Regulation S, Securities Act section 4(a)(2), and SEC Rule 144A.

The SEC has tied its own hands, so it has little information about private offerings.

- With the growth of private markets, it is not just investors that live with a dearth of material information. The SEC is in the dark as well. It knows little about how many investors participate in these offerings, how much they invest, or how they fare. In essence, the SEC has taken a series of actions to expand the private markets with limited or no reliable information with which to reasonably judge the implications of its actions. This lack of data is associated not only with primary issuances but also with the absence of ongoing reporting obligations.
- A classic example is the Form D filed by Theranos, which included only the most skeletal information about the company as it sought to raise $100 million in the private markets. The company was eventually embroiled in a huge scandal and its CEO is scheduled to be sentenced on fraud charges in September.

Most private securities offerings are not moored to their statutory and judicial origins.

- In 1953, the U.S. Supreme Court's decision in SEC v. Ralston Purina Co. perhaps inadvertently set us in motion towards the current state of the markets. The Court's reasoning did not contemplate that years later, the SEC would allow "private" offerings involving (1) general solicitation of investors, (2) leading to hundreds of millions of dollars or more in securities sales, and (3) involving hundreds of "accredited investors" or more, (4) all without required disclosures (beyond what little there is in Form D).
- While private offerings rely heavily on the concept of "accredited investors," that test, based on a relatively modest level of wealth rather than sophistication, is a poor proxy for investors truly able to "fend for himself or herself." Furthermore, the accredited investor standard is seriously outdated, eroded by almost four decades of inflation and increasing economic activities, incomes, and wealth.

The public market framework has proven its merit.

- The U.S. regulatory framework for public offerings is simple in one sense: It rests on the notion that investors can decide for themselves where to place their money at risk, provided they receive full and fair disclosure of all material information about a particular security before arriving at their own judgments. This system as led to broad, deep, and liquid capital markets with a worldwide reputation for integrity and strong oversight.

- Consider one case exemplifying the benefits of robust disclosure that comes with public offerings: The 2019 lead-up to the We Company (parent of WeWork) IPO, a unicorn private company that had raised billions of dollars in private financings over its ten-year history. As it prepared for its IPO in 2019, it was required to disclose all material information in the registration documents it was required to file with the SEC. The ensuing public and investor scrutiny ultimately unearthed a variety of concerns about the company and its valuation. The result is well known: WeWork imploded; the CEO was ousted; there was a major retrenchment and restructuring of the company; and the IPO was withdrawn (although resurrected in 2021).

Conclusion

- The SEC has all but abandoned its mandate to curb and rationalize the ever-expanding exemptions from the registration and transparency framework envisioned by the Securities Act. Yet expanding the dark, unregulated private markets at the expense of public markets threatens the integrity and vitality of our capital markets and ultimately the financial lifeblood of our economy. Balance must be restored, and that will require the SEC to stop enlarging the private markets and then begin scaling back those that are now in place.

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Better Markets is a public interest 501(c)(3) non-profit based in Washington, DC that advocates for greater transparency, accountability, and oversight in the domestic and global capital and commodity markets, to protect the American Dream of homes, jobs, savings, education, a secure retirement, and a rising standard of living.

Better Markets fights for the economic security, opportunity, and prosperity of the American people by working to enact financial reform, to prevent another financial crash and the diversion of trillions of taxpayer dollars to bailing out the financial system.

By being a counterweight to Wall Street's biggest financial firms through the policymaking and rulemaking process, Better Markets is supporting pragmatic rules and a strong banking and financial system that enables stability, growth, and broad-based prosperity. Better Markets also fights to refocus finance on the real economy, empower the buyside and protect investors and consumers.

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