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Expanding Retail Access to Private Markets

The private markets are experiencing remarkable growth and offer potentially significant benefits to investors. Unfortunately, current Securities and Exchange Commission ("SEC") regulations limit retail investors' participation in these markets. Expanding access to private markets for retail investors (while simultaneously reducing the regulatory burdens on public companies) is crucial for promoting wider participation in economic growth and wealth creation.

The Current Landscape

In recent years, private markets have witnessed substantial growth, surpassing public markets in terms of capital raising. At their peak in 1996, there were 7,300 US public companies. Today there are only around 4,300, while the number of private equity backed firms has grown five-fold over the last 20 years. In fact, from July 2020 to June 2021, private offerings raised a total of $3.3 trillion, compared to the $317 billion raised in IPOs in the same period.[1] This is unsurprising given that nearly ninety percent of the companies in the United States with more than $100 million in revenue are private.[2] Additionally, companies are staying private longer, with the median age of a company at its IPO going from six years in 1980 to eleven years in 2021.[3] There are a number of reasons companies are choosing to remain private including, but not limited to, the substantial regulatory burdens placed on public companies, less capital flexibility, more onerous reporting requirements, and higher litigation expenses.[4]

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[1] U.S. Securities and Exchange Commission Office of the Advocate for Small Business Capital Formation, Annual Report for Fiscal Year 2021 (Sept. 27, 2021), available at https://www.sec.gov/files/2021-oasb-annual-report.pdf.

[2] Hamilton Lane, Private Market Investing: Staying Private Longer Leads to Opportunity (April 14, 2022), available at https://www.hamiltonlane.com/en-us/insight/b3d3560b-bc62-40c2-942d-24027ab15fdb/private-market-investing-staying-private-longer-le; Apollo, Many More Private Firms in the US (April 20, 2024), available at https://www.apolloacademy.com/many-more-private-firms-in-the-us/.

[3] Nasdaq, As Companies Stay Private Loner, Advisors Need Access to Private Markets (Aug. 11, 2022), available at https://www.nasdaq.com/articles/as-companies-stay-private-longer-advisors-need-access-to-private-markets.

[4] U.S. Securities and Exchange Commission Commissioner Hester Peirce, Statement on Mandatory Climate Risk Disclosures. U.S. Securities and Exchange Commission (2024, March 6), available at https://www.sec.gov/newsroom/speeches-statements/peirce-statement-mandatory-climate-risk-disclosures-030624 ("The Commission performs impressive math-crobatics to slash the anticipated cost of the rule by almost 90 percent, but even with these potentially understated estimates, the Commission still must concede that this rule will increase the typical external costs of being a public company by around 21%. The rule is particularly likely to overwhelm small public companies, many of which are already struggling under the costs of being public. At a time when few companies are choosing to go public, why would we add so substantially to the price tag?")

Despite the growth of the private markets, private markets remain largely inaccessible to retail investors due to regulatory restrictions, particularly the "accredited investor" standard. In order to qualify as an "accredited investor," an investor must have a net worth over $1 million (excluding their primary residence) or have an income of over $200,000 in each of the previous two years.[5] According to a 2023 study from the SEC, only 18.5% of U.S. households qualify as accredited investors.[6] Importantly, minority households are much less likely to qualify as accredited investors. Despite being nearly twenty percent of the U.S. population, only 2.8 percent of accredited investors are Latino.[7] Similarly, despite being more than 12 percent of the U.S. population, only 1.3 percent of accredited investors are Black.[8]

As the private markets continue to grow and companies stay private longer, a greater percentage of the investment returns occur before companies go public.[9] Thus, by preventing ordinary investors from participating in the private markets, SEC regulations are exacerbating existing social and economic divides.

Why Increased Access is Essential

Significant Growth and Returns in Private Markets: The private markets have grown significantly in recent years, and a substantial portion of investment returns is generated in private markets before companies go public. Limiting access to these markets effectively denies most retail investors access to these returns.

Promoting Financial Inclusion and Equity: Limiting private market access based on wealth perpetuates financial inequality. The current "accredited investor" definition, based primarily on wealth and income, disproportionately excludes minority investors. This disparity restricts opportunities for wealth creation and exacerbates existing social and economic divides. Wealth does not equal knowledge and understanding of investments, which is the most important factor when evaluating a private market investment.

*Private Markets Foster Innovative New Products and Service*s: Many of the most innovative new financial products and services are being developed in the private markets and are therefore unavailable to most retail investors. A prime example is the "tokenization" of real world assets, which allows traditionally illiquid assets like real estate or fine art to be fractionalized and traded globally on digital platforms, unlocking new opportunities for investors and reducing transaction costs through smart contracts. Currently, the only viable option available in the U.S. is to offer tokens to "accredited investors" and to rely on Regulation D, an exemption from the registration requirements of the federal securities laws. As a consequence, the potential investor pool in

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[5] U.S. Securities and Exchange Commission, Accredit Investors (Sept. 19, 2024), available at https://www.sec.gov/resources-small-businesses/capital-raising-building-blocks/accredited-investors.

[6] U.S. Securities and Exchange Commission, Review of the "Accredited Investor" Definition under the Dodd-Frank Act (Dec. 14, 2023), available at https://www.sec.gov/files/review-definition-accredited-investor-2023.pdf.

[7] U.S. House Committee on Financial Services, Republican Staff Report, Ten Years of the Jumpstart Our Business Startups (JOBS) Act of 2012 (April 5, 2022), available at https://financialservices.house.gov/uploadedfiles/jobs_act_at_10_report_final.pdf.

[8] *Id.*

[9] AngelList, Comment Letter on Concept Release on Harmonization of Securities Offering Exemptions (Sept. 25, 2019), available at https://www.sec.gov/comments/s7-08-19/s70819-6203757-192567.pdf.

tokenized real-world assets ("RWAs") is limited to high net-worth individuals ("accredited investors") and qualified institutions, blocking the vast majority of retail investors in the U.S. from accessing this potentially beneficial market. This severely impacts the potential for large-scale adoption and trading of tokenized RWAs in the U.S. capital markets.

Pathways to Expand Retail Access

Abandon Antiquated Barriers to Access Such as the Accredited Investor Definition: Access to private securities markets is still largely limited to those meeting wealth-based criteria under the SEC's "accredited investor" definition, leaving many locked out of high-growth investment opportunities. The SEC should explore regulatory reforms that allow more individuals to responsibly access the private securities markets without sacrificing important investor protections under the federal securities laws. While additional measures to expand the number of individuals who qualify under the SEC's "accredited investor" definition would help, rules like this are simply antiquated, irrelevant, and unnecessary in today's age of Artificial Intelligence (AI) and ubiquitous access to information. Technology already exists today that can help retail investors of all backgrounds better understand the risks associated with investing in the private markets and responsibly determine – without paternalistic government intervention – whether and how to participate. In particular, AI and tokenization, which can help retail investors access the private markets in a responsible, informed, cost-effective, and efficient manner, can and should eliminate the need for the SEC's accredited investor standard.

Short of Eliminating It, Democratize Accredited Investor Standard: Until the accredited investor standard is eliminated altogether, there are a number of steps the SEC could take to democratize access to the private markets under the accredited investor definition. For example:

> *Knowledge-Based Qualification*: The SEC should implement a knowledge-based test to qualify as an accredited investor. In 2020, the SEC modernized the "accredited investor" definition to permit "natural persons to qualify as accredited investors based on certain professional certifications, designations or credentials or other credentials issued by an accredited educational institution, which the Commission may designate from time to time by order."[10] However, to date, the SEC has not designated any additional professional certification or credentials that would allow an investor to meet the "accredited investor" definition. In 2023, the U.S. House of Representatives passed a bill by a vote of 383 to 18 that would "create a new pathway for investors to gain accredited investor status by passing a thorough investment exam administered by FINRA."[11]
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> *"Chaperoned Access"*: The SEC should revise the "accredited investor" definition to include any investor who is advised on the merits of making a private investment by an SEC- or state-registered investment adviser or a registered broker-dealer providing investment advice subject to Regulation Best Interest.

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[10] U.S. Securities and Exchange Commission, SEC Modernizes the Accredit Investor Definition (Aug. 26, 2020), available at https://www.sec.gov/newsroom/press-releases/2020-191.

[11] Congressman Mike Flood, Congressman Flood's First Bill, the Equal Opportunity for All Investors Act of 2023, Passes the House with Bipartisan Support (May 31, 2023), available at https://flood.house.gov/media/press-releases/congressman-floods-first-bill-equal-opportunity-all-investors-act-2023-passes.

> *Self-Certification*: The SEC should explore allowing investors to participate in the private markets by self-certifying that they understand the risks associated with such investments. As SEC Commissioner Hester Peirce said, "Americans should be able to invest and build wealth without having to convince regulators—even those operating with a protective impulse—that they are sophisticated enough or rich enough."[12]

Leveraging Closed-End Funds: The SEC staff has an informal position that securities issued by a closed-end fund that invests more than 15% of its assets in private funds can be sold only to accredited investors. The position is not set forth in a law, rule, or even formal guidance. The SEC should allow closed-end funds that invest in the private markets to sell shares to all investors.

Conclusion

Expanding retail access to private markets is not simply about increasing investment options; it's about creating a more inclusive and equitable financial system, and allowing retail investors to participate in the financial upside of fast-growing private companies, just like institutional investors can do today. By removing arbitrary barriers and empowering individuals with the knowledge and tools to participate in these markets, we can unlock greater economic opportunities and foster broader participation and wealth creation opportunities for all Americans.

[12] U.S. Securities and Exchange Commission Commissioner Hester Peirce, Freedom: Remarks at Meeting of the Small Business Capital Formation Advisory Committee (Nov. 29, 2023), available at https://www.sec.gov/newsroom/speeches-statements/peirce-remarks-sbcfac-112923.