BETTER MARKETS

SPECIAL REPORT

Private Securities Offerings Should Be the Exception, Not the Rule

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Introduction

Our public capital markets are the envy of the world, yet the ever-increasing ability to raise money privately is bleeding the public markets dry. Now Congress wants to make it even easier to raise money through private securities offerings. Before doing so, policymakers should consider the ramifications for capital formation and, therefore, the entire economy and all Americans.

Capital formation—real capital formation—is about getting capital to its most productive uses. The public markets facilitate real capital formation through mandatory disclosure requirements. Disclosures allow investors to determine where best to invest their capital so that the companies with the best ideas can turn those ideas into a reality. But the private markets lack these disclosure requirements. As a result, expanding access to the private markets may increase the ability to raise funds but not necessarily the ability to get capital to its most productive uses.

In this regard, it is not surprising that a recent study found that public markets allocate capital much more efficiently than private markets. This means that, rather than further expanding the private markets, policymakers need to curb the ability to raise funds in the private markets and instead revitalize the public markets. Unfortunately, Congress appears poised to do the opposite.

The Accredited Investor Definition Protects Retail Investors

On May 20, 2025, the House Financial Services Committee will hold a markup to consider several bills pertaining to the capital markets, including bills to expand the definition of an accredited investor who may participate in private securities offerings by allowing individuals to qualify by taking a test. But policymakers should consider the issues carefully before deciding to expand the definition of an accredited investor. The definition ensures that unregistered private securities offerings are limited to investors who can “fend for themselves.” Investors who do not meet the definition—ordinary retail investors—need and deserve the protection of the federal securities laws. Expanding the definition would subject investors who may not have the resources to withstand losses in the opaque and unregulated private markets to undue risks.

Under the current definition, individuals may qualify as accredited investors if they had an income over $200,000 (or $300,000 with a spouse or partner) in each of the prior two years and reasonably expect the same for the current year; or if they have a net worth over $1 million, excluding their primary residence (individually or with a spouse or partner). The income and net worth thresholds matter because ordinary retail investors with much fewer financial resources are not on equal footing with the accredited investors who have traditionally invested in the private markets. These thresholds ensure that the investors who put their hard-earned money at risk in low-to-no investor protection private securities offerings are those who have the financial resources to sustain the large losses that often result from such investments.

Those investors often have broadly diversified investments and the financial means to absorb even substantial losses when they occur, and in the private markets there are going to be losses, because the odds of a startup folding are much higher than that of an established public company collapsing quickly. Unlike these investors, however, the typical retail investor can’t invest in ten private offerings (let alone 100 private offerings) and hope one pans out.

The typical retail investor is also going to be less able than accredited investors to distinguish between meritorious and worthless offerings in the private markets. That's because the absence of disclosure requirements in the private markets means that the bargaining power, sophistication, and access to information that insiders and institutional investors have gives them every advantage. These accredited investors have the resources to conduct their own due diligence into offerings for which there is very little information available. Ordinary retail investors who lack these resources have less ability to determine for themselves which opportunities in the private markets are worthwhile. Therefore, although proponents of expanding the accredited investor definition say that retail investors should not be excluded from the high returns supposedly offered by private firms' early-stage growth, retail investors are unlikely to invest early in the next Google.

Indeed, those who say that restricting access to the private markets unfairly discriminates against lower income Americans and deprives them of opportunities to profit from private offerings ignore the important historical purpose for the accredited investor standard. The standard exists to protect everyday investors from the devastating financial consequences of high-risk investments that are not as transparent or well-regulated as publicly-listed securities. Accredited investors are deemed able to fend for themselves. They do not need the protection of the federal securities laws as much as retail investors. Expanding the definition to capture retail investors would take away those protections in high-risk offerings from the investors who need them most. As Stephen Amdur, global leader of Pillsbury's mergers & acquisitions and private equity practices, said

> The SEC's historical accreditation rules were done for a reason.

This is why the SEC's recent guidance allowing private funds to sell to investors so long as the investors agree to certain minimum investment amounts and self-certify that they are accredited is so dangerous to retail investors. Previously, private funds had to take "reasonable steps" to verify that purchasers were accredited investors who could fend for themselves, undertake their own due diligence and research, and absorb very substantial losses. Now, individuals may certify that they are able to participate in private offerings even though they may not have the resources to determine which companies to invest in or to absorb the losses that may occur. When the SEC adopted the verification requirement, it said specifically that an issuer would not be considered to have taken reasonable steps to verify accredited investor status if it requires only that a person check a box in a questionnaire or sign a form. So the guidance eviscerates the verification requirement and leaves investors without the very protections that the rules were designed to provide. Additional steps to liberalize or circumvent the definition of an accredited investor will only further endanger ordinary retail investors, many of whom will suffer crippling losses.

Private Market Assets are Illiquid and Hard to Value

The reason that the private markets are so risky—and the reason it matters that the accredited investors who can invest in the private markets include only those investors who can really fend for themselves—is that the private markets lack the disclosure requirements that exist in the public markets and contain assets that are far more illiquid and hard to value. For these reasons, the SEC's Office of the Investor Advocate has frequently expressed concern "about the heightened risks of investing in the private markets compared to investing in the public markets, particularly for retail investors."

Indeed, the lack of clarity on what an asset is worth is a regular complaint even among the accredited investors who participate in the private markets. The difficulty with private market valuations has led even sophisticated institutional investors such as BlackRock to lose hundreds of millions of dollars in investments in private companies. If the most sophisticated institutional investors in the world can suffer gigantic losses because private market assets are hard to value, what chance do retail investors have?

The lack of disclosures, illiquidity, and valuation difficulties that plague the private markets would be nearly impossible to navigate for retail investors. And the potential harm is unmistakable, as evidence increasingly shows the risks of the private markets. Private equity portfolio companies are about 10 times as likely to go bankrupt as non-private equity owned companies. Bankruptcy filings by U.S. companies backed by private equity and venture capital increased by more than 15% in 2024 to the highest annual total on record. Research also shows that investors who boost their allocations to the private markets are driven largely by a mistaken belief that private debt and equity deliver returns orders of magnitude above those of the public markets. The benefits of exposing retail investors to the private markets are therefore unlikely to outweigh the risks.

Providing retail investors with greater access to the private markets would also subject them to markets that are ill-suited to their needs. Retail investors are used to easy access to their money. So liquidity is one major reason retail investors should not have access to the private markets.

Additionally, the illiquid nature of these [private market] assets means investors may be prepared to wait years for an exit, with no guarantee of returns. What happens if a retail investor needs to liquidate their positions during a market downturn? The options are limited, and the consequences can be severe.

Indeed, retail investors also would be investing in the private markets at a time of unprecedented illiquidity. So retail investors would face a market with which they are unfamiliar, at an inopportune time, and which does not have the basic protections of the foundational securities laws.

Any attempt to provide retail investors with the supposedly lucrative opportunities in the private markets must account for the fact that these opportunities come with much higher risk and much less transparency about the nature of that risk. Given "the risks associated with investing in private firms, it is only logical that there should be additional investor protections, not less." Policymakers should not facilitate retail investor access to the private markets without these protections.

Private Market Assets are Especially Risky for 401(k)s

The push to open 401(k)s to private market investments is especially dangerous. Retirement plans such as 401(k)s should not have greater access to the private markets. There are good reasons for preventing private funds from gaining access to 401(k)s.

> [T]he law requires companies to act in retirees' best interest when selecting investments to offer in their 401(k) plans. That's made companies wary of investments that are expensive, hard to price or difficult to sell. Private equity is all three.

Then there are the fees. Private funds charge higher fees than public funds.

> It's unclear what 401(k) investors would pay, but a look at interval funds isn't encouraging. The average interval fund has an expense ratio of 2.5%, according to Morningstar. That's almost 10 times higher than the 0.3% average for target-date funds holding mainly stocks and bonds.

Indeed, expenses at some private funds can run as high as 5.94%, with an average of 2.91%.

This makes it understandable that "the private equity industry is eager to get their hands on" the $37.8 trillion that Americans hold in direct contribution and individual retirement accounts. Retirement plan participants, though, may be less eager to get their hands on private funds. "Most employers have historically shied away from offering investments beyond stocks and bonds to their 401(k) plan participants due to higher fees associated with alternative investments and a fear of getting sued for drifting beyond more traditional asset allocations." Some employees have come to see high fees as a drag on performance and, possibly, a breach of their employers' fiduciary responsibility. Again, this is understandable as allowing 401(k)s and other retirement plans to have greater access to the private markets would create significant dangers "for mainstream investors who might not understand these opaque, high-risk, and expensive investments."

Bloomberg's editorial board has noted that the private funds industry portrays its push to access 401(k) plans as allowing regular people to reap returns currently reserved for the wealthy. It then asks why "only so-called accredited individual investors, who are already relatively wealthy, have access to the expanding and potentially lucrative sphere of private assets?" Fortunately, Bloomberg's editorial board also answers that question:

> There are at least three reasonable objections to [private funds accessing 401(k)s].
>
> One is transparency. Investors in public securities always know what they're worth: They can see market prices based on actual trading and extensive disclosures. Private assets, by contrast, often leave them in the dark, relying on 'fair value' estimates from fund managers. Even big institutional investors complain that they lack the information needed to properly understand the funds' performance and risks.
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> Costs are another concern. Investing in illiquid stuff is expensive. Private funds often charge 2% of assets plus 20% of gains, compared to less than 0.1% of assets for a typical 401(k) offering. Meanwhile, evidence is mixed on whether end investors, after fees, do much better than they would in public markets, particularly when adjusted for risk. Research suggests that less sophisticated investors get the worst returns—a dynamic that doesn't bode well for the 401(k) crowd.
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> Timing, finally, presents a risk. Many private capital managers have lately struggled to deliver the returns investors expect, as illiquid assets have proved, well, hard to sell. To generate cash, they've turned to practices including myriad types of borrowing and so-called continuation funds, which raise money from new investors to pay off the old. This could be a hiccup or an impending reckoning. In any case, there's a danger that if retail investors pile in, they'll be left holding the bag.

For these reasons, even if private funds obtain access to 401(k) plans, "investors should proceed with caution." But there is no reason to allow private funds to access 401(k)s. Again, the conclusion of Bloomberg's editorial board is insightful: "[I]t's hard to see why private assets belong in the tax-advantaged accounts intended to ensure a comfortable old age for millions of Americans."

Policymakers Should Revitalize the Public Markets

Rather than further expanding the private markets, policymakers should revitalize the public markets. The ever-expanding exemptions from the basic requirement that most securities offerings be registered has allowed the private markets to overtake the public markets. Policymakers should curb those exemptions and return to the regime that Congress originally envisioned.

Congress enacted the federal securities in the 1930s after the stock market crash of 1929, and in doing so generally required that securities offerings be registered. That is why, to avoid registration, issuers must rely on an *exemption* from registration. So the framework Congress originally created made the default a registered public offering.

Registered offerings include disclosures about the company, its financial status, and the funds being raised. As a result, registered offerings are available to all investors, which is why they are also referred to as public offerings. Conversely, private offerings require far fewer disclosures. So they are mainly available to financial institutions or other investors who are better positioned to absorb the risk of loss and make informed decisions with the reduced information disclosed in a private offering. For these reasons, the registration exemptions were originally limited in scope.

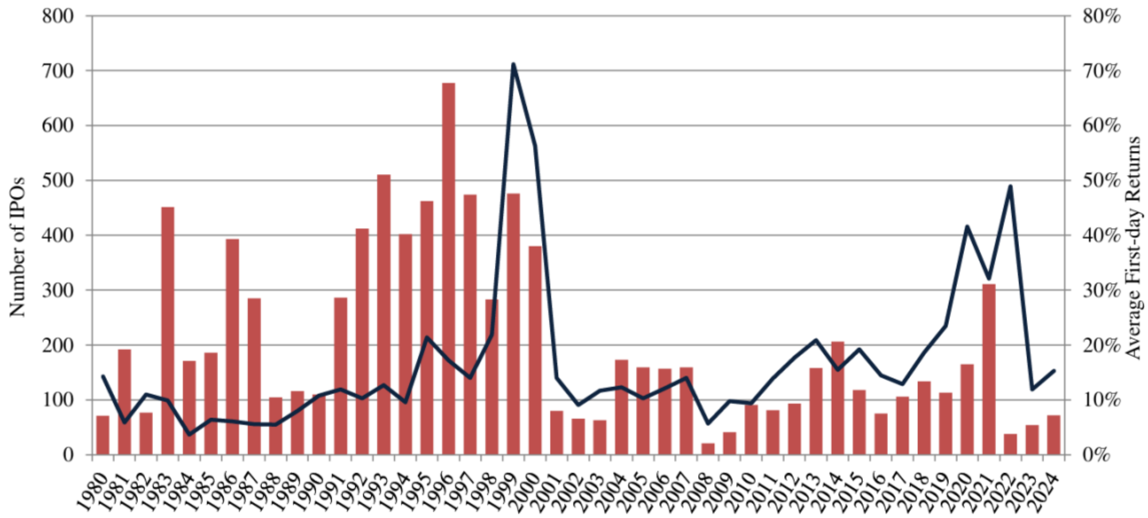
But over the last several decades, the SEC has used the authority Congress delegated to it to steadily expand the exemptions that permit private offerings free from the registration and disclosure requirements that govern public offerings. The most prominent of these exemptions are Regulation Crowdfunding, Regulation A, and Regulation D—which itself comprises Rule 504, 506(b), and 506(c). The exemptions from the registration requirement are now so numerous that the SEC has an 8x10 chart to explain all the different ways companies can raise money privately.

It is these expanded exemptions that have allowed capital raising in the private markets to surpass capital raising in the public markets. Companies have less need for the public markets since they may raise capital privately without required disclosures.

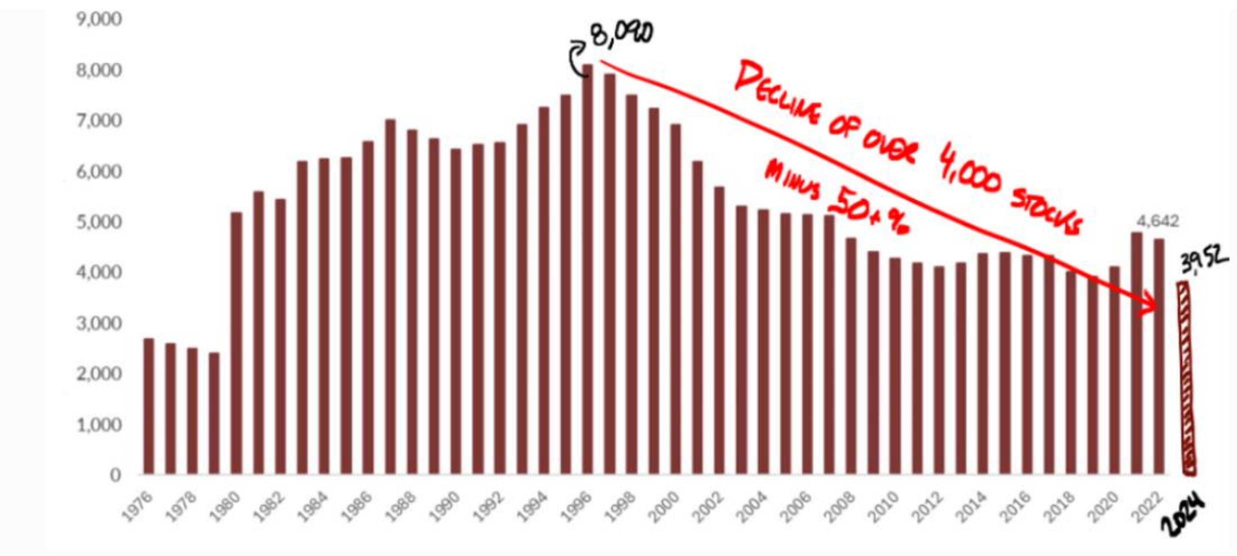
> David Solomon, the chief executive of Goldman Sachs, said last month that one reason I.P.O activity had been slow was that start-ups could get the capital they needed from private investors. . . . Mr. Soloman said he has often told start-up founders there are three reasons to go public, and two of them—raising money and letting shareholders sell their stock—have been solved by the private markets.

As this statement suggests, the increasing availability of private offering exemptions has not only allowed the private markets to proliferate but has also led to fewer IPOs and public companies. In other words, a big reason for the ongoing decline in IPOs and public companies is the availability of private financing. And the fall in IPOs and public companies that has coincided with the rise in the use of private offering exemptions has been staggering in its speed and scale.

The number of IPOs and average first-day returns per year, 1980-2024



The number of listed U.S. Public Companies, 1976-2024



The decline and low number of U.S. IPOs over the past 25 years have understandably raised concerns. As has the fact that there were fewer than 4,000 publicly traded companies in the United States last year, down from over 8,000 companies in the 1990s. To revitalize the public markets, policymakers need to return to the framework Congress originally envisioned—with registered public offerings the default and exemptions available only in narrow circumstances.

This is necessary to not only revitalize public markets but also maintain investor trust.

> It's not that America has half as many companies as 30 years ago—it's that companies are increasingly staying private, largely outside the scrutiny of the public eye. Publicly listed companies are subject to regulatory oversight and disclosure requirements, which help ensure transparency and maintain investor confidence. With fewer companies listed, there may be a decrease in overall transparency and investor trust in the market.

The decline in IPOs and public companies also limits who benefits from our markets. Private securities offerings do not have the essential disclosures that protect investors and therefore are not available to everyone, which is why they are supposed to be limited. So by neglecting public markets, we are denying an essential democratic component of our economic structure.

Expanding the Private Markets Would Hurt Retail Investors

Policymakers seem to have recognized that one of the main problems with growing private markets and shrinking public markets is that ordinary investors are unable to participate in the private markets. But their solution seems to be to allow private companies and funds to solicit retail investors. This is a huge mistake that will harm investors, markets, and the economy.

The problem is that the private markets are already too big, not that they are too small. Retail investors already fear that the best opportunities are in the private markets.

> The worry is that much of the good stuff has been scooped up in private deals, leaving public investors to rummage through what's left – often companies struggling to secure private funding or whose shareholders are racing for an exit. This raises the spectre of adverse selection, with private owners trying to offload unwanted inventory on to the stock market.

Expanding retail access to the private markets would exacerbate, not fix, this situation. Retail investors would not end up investing in the same opportunities as the institutional investors who access the private markets now. Instead, retail investors likely would end up investing in the private securities offerings that institutional and accredited investors reject.

> Private firms have a seemingly bottomless supply of capital from institutional and high-net-worth individuals . . . . The notion that institutional investors may have passed over a large set of attractive private investments is therefore implausible. There is simply no evidence that issuers with reasonable prospects for growth and profitability currently lack capital in the private markets. . . . The private issuers that seek out direct investment from small-dollar retail investors are likely to be the smallest issuers with the worse prospects—the product of severe adverse selection, if not fraud. It would be ill-advised to steer retail investors towards these firms.

Indeed, even private equity industry executives worry that retail investors will not be able to discern between "credible funds and fly-by-night entrants chasing lucrative fees," which will lead retail investors to be stuck with the private market leftovers.

Retail investors would be in an much worse position than they are now, since they would not have the disclosures that exist in the public markets, and would likely lack the ability to do their own due diligence, unlike the traditional private market investors who are better able to fend for themselves. So retail investors in the private markets would face a strikingly uneven playing field.

> With limited funds to invest and limited opportunities in private securities, retail investors would almost certainly *increase* their overall risk . . . .

Retail investors would also face heightened risks because it is easier to perpetrate a fraud without required disclosures. In the absence of such disclosures, "there is undoubtedly a 'loss of the information needed to detect and punish fraud.'" In other words, because the private markets are opaque and unregulated, it can be easier to deceive investors—even investors who would have the resources to conduct their own due diligence. For example, Theranos and Elizabeth Holmes raised $700 million from mostly wealthy investors without ever having to provide financial statements audited by an independent public accounting firm. Theranos turned out to be a massive fraud. If those investors were deceived, one can only imagine what would happen to retail investors.

For similar reasons, further expanding the private markets would also threaten the economy. That's because information as basic as who actually owns a company, how it makes its money, and whether it is profitable is not readily available in the private markets. That information is effectively invisible to investors, the media, and regulators.

> This is not a recipe for corporate responsibility or economic stability. A private economy is one in which companies can more easily get away with wrongdoing and an economic crisis can take everyone by surprise.

Yet if current trends continue and the private markets continue to expand, "'we could end up with a completely opaque economy." This means that the solution to the problem of companies staying private isn't to allow them to access even more capital privately by soliciting retail investors. Instead, the solution is to return to a framework where public offerings are the default. This would provide the appropriate level of protection for retail (and other) investors from the risks of the private markets, as Congress originally intended. It would also mean that more investors would have more information about the companies that seek their capital and that information would be subjected to more scrutiny. All investors thus would be able to make better investment decisions.

Policymakers, therefore, should ensure a healthy pipeline of companies going and remaining public by reversing the ever-expanding exemptions from the registration requirements of the securities laws. Allowing the increasing use of these exemptions draws issuers and capital away from the public markets and thereby "reduce[s] the liquidity, price discovery, and information quality that have made the U.S. capital markets the envy of the world for over 80 years." The even playing field that retail investors deserve is one where most companies provide all investors with the disclosures that are required in a public offering and that are necessary to inform their investment decisions, as Congress intended when it first passed the securities laws in the 1930s.

Expanding the Private Markets Would Hurt Real Capital Formation

Congress's intention that most securities offerings be registered offerings available to the public was not designed simply to protect investors; instead, it was also designed to facilitate real capital formation—getting capital to its most productive uses. As the Supreme Court has recognized, the intent of Congress in mandating disclosure in registered public offerings was

> to prevent further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation, to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities; [and] to bring into productive channels of industry and development capital . . . .

In this way, Congress thought regulated public offerings would contribute to economic growth.

As a result, the increasing ability to raise money privately harms not just investors but also capital formation. Disclosures help investors "assess risks and make informed investment decisions." So "disclosure leads to an informed investor—and informed investors are ones who will make investment decisions that collectively, in the aggregate, will yield productive benefits and growth to the real economy." That is why disclosure is "essential to strong capital formation and to real economic growth." Yet private markets lack meaningful disclosure requirements.

Policymakers should consider the relationship between disclosures, strong capital formation, and real economic growth as they grapple with the divide between the public and private markets. Strong capital formation and real economic growth are about "creating productive capital in our economy." This is meaningfully different than the "singular act of raising capital":

> But, in the discussions about capital formation, it seems to have become synonymous with the ability to raise funds. Whatever makes it easier and cheaper for issuers to raise money seems to constitute capital formation. However, the singular act of raising capital does not necessarily result in capital formation. . . .
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> Facilitating true capital formation is about helping investors and other capital providers to make informed decisions. . . . Capital formation is about ensuring that the companies with the best ideas, even if those ideas are risky, can get the financing to make those ideas a reality. The goal is for issuers to provide potential investors with appropriate information so that investors can assess the risk of investing their capital. For that goal to be reached, we need strong and effective securities regulation that fosters appropriate disclosures.
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> By comparison, just think about the recent financial crisis, as well as the Great Depression, and you will see that poor securities regulation does not facilitate the formation of productive capital. In both crises, the savings of hard working Americans went into investments that wound up being worth little, if anything. And in many cases it was because of a lack of regulation and disclosures.

In other words, disclosures such as those mandated in the public markets allow investors to identify where capital is best directed. And mandatory disclosures also benefit companies by compelling them to disclose an optimal amount of information to the market, which reduces their collective cost of capital. The continued expansion of private markets, on the other hand, would result in investors receiving far less information and companies facing a higher cost of capital.

Indeed, a recent study shows that public markets allocate capital much more efficiently than private markets. According to the study, a dollar of capital allocated in public markets generates $0.35 more in annual revenue over the next three years than a dollar allocated to a comparable firm via a private market deal. The study finds the reason for greater allocative efficiency in public matters to be better informational efficiency and governance mechanisms, which increase allocation efficiency by helping investors direct capital to more productive projects.

Conclusion

The prevailing view these days is that we need deregulation. But there is a problem with that view.

> That view is inconsistent with the underlying philosophy of the Exchange Act: that prevention of fraud, maintaining of fair and orderly markets, and assurance of honest corporate disclosure are the essential underpinnings of capital formation.

Our foundational securities laws were designed to provide investors with the information they need to determine how best to allocate their capital through registered public offerings. The deregulation of our securities markets through the expansion of unregulated private markets therefore threatens the basis on which our capital markets thrive. Instead of further expanding those private markets, policymakers should focus on revitalizing the public markets with all of their attendant benefits.

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