Written Testimony of

Alexandra Thornton, Senior Director

Center for American Progress

Before the United States House of Representatives Financial Services Committee

Subcommittee on Capital Markets

"The Future of American Capital: Strengthening Public and Private Markets by Increasing Investor Access and Facilitating Capital Formation"

February 26, 2025, 10am

Chairwoman Wagner, Ranking Member Sherman, and members of the subcommittee, thank you for the opportunity to appear before you today to discuss access to capital markets and facilitating capital formation.

My name is Alexandra Thornton. I am senior director of financial regulation at the Center for American Progress, an independent, nonpartisan policy institute that is dedicated to improving the lives of all Americans through bold, progressive ideas, as well as strong leadership and concerted action.

Capital markets work best when there is an informed bargain between the seller and buyer of securities. Investors seeking returns provide their capital to businesses and funds, who in turn, seek to put that capital to use. But what if the capital that is formed by those businesses and funds is not put to good use? What if it is used to provide more compensation for the company executives? Or what if the company's products do not sell? Would the investors have provided the capital if they had known about these risks?

The way the US. capital markets, which are the most robust in the world, guard against investor loss and economic waste is to require those seeking to raise capital from investors to provide basic information to investors. The government does not block investors. It does not approve or disapprove of investments. Congress decided long ago that investors needed the government to ensure they had fundamental, accurate information, and basic rights. And with those tools, investors would be empowered to drive our capital markets and economy forward.

Many of the bills before the committee today would expand the ability of private market companies and funds to sell securities to a broader range of investors without providing accurate information about operations, management, risks, and financial position—the amount and type of information that potential investors and other participants in the public markets receive. This is not expanding or improving capitalism. It is unreasonably increasing risks for investors and tilting the bargain in favor of the party seeking capital.

Expanding access to a wider swath of investors and the public would do nothing to reduce the hidden risks of those investments, but it would expand the reach of those risks into potentially millions of American homes.

The timing for much of this legislation seems particularly ill-advised.

Private markets are becoming ever larger.[1] Asset prices frequently become detached from the underlying intrinsic values of the assets themselves, especially among large highly-valued private firms, or unicorns, as I will explain later in my testimony. Private company and private fund stakes are frequently being sold in loosely regulated secondary markets among sophisticated investors at fractions

[1] McKinsey & Company, "Global Private Markets Report 2025: Private equity emerging from the fog," February 13, 2025, available at https://www.mckinsey.com/industries/private-capital/our-insights/global-private-markets-report.

on the dollar.[2] Adding further risk is the relatively new phenomenon of billion-dollar private company frauds every year or so.[3]

Introducing to these markets non-professional investors who do not have dedicated accountants, lawyers, risk officers, or investment professionals, or billions of dollars that they can afford to leave locked up for ten years at a time, is extremely risky and will likely lead to extensive losses and waste, as it could facilitate the ability of private companies, funds, and their founders and early investors to offload their riskiest, worst opportunities onto a less discerning customer. That is not improving or forming capital, it is simply enabling a wealth transfer away from retail investors who lack information.

Worse, the Securities and Exchange Commission (SEC), which ensures this essential bargain between companies, funds, and investors, is being severely strained. With fewer enforcement staff[4] and insufficient data collection,[5] not to mention the potential for greater influence from billionaires whose companies have been and likely would otherwise be subject to regulatory oversight,[6] investor protection is in jeopardy.

---

[2] David Snider, "Secondary Stock Sales: A Guide for Startup Employees Looking to Sell Private Company Stock," Harness, October 5, 2024, available at https://www.harnesswealth.com/articles/secondary-sales-private-company-stock/#:~:text=In%20secondary%20sales%2C%20private%20company,to%20the%20potential%20future%20value..

[3] See, e.g., Verity Winship, "Private Company Fraud, UC Davis Law Review, December 2020, available at https://lawreview.law.ucdavis.edu/archives/54/2/private-company-fraud.

[4] Matthew Goldstein, Eric Lipton and David Yaffe-Bellany, "SEC Moves to Scale Back Its Crypto Enforcement Efforts," The New York Times, February 4, 2025, available at https://www.nytimes.com/2025/02/04/business/sec-crypto-task-force.html.

[5] Release No. 34-102386, Securities and Exchange Commission, February 10, 2025, available at https://www.sec.gov/files/rules/sro/nms/2025/34-102386.pdf.

[6] See, e.g., Dave Michaels, "SEC Probes Trading by Elon Musk and Brother in Wake of Tesla CEO's Sales," The Wall Street Journal, February 24, 2022, available at https://www.wsj.com/articles/sec-probes-trading-by-elon-musk-and-brother-in-wake-of-tesla-ceos-sales-11645730528?mod=Searchresults_pos1&page=1; Jonathan Weil, "Elon Musk Sold Tesla Shares Before Company Acknowledged Weakness," The Wall Street Journal, January 20, 2023, available at https://www.wsj.com/articles/elon-musk-sold-tesla-shares-before-company-acknowledged-weakness-11674177642; and Paul Wiseman, Senate confirms Howard Lutnick as commerce secretary, a key role for Trump's trade agenda," Associated Press, February 18, 2025, available at https://apnews.com/article/howard-lutnick-trump-tariffs-commerce-department-9788590bbee10d09d3cb91822b0c9687. ("His financial disclosure statement showed that he had positions in more than 800 business and other private organizations.").

Access to Capital Markets Is Important

Entrepreneurs and small businesses have been an important part of the American success story from our country's beginning. As SEC Commissioner Caroline Crenshaw has said, small businesses "form the backbone of communities, are drivers of jobs, are critical for the development of new ideas and new technology, and are an avenue to wealth creation…"[7]

Entrepreneurs and small businesses make an enormous contribution to the innovation and creativity that America is known for. At the same time, they benefit a great deal from our capital markets.

And they have more access to capital, whether through uniquely tailored loans or through the sale of securities using multiple public or private options, than ever before. According to the Congressionally created SEC Office of the Advocate for Small Business Capital Formation, in 2023, there were over 420,000 active angel investors, and more than 50,000 small businesses received angel funding.[8]

The simple reality is that, if a small business wants to get a loan, it must go to a bank and fill out detailed loan application documents with information about its assets, projected finances, operations, and more. Its executives may have to offer meaningful collateral, such as their homes or their essential equipment and inventories. Those business loans are considered by the banks and their regulators to be among the riskiest activities in banking. Thus, they are subject to significant regulatory limitations, reviews, and

[7] Commissioner Caroline A. Crenshaw, "'Big 'Issues' in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute," U.S. Securities and Exchange Commission, January 30, 2023, available at https://www.sec.gov/news/speech/crenshaw-remarks-securities-regulation-institute-013023.
[8] Annual Report Fiscal Year 2024, Office of the Advocate for Small Business Capital Formation, available at https://www.sec.gov/files/2024-oasb-annual-report.pdf.

compliance processes. For example, federal banking regulators frequently release guidance and notices intended to inform banks' risk management in lending to small businesses.[9]

By contrast, if a company wants to turn to the capital markets to raise capital, there may be no substantive, regulatorily imposed requirements at all. That is because today, after decades of deregulation, a company can raise an unlimited amount of money from an unlimited number of so-called sophisticated investors without making any disclosures at all. As the SEC itself explained in 2019, "[i]ssuers in [Rule 506] offerings are not required to provide any substantive disclosure and are permitted to sell securities to an unlimited number of accredited investors with no limit on the amount of money that can be raised from each investor or in total."[10]

Unlike banks and their employees, private equity and venture capital investors are generally not expected to follow regulator-mandated, standardized documentation requirements (and regulatory oversight) of their capital allocation decision making.

It is worth noting that small companies can also raise money through leveraged loans that are packaged into collateralized products—a practice that has been institutionalized in private equity and hedge funds and grown exponentially to trillions of dollars today.[11]

So, the problem is not that the rules prevent small businesses or start-ups from obtaining capital; it is that the rules today allow companies with billion-dollar valuations, billions in revenues, and thousands

---

[9] See, e.g., Small Business Administration Lending Risk Management Principles, Office of the Comptroller of the Currency, OCC Bulletin 2021-34, available at https://www.occ.gov/news-issuances/bulletins/2021/bulletin-2021-34a.pdf.

[10] "Concept Release on Harmonization of Securities Offering Exemptions," U.S. Securities and Exchange Commission, 84 Fed. Reg. 30460, 30470, June 26, 2019, available at https://www.govinfo.gov/content/pkg/FR-2019-06-26/pdf/2019-13255.pdf.

[11] See, e.g., "A Giant in the Shadows: Subprime Corporate Debt," Americans for Financial Reform Education Fund, January 2023, available at https://ourfinancialsecurity.org/wp-content/uploads/2023/01/1.6.23-Subprime-Corporate-Debt-A-Giant-in-the-Shadows.pdf.

of investors to never provide basic information to investors, regulators, or the public, and private funds to raise billions of dollars from underlying investors without basic expectations like timely, comprehensive, and reliable disclosures about their finances, governance, or operations. There is no regulatory requirement for these billion-dollar enterprises to provide investors with basic audits.

Congress and the SEC created this perverse regulatory regime in the name of capital formation. Yet, as we have seen with Theranos, WeWork, and so many others, the current capital markets regulatory regime enables capital distortion. The regime does so in various ways, such as inflated valuations, lax internal controls, inconsistent disclosures across investors, and potential fraud and abuse.[12]

When Congress established the federal securities laws and created the Securities and Exchange Commission to implement them, it was responding to the massive investor losses and waste of the Great Crash of 1929. Congress was concerned that, without basic information about a company's finances, governance, and operations, capital would be mis-allocated and wasted. The fundamental bargain then and now is that companies that want to raise capital from the public must first provide basic information to investors and the public, including the company's financials, governance, operations, and risks. Today, public companies even need to be audited, and their auditors are subject to significant regulatory oversight. These robust audits are essential to promoting the integrity of the companies and the markets in which they operate. This disclosure of information improves price discovery, makes the markets more fair, more orderly, and more efficient, and protects investors from abuses, such as information asymmetry. Even the most sophisticated investors cannot exercise their superior knowledge and expertise if they do not have reliable information about a company's financials, operations, and risks – a lesson that, sadly, has had to be re-learned with great frequency.

[12] Crenshaw, January 30, 2023.

When the securities laws were first adopted, and in the decades thereafter, offerings to even a single person or to a small number of employees were deemed to be public offerings in need of being registered. Congress and the SEC have since reversed those decisions, with increasingly alarming results.

Beginning in 1982 with the promulgation of Regulation D, there has been a proliferation of exemptions from the public disclosure framework.[13] The stated intention of those exemptions and their subsequent expansions has been to provide more access to capital for small businesses.[14] But the reality is that those exemptions, along with a couple of loopholes in the law, have enabled virtually any company of any size to obtain capital from the public without complying with the public disclosure framework.

As a result, a substantial and growing number of companies are choosing to remain private as they raise capital, and often only end up coming to the public markets to cash out significant investors or founders. The result of Congress and the SEC creating and expanding exemptions from the federal regulatory disclosure framework is that the vast majority of capital raised is exempt. That explosive growth of the private markets has come at the expense of public markets.[15]

If a company can raise all the capital it needs in the private markets without making disclosures, developing robust operational safeguards, subjecting itself to audits, having a headquarters, dealing with a large number of retail investors, exposing details of its sales or operations to its competitors, suppliers, customers, or other business partners, or subjecting itself to SEC oversight and potential class action plaintiffs, why would it go public?[16]

---

[13] Elisabeth De Fontenay, "The Deregulation of Private Capital and the Decline of the Public Company," Hastings Law Journal, Vol. 68:445, 2017, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951158.
[14] Crenshaw, January 30, 2023.
[15] George S. Georgiev, "The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms," Emory University School of Law, Fall 2021, available athttps://scholarlycommons.law.emory.edu/cgi/viewcontent.cgi?article=1001&context=faculty-articles.
[16] See, e.g., "In the Public Interest," Healthy Markets Association, January 2022, available at https://healthymarkets.org/product/public-vs-private-markets-a-special-report.

The situation is truly alarming. Today, there are more than 1,200 private companies worth more than a billion dollars each, with over 600 of those established in the U.S. private markets.[17] This number has grown rapidly in the last few years, with 354 added in 2021 alone.[18] Commissioner Crenshaw has pointed out that these "unicorns," as they are called, "have consistently relied on Rule 506 of Reg D to raise billions of dollars in U.S. capital."[19] These companies have been allowed to grow extremely large, competing with similar publicly traded companies and selling products and services to a broad swath of the American public, without making meaningful disclosures. As the examples of large, opaque company failures demonstrate,[20] these companies can pose huge risks to their investors, the economy, and the country. They do not belong in the private markets.

Since 2021, inflation and higher interest rates are laying bare the overvaluations of private market companies,[21] whose valuations are often driven by success narratives created for the next funding round rather than fiscal discipline. One study in 2017 – before the recent private market valuation boom -- found that on average unicorns were valued at 50 percent above their fair value.[22]

It is one thing to allow this for small or brand-new start-ups, but when this approach is applied to companies purportedly valued at one billion dollars or more, it is time to give new investors the facts.

---

[17] CB Insights, The Complete List of Unicorn Companies, available at https://www.cbinsights.com/research-unicorn-companies.

[18] Katie Roof, "The Unicorn Boom Is Over, and Startups Are Getting Desperate," Bloomberg, February 14, 2025, available at https://www.bloomberg.com/news/articles/2025-02-14/silicon-valley-unicorn-startups-are-desperate-for-cash?cmpid=BBD021825_MONEYSTUFF&utm_medium=email&utm_source=newsletter&utm_term=250218&utm_campaign=moneystuffT.

[19] Crenshaw, January 30, 2023.

[20] See, e.g., Gillian Tan, Liana Baker, and Michelle Davis, "WeWork Postpones Long-Awaited IPO, Sending Its Bonds Falling," Bloomberg, September 16, 2019, available at https://www.bloomberg.com/news/articles/2019-09-16/wework-is-said-to-likely-delay-ipo-after-valuation-plummets?srnd=premium&sref=S5RPfkRP; and Zaw Thiha Tun, "Theranos: A Fallen Unicorn," Investopedia, January 4, 2022, available at https://www.investopedia.com/articles/investing/020116/theranos-fallen-unicorn.asp.

[21] Roof, February 14, 2025.

[22] William Gornall and Ilya A. Strebulaev, "Squaring Venture Capital Valuations With Reality," National Bureau of Economic Research, October 2017, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3049719.

Otherwise—and this is the paramount concern for this committee—new investors, including those allowed new access to these highly risky markets, will end up losing even as founding and early round investors exit with profits based on inflated valuations.

Recommendations

Rather than enabling small businesses to access needed private capital, Regulation D and other exemptions are being used by companies of all sizes to skirt the disclosure requirements Congress established to ensure transparency and investor protection. There are many steps that Congress and the SEC can take to rebalance the public and private markets and make more room for capital for small businesses.

Section 12g of the Securities and Exchange Act of 1934[23] was intended to prevent companies from becoming too large without adhering to the public disclosure framework. Originally enacted in 1964, it required expanded disclosures when a private company reached 500 holders of record, which the JOBS Act of 2012 increased to 2,000. When 12g was enacted, the number of holders of record was closer to the number of actual owners of shares. But now, due mainly to changes in technology, the holder of record definition is exponentially larger since intermediaries today may hold millions of shares *on behalf of* thousands of investors yet are counted as one holder of record for purposes of the threshold. This is why Facebook was able to remain a private company and avoid public disclosures for years after it had thousands of shareholders.[24] Clarifying that "holder of record" under Section 12g means actual security owners or beneficial owners , not intermediaries, would help ensure that smaller businesses are not competing for capital in the private markets with huge companies.

---

[23] 17 CFR Section 240.12g-1.

[24] Steven Davidoff Solomon, "Facebook May Be Forced to Go Public Amid Market Gloom," New York Times, November 29, 2011, available at https://archive.nytimes.com/dealbook.nytimes.com/2011/11/29/facebook-may-be-forced-to-go-public-amid-market-gloom/.

A critical companion measure would be for Congress to statutorily require all very large companies and funds to be public. Many private market companies have thousands of actual shareholders, employ hundreds or even thousands of employees, and may sell products and services to millions of customers in the U.S. and abroad. These companies and funds may have significant impacts on investors but also markets overall and commerce generally. For example, there should be no such thing as a unicorn. Companies with billion-dollar valuations should be required to make basic public disclosures of their finances, governance, and operations, as should companies with more than 250 employees.

Beyond that, instead of trying to expand exemptions that are currently being used by much larger companies, Congress could do more for small businesses by scaling back the exemptions to their intended purpose, possibly eliminating some of them altogether, and by building on the success of the public markets with their mandatory disclosures. In this way, businesses would be more fairly competing for investors' capital, as well as more fairly competing against one another.

At a minimum, Congress should ensure that what an issuer discloses to one investor, it discloses to all of them. If a pension fund or venture capital investor is getting updated, audited financials or sales updates, that information should be offered to everyone. To allow some investors to have access to material, non-public information used for investment decisions, while others do not have access, is simply to enable waste, fraud and abuse. Even if the government does not mandate an issuer disclose a particular piece of information, it should mandate that issuers not selectively disclose information in a discriminatory manner.

Further, Congress should be cognizant of the unique differences between professional investment firms and retail investors. Investors with billions of dollars and reliable cash needs and investment flows may be able to weather a seven or ten-year investment lockup period. Individual investors, with deaths, divorces, home purchases, and health concerns often cannot. So, while many current private market

investors are frustrated when they are unable to redeem their shares for cash or otherwise sell their investments, the inconvenience is often not catastrophic, as it might be with a family. Any retail investors given access to these investments should have clear, timely, and reliable redemption opportunities.

Together, the above measures would go a long way toward restoring the private markets to the businesses and investors they were intended for, while ensuring that larger companies that raise capital from the public comply with the public disclosure framework and thus provide the information those investors need to make investment decisions.

Thank you again for inviting me to testify today. I look forward to answering your questions.