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Capital Markets: Public and Private Securities Offerings

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Summary

U.S. capital markets are the largest and considered to be the most efficient in the world. Companies rely heavily on capital access to fund growth and create jobs. As the principal regulator of U.S. capital markets, the Securities and Exchange Commission (SEC) requires that offers and sales of securities be either registered with the SEC or undertaken with an exemption from registration. Registered securities offerings, often called *public offerings*, are available to all types of investors and have more rigorous disclosure requirements. By contrast, securities offerings that are exempt from SEC registration are referred to as *private offerings* and are mainly available to narrower categories of investors.

Some policymakers have concluded that changes in market trends require updated regulations governing capital access. Specifically, the number of publicly listed U.S. companies has declined by half over the past two decades, and small- to medium-size companies are said to have more difficulty accessing capital relative to larger companies. Additionally, new capital access tools not previously part of the SEC regulatory regime, such as crowdfunding and initial coin offerings, have emerged. The Jumpstart Our Business Startups Act of 2012 (JOBS Act; P.L. 112-106) was the last major piece of enacted legislation that was aimed at addressing some of the related concerns. The law scaled regulation for smaller companies and reduced regulations in general for certain types of capital formation. It established a number of new options to expand capital access through both public and private offerings, including a new provision for crowdfunding. Parts of the Fixing America's Surface Transportation Act (P.L. 114-94) provided additional relief. Following the JOBS Act, the public and private offering dichotomy has started to blur, and securities regulation has become increasingly tailored to suit companies of different sizes and with different needs.

Concerns over capital formation have persisted given that the number of *initial public offerings* (IPOs) remained below long-term average levels post–JOBS Act, and smaller businesses continue to face capital access pressure. To address these concerns, Congress has considered numerous legislative proposals to further expand the scaled approach, with some proposals building on existing JOBS Act provisions.

The policy debate surrounding capital formation proposals often focuses on expanding capital access and protecting investors, two of the SEC's core missions. Expanding capital access promotes capital formation and allows for greater access to investment opportunities for more investors. Investor protection is considered to be important for healthy and efficient capital markets, because many investors would be more willing to provide capital, and at lower cost, if they trust the integrity of securities issuers and disclosures. At times, expanding capital access can come at the expense of investor protection. For example, proposals that reduce the registration and disclosures that a company must make can decrease the company's compliance costs and increase the speed and efficiency of capital formation. But the reduced disclosures may expose a company's investors to additional risks if they are not receiving information that is important to making informed investment decisions. In addition, as private markets become increasingly important, some observers have voiced concerns about market transparency for purposes of investor protection and systemic risk monitoring and about fairness for the purposes of retail investor access.

This report analyzes legislative frameworks that would generally affect the terms and amounts of capital provided to companies by investors. It analyzes methods to alter both public and private securities offerings through amendments to program design, investor access, and disclosure requirements, among other options. The report also highlights policy debates under the potential alternatives.

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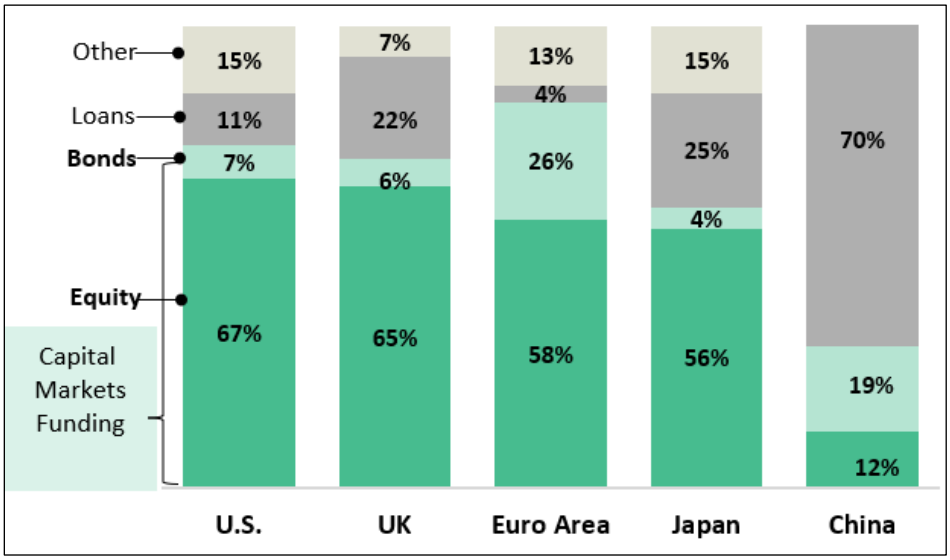
Introduction

Companies turn to a variety of sources to access the funding they need to grow. Capital markets are the largest source of financing for U.S. nonfinancial companies, representing 74% of all financing for such companies (**Figure 1**). Capital markets are segments of the financial system in which funding is raised through equity or debt securities.[1] Equity, also called stocks or shares, refers to ownership of a firm. And debt, such as bonds, refers to borrowed money that must be repaid. In addition to capital markets, companies obtain funding from bank loans and other financing.

Figure 1. Financing of Nonfinancial Companies



Source: CRS using data from the Securities Industry and Financial Markets Association.

Notes: "Bonds" and "equity" include both public and private offerings. "Loans" include all bank financing. "Other financing" generally includes insurance reserves, trade credits, and trade advances. Data as of 2023, except for China as of 2021.

U.S. capital markets are the deepest and most liquid in the world as measured by size and importance. U.S. companies are more reliant on capital markets for funding than are companies in the United Kingdom, the euro area, Japan, or China, which rely more on bank loans (**Figure 1**).[2]

Access to capital allows businesses to fund their growth, innovate, create jobs, and ultimately help raise society's overall standard of living. Given the importance of U.S. capital markets and their role in allocating funding, issues affecting the markets generally warrant policy attention. Some of the most discussed trends include the decline in the number of public companies and the increased tendency of public capital to concentrate in larger companies.[3] In addition, there are indications that private capital—which has less regulation and information disclosure—is

[1] 15 U.S.C. §78c; 15 U.S.C. §77b.

[2] SIFMA, "2024 Capital Markets Fact Book," July 30, 2024, https://www.sifma.org/wp-content/uploads/2023/07/2024-SIFMA-Capital-Markets-Factbook.pdf.

[3] For example, U.S. Congress, House Committee on Financial Services, *Hearing Entitled: A Roadmap for Growth: Reforms to Encourage Capital Formation and Investment Opportunities for All Americans*, 118th Cong., April 19, 2023.

growing in size and influence. Also of concern is the emergence of financial technology that both enables new methods of capital formation and poses significant regulatory challenges.[4]

Congress passed the Jumpstart Our Business Startups Act of 2012 (JOBS Act; P.L. 112-106; see text box below) to establish a number of new options for expanding capital access, especially for smaller companies. As discussed later in this report, some of the changes made by the JOBS Act have been successful in facilitating capital formation, but in other areas, the same concerns about capital access remain.

This report provides background and analysis on capital formation through the two main ways of raising capital—public and private securities offerings—and the regulatory environment in which they operate.[5] The report also explores key policy issues and their connection to legislative discussions.

Jumpstart Our Business Startups Act (JOBS Act; P.L. 112-106)

The JOBS Act was designed to reduce regulatory burdens on certain types of capital formation, especially for smaller companies. As a legislative response to the slow growth coming out of the 2007-2009 recession, the act was passed with bipartisan support in 2012.

The JOBS Act established a number of new options to expand capital access through both public and private offerings. For example, it established the IPO On-Ramp as a scaled-down version of a standard initial public offering for smaller companies. It also expanded access to existing private offerings traditionally serving smaller companies' funding needs—for example, the expansion of capital access through Regulation A+, the Threshold Rule, and Regulation D. The JOBS Act also established a new type of offering for crowdfunding. Some of these program changes have already generated significant issuer participation and impact. Much of the specifics of the JOBS Act are discussed in the relevant sections of this report.

Though the JOBS Act was signed into law in 2012, it took several years to implement it. Effective implementation dates for JOBS Act provisions were as follows:

- Title I Emerging Growth Company (IPO On-Ramp): April 5, 2012
- Title II Regulation D General Solicitation: September 23, 2013
- Title III Regulation Crowdfunding: May 16, 2016
- Title IV Regulation A+ (Mini-IPO): June 19, 2015

Raising Capital Through Securities Offerings

As the principal regulator of U.S. capital markets, the Securities and Exchange Commission (SEC) requires that offers and sales of securities—whether debt or equity—be either registered with the SEC or undertaken with an exemption from registration.[6] Companies seeking funding through securities offering are referred to as *issuers*. Registered offerings, often called *public offerings*, are available to all types of investors and are not limited in the amount of funds that can be raised or resold. A registered offering includes a significant amount of disclosure about the

[4] For example, U.S. Congress, House Committee on Financial Services, *Hearing Entitled: Dazed and Confused: Breaking Down the SEC's Politicized Approach to Digital Assets*, 118th Cong., September 18, 2024.

[5] This report focuses on primary markets, the markets in which securities are initially issued. The secondary market is where the securities issued in the primary market are traded.

[6] The Securities Act of 1933 (P.L. 73-22) and the Securities Exchange Act of 1934 (P.L. 73-291) regulate the offers and sales of securities. The Securities Act requires companies to go through the SEC registration process for securities offerings. It also provides exemptions to permit securities offers and sales without SEC registration. The Securities Exchange Act requires companies having effective registration statements to file periodic ongoing reports or other information with the SEC. For more detail, see SEC, *Registration Under the Securities Act of 1933*, https://www.sec.gov/fast-answers/answersregis33htm.html; and *Exchange Act Reporting and Registration*, https://www.sec.gov/smallbusiness/goingpublic/exchangeactreporting.

company (the issuer), its financial status, and the funds that are being raised. A key attribute of public securities offerings is investors' ability to resell the securities on public secondary markets through national exchanges to all investor types.[7] By contrast, securities offerings that are exempt from SEC registration are referred to as *private offerings*, *private placements*, or *unregistered offerings*. They are mainly available to financial institutions or individual investors thought to be better positioned to absorb the risk and make informed decisions with the reduced information disclosed in a private offering, such as accredited investors.[8] Because of the restrictions on who may purchase them, private offerings generally do not trade on stock exchanges.[9] In general, private offerings provide firms with more control over their internal affairs and lower compliance costs, whereas public offerings provide broader access to potential investors.

Public Offerings

Public offerings consist of *initial public offerings* (IPOs)—the first time a company offers its shares of stock to the general public in exchange for cash—and subsequent public offerings. The IPO process, which is the source of much of the policy debate surrounding public offerings, is commonly regarded as the turning point for companies "going public." By going public, a company's shares can be owned by the public at large rather than just by the original owners, venture capital funds, and the relatively small pool of those perceived to be more sophisticated investors. SEC registration, which is a key requirement for going public, enables public disclosure of key company financial information.[10] Companies may choose to go public to access capital that would allow founders to cash out their investments, to provide substantial stock and stock options to employees and through management incentive plans, and to fuel the company's future growth.[11] Public companies may also benefit from a "liquidity premium," which translates into better share pricing compared with stock from comparable private offerings.[12] Other potential benefits include publicity and brand awareness.[13]

There are also a number of drawbacks to going public. From an issuer's perspective, two of the most discussed drawbacks are compliance costs and certain changes to business operations.

- **Compliance costs.** Some observers argue that the costs of registration are disproportionately burdensome for small and medium-size businesses, including startup firms.[14] The direct costs include underwriting, external auditing, legal fees, and financial reporting fees.

[7] A limited-scale secondary market also exists for private offerings. Nasdaq Private Market and SharesPost, for example, can both trade private securities but have to confirm accredited investor status for each transaction.

[8] CRS In Focus IF11278, *Accredited Investor Definition and Private Securities Markets*, by Eva Su.

[9] Private securities offerings generally do not trade on national securities exchanges, but exceptions could include certain Regulation A+ offerings, also referred to as "mini-IPO." For more details, see CRS In Focus IF10848, *Capital Access: SEC Regulation A+ ("Mini-IPO")*, by Eva Su.

[10] SEC, "How Can My Small Business Raise Capital?," https://www.sec.gov/about/reports-publications/infosmallbusqasbsechtm#capital.

[11] A stock option is a privilege but not an obligation to buy or sell a stock at an agreed-upon price within a certain period of time.

[12] *Liquidity premium* refers to the additional yield on a financial asset the investors would demand if such investment cannot be easily converted to cash through trading in a timely manner or at its perceived fair market value.

[13] SEC, "Should My Company 'Go Public'?," June 29, 2024, https://www.sec.gov/smallbusiness/goingpublic/companygoingpublic.

[14] SEC Commissioner Mark Uyeda, "Remarks at the 'Going Public in the 2020s' Conference, Columbia Law School/Business School Program in the Law and Economics of Capital Markets," March 3, 2023, https://www.sec.gov/newsroom/speeches-statements/uyeda-remarks-going-public-conference-030323.

- **Business operations.** Public companies are often perceived to face incremental market pressure to perform well over the short term, to reduce insider control and decisionmaking flexibility, and to contend with increased shareholder activism (which sometimes may benefit a firm financially).[15] Some research has indicated that going public can adversely affect corporate innovation.[16] However, there are also many examples of innovative public companies.

Initial Public Offering

An IPO is the first time a company offers its shares of capital stock to the general public.[17] An IPO gives the investing public the opportunity to own and participate in the growth of a formerly private company. The process begins with the company's selection of underwriters, lawyers, and accountants to prepare for the issuance of the securities, and, along with the company's top executives, they form an IPO working group. The process generally consists of three phases.

1. **Prefiling period.** As part of an IPO, a company must file a registration statement and other documents that contain information about the company and the funds it is attempting to raise. During the prefiling period, the public filings are prepared, and the planning begins with a thorough review of the company's operations, procedures, financials, management, competitive positioning, and business strategy.[18] The disclosure documents serve the dual purpose of satisfying SEC registration requirements and informing investors.[19]
2. **Waiting period.** Once the key disclosures are filed, the company waits for the SEC to review and approve its draft registration statements. The company then concurrently addresses SEC comments and prepares roadshow presentations as well as legal documents. Roadshows are presentations made by an issuer's senior management to market the upcoming securities offering to prospective investors. Roadshows can commence only after the filing of registration statements, because Section 5(c) of the Securities Act prohibits public offers of securities prior to the filing of a registration statement.[20]
3. **Posteffective period.** The actual sales to investors take place after the SEC declares that the IPO registration is effective. The posteffective period extends from the effective date of the registration statements to the completion of

[15] Martin Lipton et al., "Wachtell Lipton Discusses How to Deal with Activist Investors," Columbia Law School, August 31, 2023, https://clsbluesky.law.columbia.edu/2023/08/31/wachtell-lipton-discusses-how-to-deal-with-activist-investors.

[16] Shai Bernstein, "Does Going Public Affect Innovation?," *Journal of Finance*, vol. LXX, no. 4 (August 2015), https://onlinelibrary.wiley.com/doi/pdf/10.1111/jofi.12275.

[17] SEC, "Investing in an IPO," https://www.sec.gov/investor/alerts/ipo-investorbulletin.pdf.

[18] The goal of the due diligence review is to independently investigate and verify information about the company and its business to ensure that the information contained in the registration statement is accurate and that the registration statement includes all information about the company's business, operations, financial condition, and prospects that would be material to investors. Thomas France, "How to Manage the Due Diligence Process for an IPO," *Law360*, September 2013, https://www.law360.com/articles/475791/how-to-manage-the-due-diligence-process-for-an-ipo.

[19] New York Stock Exchange, *NYSE IPO Guide, 3rd ed.* (Chicago: Caxton Business and Legal, 2021), https://www.caxtoninc.com/_files/ugd/ceeb6f_4dee169e2ee647be95a3c02ae5e7e8f1.pdf.

[20] Craig F. Arcella, "The Nuts and Bolts of Roadshows," Cravath, Swaine and Moore LLP, https://www.cravath.com/files/Uploads/Documents/The%20Nuts%20and%20Bolts%20of%20Road%20Shows%20%285-502-2419%29.pdf.

distribution of the securities.[21] With the completion of the IPO, a security generally continues to trade on a stock exchange.

IPO On-Ramp and Emerging Growth Company

Title I of the JOBS Act established streamlined compliance options for companies that meet the definition of a new type of issuer, called an emerging growth company (EGC).[22] The streamlined process available to an EGC is also referred to as the "IPO On-Ramp," because it is a scaled-down version of a traditional IPO. This new process reduces regulatory requirements for companies to go public.

To qualify as an EGC, an issuer must have total annual gross revenues of less than $1 billion (adjusted for inflation) during its most recently completed fiscal year.[23] An EGC maintains its status for five years after its IPO or when its gross revenue exceeds $1 billion, whichever occurs first, among other conditions. The $1 billion gross revenue threshold is inflation-adjusted every five years. The SEC raised the threshold in 2022 from $1.07 billion to $1.235 billion.[24] Relative to a standard IPO, EGCs' IPOs can take advantage of the following forms of relief:[25]

- Scaled disclosure requirements mean that EGCs (1) need to provide two years of financial statements certified by independent auditors instead of three years for a traditional IPO and (2) are not required to provide compensation committee reports, among other things.
- EGCs are exempted from auditor attestations of internal control over financial reporting that are required by Section 404(b) of the Sarbanes-Oxley Act.[26]
- "Test-the-waters" communications mean EGCs may meet with qualified institutional buyers and institutional accredited investors to gauge their interest in potential offerings during the registration process, an activity prohibited during a normal IPO prior to 2019.[27] The SEC expanded this benefit to all issuers in September 2019.[28]
- A confidential SEC review process allows companies to submit draft registration statements to the SEC for confidential review prior to making the filings public. This benefit was initially limited to EGCs, but the SEC expanded it to all companies in 2017.[29]

[21] Gibson Dunn, *IPO Guidebook February 2024*, https://www.gibsondunn.com/wp-content/uploads/2017/03/Gibson-Dunn-IPO-Guidebook-02.2024.pdf.

[22] P.L. 112-106.

[23] SEC, "Generally Applicable Questions on Title I of the JOBS Act," https://www.sec.gov/divisions/corpfin/guidance/cfjjobsactfaq-title-i-general.htm.

[24] SEC, "SEC Adopts JOBS Act Inflation Adjustments," press release, September 9, 2022, https://www.sec.gov/newsroom/press-releases/2022-157.

[25] SEC, "SEC Adopts JOBS Act Inflation Adjustments."

[26] For more details on Sarbanes-Oxley and auditing regulation, see CRS Report R44894, *Accounting and Auditing Regulatory Structure: U.S. and International*, by Raj Gnanarajah.

[27] The communications could take place either before or after the registration.

[28] SEC, "SEC Adopts New Rule to Allow All Issuers to 'Test-the-Waters,'" press release, September 26, 2019, https://www.sec.gov/newsroom/press-releases/2019-188.

[29] SEC, "Draft Registration Statement Processing Procedures Expanded," June 29, 2017, https://www.sec.gov/newsroom/whats-new/draft-registration-statement-processing-procedures-expanded.

Whereas the first two compliance-related forms of relief would appear to generate cost savings for all EGC status holders, the test-the-waters and confidential review features may be especially valuable for companies in industries where valuation is uncertain and the timing of the IPO depends on regulatory or other approval (e.g., the biotech and pharmaceutical industries).[30] The ability to submit confidentially and to "test-the-waters" with prospective investors can provide additional flexibility to company issuers. EGCs that take advantage of these can either continue the IPO process or withdraw after receiving feedback from the SEC and prospective investors prior to making public disclosures.

Following the SEC's expansion of the confidential review and test-the-water options to all company issuers, most companies used the processes to incorporate feedback prior to public disclosure and announcement. Some research indicates that the IPO processes that used to take up to seven months from announcement to trading took less than 50 days following the changes, with the reduced time due mostly to shifting of the review time to prior to announcements.[31]

Private Offerings

Both public and private companies can conduct private offerings to offer or sell securities in accordance with registration exemptions under the Securities Act. To raise capital through a private offering, a company must use one of the registration exemptions under federal securities laws, including the following:

- **Regulation D**[32] is the most frequently used exemption to sell securities in unregistered offerings. Companies relying on Regulation D exemptions do not need to register their offerings with the SEC, but they face limitations regarding investor type and resale restrictions of their offerings.[33] Regulation D includes two SEC rules—Rules 504 and 506—that provide different maximum offering amounts, among other conditions.[34]
- **Regulation A**[35] facilitates capital access for small to medium-size companies. It has fewer disclosure requirements than the conventional securities registration process. Due to the JOBS Act, Regulation A was initially updated in 2015 to create a two-tiered structure (adding Regulation A+) to exempt registration offerings of up to $75 million annually as of 2021 if specified requirements are met.[36]
- **Regulation Crowdfunding**[37] permits companies to offer and sell securities through crowdfunding, which generally refers to small businesses using the

[30] Latham & Watkins, "The JOBS Act, Two Years Later: An Updated Look at the IPO Landscape," April 2014, https://www.lw.com/thoughtLeadership/lw-jobs-act-ipos-second-year.

[31] Brandon Kochkodin, "IPO Timelines Are Cut by 80% After SEC's Private Filing Decision," *Bloomberg*, December 2017, https://www.bloomberg.com/news/articles/2017-12-22/ipo-timelines-are-cut-by-80-after-sec-s-private-filing-decision; and SEC, "SEC's Division of Corporation Finance Expands Popular JOBS Act Benefit to All Companies," press release, June 2017, https://www.sec.gov/news/press-release/2017-121.

[32] 17 C.F.R. §§230.501 et seq.

[33] SEC, "Regulation D Offerings," https://www.sec.gov/fast-answers/answers-regdhtm.html.

[34] Regulation D Rule 505 was repealed effective May 22, 2017. See 17 C.F.R. §§200, 230, 239, 240, 249, 270, and 275, https://www.sec.gov/rules/final/2016/33-10238.pdf; SEC, "Private Placements Under Regulation D," https://www.investor.gov/additional-resources/news-alerts/alerts-bulletins/investor-bulletin-private-placements-under.

[35] 17 C.F.R. §§200, 230, 232, 239, 240, 249, and 260.

[36] SEC, "Regulation A," https://www.sec.gov/oiea/investor-alerts-bulletins/ib_regulationa.html.

[37] 17 C.F.R. §§200, 227, 232, 239, 240, 249, 269, and 274.

internet to raise capital through small investments from a large number of investors.[38]

- **Rule 144A**[39] is for resale transactions only. Issuers generally use it in a two-step process to first facilitate offerings on an exempt basis to financial intermediaries, and then resell to qualified institutional buyers, or QIBs (corporations deemed to be accredited investors).[40]
- **Rule 147A**[41] permits companies to raise money from investors within their home states by registering at the state level without concurrently having to register the offers and sales at the federal level.[42]

Regulatory Framework

Regulatory Entities and Approaches

U.S. capital markets are mainly regulated by the SEC, state securities regulators, and self-regulatory organizations (SROs).[43]

As the principal regulator of capital markets, the SEC is responsible for overseeing significant parts of the nation's securities markets and certain primary participants such as broker-dealers, investment companies, investment advisors, clearing agencies, transfer agents, credit rating agencies, and securities exchanges, as well as SROs such as the Financial Industry Regulatory Authority (FINRA), Municipal Securities Rulemaking Board, and Public Company Accounting Oversight Board.[44]

The SEC uses a combination of rules, enforcement, and examinations to construct a three-pronged regulatory approach that focuses on (1) disclosure-based rules, (2) an antifraud regime, and (3) rules governing securities market participants (for example, exchanges, broker-dealers, and investment advisors).[45]

[38] FINRA Investor Alerts, "Crowdfunding: What Investors Should Know," May 1, 2024, http://www.finra.org/investors/alerts/crowdfunding-and-jobs-act-what-investors-should-know; and SEC, "Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers," May 13, 2016, https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm.

[39] 17 C.F.R. §230.144.

[40] SEC, "Rule 144: Selling Restricted and Control Securities," January 16, 2013, https://www.sec.gov/reportspubs/investor-publications/investorpubsrule144htm.html.

[41] 17 C.F.R. §§200, 230, 239, 240, 249, 270 and 275.

[42] SEC, "SEC Adopts Final Rules to Facilitate Intrastate and Regional Securities Offerings," press release, October 26, 2016, https://www.sec.gov/news/pressrelease/2016-226.html.

[43] The Commodity Futures Trading Commission, which regulates derivatives markets, may conduct joint rulemaking with the SEC on certain market segments such as security-based derivatives. SEC, "Derivatives," https://www.sec.gov/spotlight/dodd-frank/derivatives.shtml. For more details, see CRS Report R43117, *The Commodity Futures Trading Commission: Background and Current Issues*, by Rena S. Miller.

[44] Under the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (P.L. 111-203) Titles VII, IX, and XVI, the SEC's jurisdiction also expanded to include certain participants in the derivatives markets, private fund advisers, and municipal advisors.

[45] SEC Chairman Jay Clayton, "Remarks at the Economic Club of New York," July 12, 2017, https://www.sec.gov/news/speech/remarks-economic-club-new-york.

Securities Disclosure Through Registration

One of the cornerstones of securities regulation—the Securities Act of 1933—is often referred to as the "truth in securities" law.[46] As the phrase suggests, disclosures pertaining to securities allow investors to make informed judgments about whether to purchase specific securities by ensuring that investors receive financial and other significant information on the securities being offered for public sale. The SEC does not make merit-based recommendations as to whether to invest.[47] The disclosure-centric regulatory philosophy is consistent with Supreme Court Justice Louis Brandeis's famous dictum that "sunlight is said to be the best of disinfectants; electric light the most efficient policeman."[48]

As mentioned previously, the types of disclosure vary based on whether a company is making a public or private offering. The registration process requires a public company to file with the SEC essential facts, including financial statements certified by independent accountants, information about the management of the company, a description of the security to be offered for sale, and a description of the company's properties and business.[49] Registration statements generally become public shortly after the company files them with the SEC. As such, registering an offering with the SEC would make a company a public company.[50] Private offerings also involve a compliance process, but the process is scaled down, and these offerings are generally limited to more sophisticated investors who are perceived as better positioned to comprehend or tolerate the risks associated with less disclosure.[51]

Securities and Banking Regulation Compared

Capital market regulation differs from banking regulation in its regulatory philosophy and structural setup. Stocks, bonds, and other securities are not guaranteed by the government and can lose value for investors. As such, the SEC's primary concerns are promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud.[52] This is designed to help investors make informed investment decisions. Although the SEC requires that the information provided be accurate, it does not guarantee it. Investors who purchase securities and suffer losses have recovery rights if they can prove incomplete or inaccurate disclosure of important information.

Banking regulation's prudential regulatory approach, on the other hand, emphasizes risk control and mitigation for the safety and soundness of individual institutions as well as the financial system as a whole.[53] One rationale behind banking regulation is that, because bank deposits are guaranteed by the federal government (up to a certain limit), banks may have an incentive to take

[46] 15 U.S.C. §§77a et seq.

[47] SEC, "Registration Under the Securities Act of 1933," https://www.sec.gov/fast-answers/answersregis33htm.html.

[48] Louis Brandeis, "What Publicity Can Do," Chapter 5 in *Other People's Money* (1932), first published in *Harper's Weekly*, December 20, 1913.

[49] Brandeis, "What Publicity Can Do."

[50] SEC, "How Can My Small Business Raise Capital?"

[51] For more on disclosure, see the "Disclosure Requirements" section of this report and CRS In Focus IF11256, *SEC Securities Disclosure: Background and Policy Issues*, by Eva Su.

[52] SEC, "Mission," https://www.sec.gov/about/mission; and SEC, *Agency and Mission Information*, https://www.sec.gov/about/reports/sec-fy2017-agency-mission-information.pdf.

[53] For more on prudential regulation, see Federal Reserve Bank Atlanta President Dennis Lockhart, "Thoughts on Prudential Regulation of Financial Firms," March 2015, https://www.frbatlanta.org/news/speeches/2015/150320-lockhart.aspx; and Federal Reserve Board Chair Janet Yellen, "Supervision and Regulation," September 2016, https://www.federalreserve.gov/newsevents/testimony/yellen20160928a.htm.

additional risks that they would not take in the absence of insurance on deposits. The government examines the operations of banks to safeguard taxpayer money and ensure that banks are not taking excessive risks.

These two different approaches have led to different agency designs and budget allocations. For example, banking regulators are heavily focused on examination programs that closely monitor and oversee financial institutions' operations and risk mitigation methods. One of the major banking regulators, the Federal Deposit Insurance Corporation (FDIC), allocates half of its annual budget toward mostly examination-based supervision and consumer protection programs.[54] SEC regulation, in contrast, relies less on examinations.[55] The SEC cedes certain examinations to SROs such as FINRA and focuses its own examinations on selected priority areas instead of a broader examination coverage of all securities issuers.[56]

Policy Issues

Some in Congress have called for modification of capital markets regulation to make it easier for companies to raise capital.[57] They argue that the existing regulatory structure unnecessarily restricts access to capital markets, making it more difficult for companies to grow and create jobs. Others have argued that certain approaches to expanding capital market access could put investors at risk of making uninformed decisions or becoming victims of fraud and other abuses.[58]

This section analyzes key policy issues in public and private capital markets and assesses proposals to facilitate access to capital in each segment. In addition, newer forms of fundraising related to crowdfunding and initial coin offerings are also analyzed.

Crosscutting Themes

For many of the proposals discussed below, two themes apply—the relationship between capital formation and investor protection, and a scaled regulatory approach. The section starts with an explanation of each.

Capital Formation and Investor Protection

The policy debate surrounding efforts to promote capital access illustrates the perceived tradeoffs between investor protection and capital formation, two of the SEC's statutory mandates. Expanding capital access promotes capital formation and arguably "democratizes" capital markets by allowing for greater access to investment opportunities for more investors. Investor protection is considered to be important for healthy and efficient capital markets, because some research suggests that investors would be more willing to provide capital, and at lower cost, if they have faith in the integrity and transparency of the underlying markets.

[54] The FDIC considers examination to be the core of its supervisory program. For more details on FDIC budget allocation, see *FDIC Annual Reports*, https://www.fdic.gov/about/financial-reports/reports/index.html.

[55] SEC, *Fiscal Year 2025 Congressional Budget Justification*, https://www.sec.gov/files/fy-2025-congressional-budget-justification.pdf.

[56] SEC, *2024 Examination Priorities*, October 16, 2023, https://www.sec.gov/files/2024-exam-priorities.pdf.

[57] For example, the Expanding Access to Capital Act of 2023 (H.R. 2799, 118th Congress).

[58] For example, Americans for Financial Reform, "Letters to Congress: Letter in Opposition to H.R. 2799, the Expanding Access to Capital Act," March 8, 2024, https://ourfinancialsecurity.org/2024/03/letters-to-congress-letter-in-opposition-to-h-r-2799-the-expanding-access-to-capital-act.

Maintaining a balance between these two goals can pose challenges for policymakers. For example, capital formation needs may be better met if issuers could choose their preferred methods of fundraising without regard to SEC registration. This is because the registration process raises the costs of accessing securities markets, which could potentially deter investment activities and reduce funding to businesses. At the same time, the reduced disclosure may expose retail investors of limited financial means to additional risks if they are not aware of key risk factors prior to making investment decisions.[59]

A Scaled Regulatory Approach

The relationship between public and private offerings used to be more clearly defined. Registration requirements were generally more substantial for public offerings than for private offerings prior to the 2012 JOBS Act. The public and private offering dichotomy started to blur following the JOBS Act, offering a more scaled regulatory approach. The act created a number of "hybrid" offerings that incorporate design features of both public and private offerings. The most obvious example is Regulation A+, a private offering that could potentially trade on public exchanges to a greater extent. As such, capital access regulation is less "one size fits all" than before, though the debate about whether regulation has been appropriately tailored is ongoing.

Table 1 highlights a number of key attributes that determine each securities offering's capital access capacity. These attributes should not be viewed in isolation, as they work together to form a holistic design for meeting each offering's policy goal. Below are examples of key attributes of major offering programs.

- **Maximum offering amount.** This is the upper limit of the offering program. For example, Regulation Crowdfunding has a size limit of around $5 million in a 12-month period, limiting the program to smaller firms.[60] In contrast, public offerings have no maximum amount, but issuers must undergo full disclosure.
- **Filing requirements.** As mentioned previously, disclosure is at the core of securities regulation and is also the dividing point between public and private offerings.[61] Generally, a higher level of disclosure (which may be associated with higher costs) leads to larger offering size limits and broader investor access, as well as reduced resale restrictions.
- **Nonaccredited investor access.** This attribute limits the kinds of investors allowed to participate in an offering. Generally, the higher the amount of disclosure, the more open an offering is to nonaccredited investors, who are perceived as less sophisticated.[62]
- **Resale restrictions.** *Resale* pertains to owners of securities transferring ownership to others for cash. Resale restrictions determine whether the

[59] See "Investor Access to Private Offerings" section of this report and CRS In Focus IF11278, *Accredited Investor Definition and Private Securities Markets*, by Eva Su.

[60] SEC, "Regulation Crowdfunding," July 10, 2024, https://www.sec.gov/resources-small-businesses/exempt-offerings/regulation-crowdfunding.

[61] Under federal securities laws, a company may not offer or sell securities unless the offering has been registered with the SEC or an exemption from registration is available. Generally speaking, private offerings are not subject to some of the laws and regulations that are designed to protect investors, such as the comprehensive disclosure requirements that apply to registered offerings (i.e., public offerings). As such, the registration and disclosure process is considered the dividing point between public and private offerings. SEC, "Private Placements Under Regulation D," September 2014, https://www.sec.gov/oiea/investor-alerts-bulletins/ib_privateplacements.html.

[62] CRS In Focus IF11278, *Accredited Investor Definition and Private Securities Markets*, by Eva Su.

instruments could enter secondary markets.[63] Resale capability is a given for publicly traded shares, but for private offerings, resale is generally restricted. For example, the private offering with the largest volume—Regulation D—faces resale restrictions, meaning investors have fewer exit options.

- **Preemption of state registration or qualification.** States impose certain securities regulations concurrent with SEC regulations.[64] Certain offering programs—for example, Regulation A-Tier 1—face requirements to register securities with the states, which have regulatory responsibility and expertise over small and local securities. This could be challenging and costly for issuers if the offering operates in multiple states, each with different registration requirements. In contrast, Regulation A-Tier 2, Regulation D-Rule 506, and Regulation Crowdfunding preempt state laws.

The various attributes are structured so as to create a relatively tailored system in which smaller companies have available to them less compliance costs to raising capital. A former SEC chair emphasized the importance of a scaled regulatory approach in relation to the potential lifecycle of a company's funding needs:

> Recently, Congress and the SEC have taken significant steps to further develop a capital formation ecosystem that includes a scaled disclosure regime. Now, for example, a small company may begin with a Regulation A mini-public offering of up to $50 million, then move to a fully registered public offering as a smaller reporting company (EGC), and eventually develop into a larger, more seasoned issuer (Full-disclosure IPO). This is a potentially significant development and I believe there remains room for improving our approach to the regulation of capital formation over the life cycle of a company—to be clear, improvements that also serve the best interests of long-term retail investors.[65]

Reflecting the same consideration for companies of different sizes and needs, Members of Congress have continued to introduce legislative proposals to further expand the scaled approach, building on existing JOBS Act measures.[66] Many of the proposals either modify the attributes listed in **Table 1** so as to expand a particular type of offering or to create new types of offerings.

[63] The primary market is where securities are created, and the secondary market is where securities are traded. The secondary market is essential for obtaining financial asset liquidity.

[64] See the "Policy Issues" section of this report for a more detailed discussion of state blue sky laws.

[65] SEC Chairman Jay Clayton, "Remarks to the Annual Government-Business Forum on Small Business Capital Formation," November 30, 2017, https://www.sec.gov/news/public-statement/annual-government-business-forum-small-business-capital-formation.

[66] For example, see the draft legislation proposal package titled Expanding Access to Capital Act of 2023 (H.R. 2799) in the 118th Congress.

Table 1. Comparison of Key Securities Offerings

Types of Securities Offerings	Maximum Offering Amount	Key Filing Requirements	Nonaccredited Investor Access	Resale Restrictions or Limitations	Preemption of State Registration
Public Offering	No limit	Full SEC registration requirements, including, but not limited to, Regulation S-K (nonfinancial disclosure), S-X (financial disclosure), and S-T (electronic filing regulations).	Full access	No	Yes
IPO On-Ramp	No limit, but subject to EGC status eligibility	Scaled-down SEC registration, including test-the-waters provisions, two years rather than three years of audited financial statements, and certain reduced executive compensation disclosure provisions, among others.	Full access	No	Yes
Regulation A-Tier 1	$20 million within 12 months	Form 1-A (an offering circular that contains information about the offering and the related risks, use of proceeds, business description and financial statements, among other things). Financial statements disclosed in a Tier 2 offering have to be audited, whereas Tier 1 offering financial statements could be unaudited.	Full access	No	No
Regulation A-Tier 2 (Mini-IPO)	$75 million within 12 months		Nonaccredited investors subject to investment limits	No	Yes
Regulation Crowdfunding	$5 million within 12 months	Form C (include two years of financial statements that are certified, reviewed, or audited, as required). Scaled disclosure requirements.	Nonaccredited investors subject to investment limits	Yes	Yes
Regulation D-Rule 504	$10 million within 12 months	Form D (a brief four-page notice that generally includes only the names and addresses of key personnel and some details about the offering). Rule 506(b) of Regulation D financial statement requirements for nonaccredited investors are the same as Regulation A.	Full access	Yes	No
Regulation D-Rule 506	No limit		No more than 35 sophisticated but nonaccredited investors in a 90-day period for Rule 506(b)	Yes	Yes

Source: CRS, based on SEC reporting.

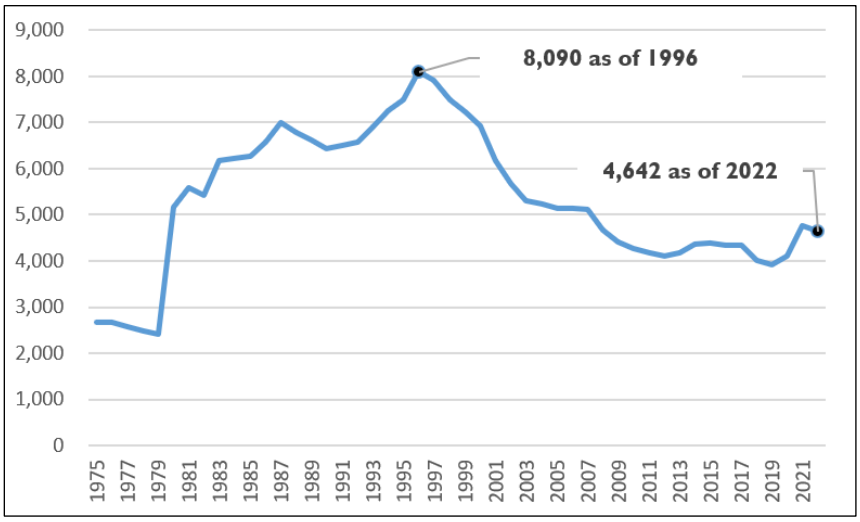
Note: The descriptions in the table apply to general conditions only. They are not inclusive of all conditions and exceptions.

Facilitating Public Offerings

Once a company goes through SEC registration and public disclosure, it is generally referred to as a public company. The advantages of going public include increased access to capital and liquidity, higher brand awareness, and more flexibility with regard to employee stock compensation.[67] For individual companies and their founders, the costs of going public could include regulatory compliance costs, potential loss of control by founders, and public scrutiny, such as potential activist investor involvement and business competitors' access to public disclosure of company operations.[68]

A public offering was traditionally viewed as a significant funding source for growing companies, but its importance has generally deteriorated in the past two decades. The number of U.S.-listed domestic public companies has declined by more than 40% from the previous peak (**Figure 2**), whereas listings rose in some other developed countries.[69]

Figure 2. Number of U.S.-Listed Public Companies (1975-2022)



Source: CRS using data from the World Bank Group, "Listed Domestic Companies, Total—United States," https://data.worldbank.org/indicator/CM.MKT.LDOM.NO?locations=US.

Notes: A company with several classes of shares is counted once. The total count excludes pooled funds, such as investment funds and unit trusts, which have business goals of holding shares of other companies.

The companies that fundraise through public offerings are increasingly large in size and concentration. Around 15% and 27% of total market capitalization is concentrated at top three and top 10 companies, respectively, as of year-end 2023.[70] As **Figure 3** illustrates, during recent decades, technology companies made up the top tier of stock market capitalization. Despite the

[67] SEC, "Should My Company 'Go Public'?"

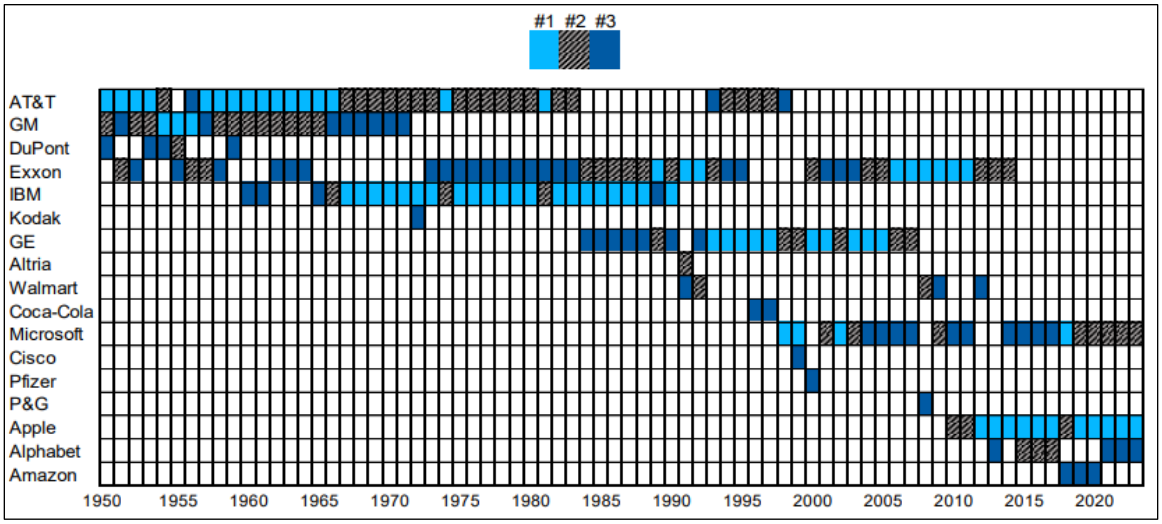
[68] From the perspective of the company going public and its founders, the costs of going public could include losing control of the company or being challenged by activist investors. However, these changes may not be a disadvantage for shareholders. For more discussions, see Steve Swidler, Tri Trinh, and Keven Yost, "The Effects of Activist Investors on Firms' Mergers and Acquisitions," *Journal of Financial Research*, vol. 42, no. 1 (Spring 2019), https://onlinelibrary.wiley.com/doi/abs/10.1111/jfir.12167.

[69] Craig Doidge, G. Andrew Karolyi, and René M. Stulz, "The U.S. Listing Gap," *Journal of Financial Economics*, vol. 123, no. 3 (March 2017), pp. 464-487, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2605000.

[70] Morgan Stanley, "Stock Market Concentration," June 4, 2024, https://www.morganstanley.com/im/publication/insights/articles/article_stockmarketconcentration.pdf#page=3.

reduced number of public companies in the 2020s relative to the 1990s, the ratio of stock market capitalization to GDP has reached an all-time high.[71] The total U.S. stock market capitalization reached a record $49 trillion in 2023.[72] These trends indicate that although the absolute number of publicly listed companies has decreased, their average size has increased (through mergers, acquisitions, organic growth, or delisting of smaller public companies), aggregating to a total market capitalization that has showed no signs of decline in recent years.

Figure 3. Stocks with the Largest Market Capitalization (1950-2023)



Source: Morgan Stanley.

Notes: Market capitalization as measured by year-end. Some of these companies changed their names over time. (For example, Altria was formerly Phillip Morris.) Because the list ends in 2023, it does not include Nvidia.

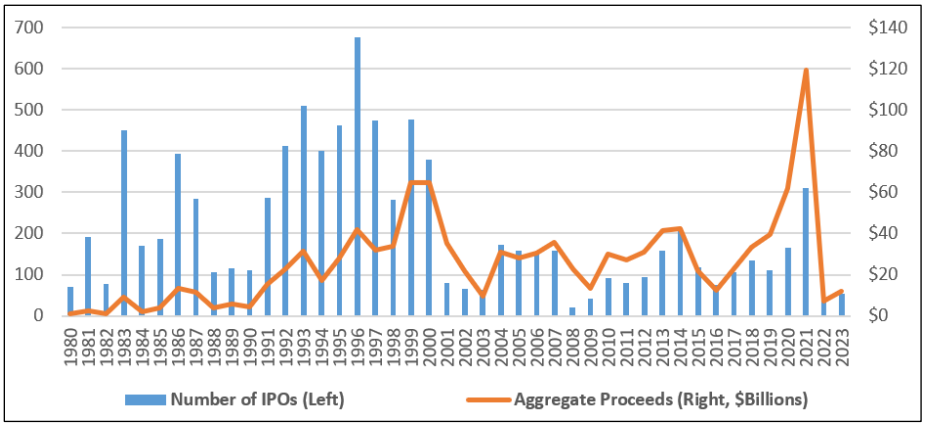
Research indicates that smaller-company IPOs were down substantially prior to the JOBS Act and that smaller firms are particularly likely to experience losses and earn lower returns.[73] Following enactment of the JOBS Act, smaller companies' relative difficulty accessing capital through public offerings improved somewhat through the EGC program (as discussed in the "Expansion of "IPO On-Ramp"—Emerging Growth Company Status" section of this report). However, some argue that the total number of IPOs has not increased significantly following enactment of the JOBS Act and is still below its long-term average, suggesting that improvements are not meaningfully reflected in the number of IPOs. There is also debate regarding whether the period around the dot-com bubble of the late 1990s is the best comparison benchmark for IPO trends.

[71] Federal Reserve Bank of St. Louis, "Stock Market Capitalization to GDP for United States," https://fred.stlouisfed.org/series/DDDM01USA156NWDB. Data as of January 2020, accessed in August 2024.

[72] SIFMA, "2024 Capital Markets Fact Book," p. 39.

[73] Jay R. Ritter, Xiaohui Gao, and John C. Chu, "Where Have All the IPOs Gone?," August 26, 2013, https://ssrn.com/abstract=1954788 or http://dx.doi.org/10.2139/ssrn.1954788.

Figure 4. Number of IPOs and Their Aggregate Proceeds (1980-2023)



Source: CRS using data from Jay Ritter, "Initial Public Offering: Updated Statistics," Warrington College of Business, University of Florida, May 10, 2024, https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf.

Notes: The chart excludes American deposit receipts; special purpose acquisition companies; natural resource limited partnerships and trusts; closed-end funds; real estate investment trusts; banks and federal savings and loans; unit offers; penny stocks (offer price of less than $5 per share); and stocks not listed on Nasdaq, the New York Stock Exchange, or the American Stock Exchange (acquired in 2008). Proceeds exclude overallotment options.

According to University of Florida professor Jay Ritter (who tracks a narrow measure of traditional IPOs), 54 operating companies raised $12 billion through IPOs in 2023, far below the long-term average of 209 IPO deals per year between 1980 and 2023 (**Figure 4**). The aggregate IPO proceeds reached a record level in 2021 followed by a sharp decline in 2022.

Although there is a general consensus that regulatory relief could reduce entry barriers and the costs of going public, disagreement persists regarding the nature of the decline in the number of IPOs and whether the issue warrants regulatory intervention.[74] Some argue that companies' decisions to shift from public offerings to private offerings are a structural change within the economy that does not require a regulatory fix. Others argue that the IPO decline is a consequence of the high costs of disclosure—an issue that could be remedied by policy.

Compliance Costs of Going Public

According to the IPO Task Force,[75] public companies in 2011 faced a one-time initial regulatory compliance cost of around $2.5 million and annual ongoing compliance costs of $1.5 million.[76] A 2024 publication estimates that the cost of conducting an IPO is at least $3 million, not including ongoing compliance costs.[77] Depending on the size and complexity of the offerings, the IPO costs could vary. One accounting firm estimates that, depending on

[74] Steven Davidoff, "A Dearth of IPOs, but It's Not the Fault of Red Tape," *New York Times*, March 28, 2017, https://www.nytimes.com/2017/03/28/business/dealbook/fewer-ipos-regulation-stock-market.html.

[75] The IPO Task Force was formed in response to discussions held during the March 11, 2011, Access to Capital Conference at the U.S. Department of the Treasury. It is composed entirely of private sector professionals. IPO Task Force, *Rebuilding the IPO On-Ramp Putting Emerging Companies and the Job Market Back on the Road to Growth*, October 2011, https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf; and IPO Task Force, *Rebuilding the IPO On-Ramp Slides*, October 20, 2011, https://www.sec.gov/info/smallbus/acsec/ipotaskforceslides.pdf.

[76] IPO Task Force, *Rebuilding the IPO On-Ramp Putting Emerging Companies and the Job Market Back on the Road to Growth*, October 2011, https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf.

[77] Simpson Thacher & Bartlett LLP, "In Brief: the IPO Market and Regulatory Framework in USA," May 31, 2024, https://www.lexology.com/library/detail.aspx?g=c1cda015-2d7a-48f1-b1c5-091e03dad227.

the industry sector, revenue range, and deal value range, the going public costs could reach between $2 million and $100 million.[78] Typical compliance costs include the following:

- **Underwriting fees** are generally gross spreads paid as commission to investment bankers in relation to their IPO-related services.[79] The underwriting fees normally range between 4% and 7%, with most (over 90%) of mid-sized deals (between $30 million and $130 million in proceeds) charging 7%.[80] Some observers have questioned the 7% "middle-market IPO tax," pointing to the higher middle-market IPO costs relative to other developed countries and the lack of correlation between the 7% and the actual costs of taking a company public.[81]
- **Legal and accounting services** occur costs during the IPO due diligence process and the filing of the SEC disclosure materials. Companies face increased accounting and auditing fees in relation to the preparation of audited financial statements and the Sarbanes-Oxley Act of 2002 compliance costs, among other things.[82]
- **The SEC registration fee** is $147.60 per million dollars.[83]
- **National securities exchange listing fees** include initial application fees and ongoing listing charges.[84]

Policy arguments concerning the IPO decline include the following:

- **Regulatory compliance.** Some argue that increased regulation may have unintended consequences for companies trying to access capital.[85] Specifically, critics of securities regulation point to laws and regulations enacted during the past two decades that have significantly affected the amount of public company compliance requirements. These laws and regulations include National Association of Securities Dealers order-handling rules (1996);[86] the 1999 passage of the Gramm-Leach-Bliley Act (P.L. 106-102); Regulation Fair Disclosure (2000);[87] the launch of decimalization (2001);[88] the Sarbanes-Oxley Act (2002; P.L. 112-106); the 2003 Global Settlement ruling restricting conflicts of interest between equity research and investment banking;[89] the Regulation National Market System (2005);[90] and the Dodd-Frank Act (2010; P.L. 111-203), among others.
- **Availability of private offerings.** Some argue that the increased disclosure obligations for public companies coupled with the "unleashing" of investors in

[78] PWC, "Considering an IPO? First, Understand the Costs," https://www.pwc.com/us/en/services/consulting/deals/library/cost-of-an-ipo.html.

[79] Hsuan-Chi Chen and Jay Ritter, "The Seven Percent Solution," June 2000, https://site.warrington.ufl.edu/ritter/files/2016/01/The-Seven-Percent-Solution-2000-06.pdf.

[80] Jay Ritter, "Initial Public Offerings: Underwriting Statistics Through 2023," Warrington College of Business, University of Florida, https://site.warrington.ufl.edu/ritter/files/IPOs-Underwriting.pdf.

[81] Former SEC Commissioner Robert Jackson, "The Middle-Market IPO Tax," April 25, 2018, https://www.sec.gov/newsroom/speeches-statements/jackson-middle-market-ipo-tax.

[82] For more on accounting and auditing, see CRS In Focus IF10701, *Introduction to Financial Services: Accounting and Auditing Regulatory Structure, U.S. and International*, by Raj Gnanarajah.

[83] SEC, "SEC Announces First Fee Rate Advisory for Fiscal Year 2024," press release, August 25, 2023, https://www.sec.gov/newsroom/press-releases/2023-162.

[84] For example, Nasdaq, "Initial Listing Guide," January 2024, https://listingcenter.nasdaq.com/assets/initialguide.pdf.

[85] Uyeda, "Remarks at the 'Going Public in the 2020s' Conference."

[86] 17 C.F.R. §240.19b-4.

[87] 17 C.F.R. §§240, 243, and 249.

[88] SEC, *Report to Congress on Decimalization*, July 2012, https://www.sec.gov/news/studies/2012/decimalization-072012.pdf.

[89] FINRA, "2003 Global Settlement," http://www.finra.org/industry/2003-global-settlement.

[90] 17 C.F.R. §§200, 201, 230, 240, 242, 249, and 270.

the "disclosure-lite" private markets have contributed to the increased use of private offerings as an alternative to public offerings, resulting in a decline in the number of public companies.[91]

- **Economies of scale.** The acquisition of smaller companies to create larger companies may lead to increased operation efficiency.[92] Some argue that long-term structural changes in markets have led to declining profitability for smaller companies, whether public or private. In addition, even after going public, smaller companies are said generally to have low liquidity and limited analyst coverage,[93] leaving them unable to reap the full benefits of public listing.[94] Some observers argue that the market infrastructure needed to support smaller IPOs—such as specialized investment banks and analyst coverage of smaller public companies—is lacking, especially when compared to the market infrastructure for larger IPOs.[95]
- **Financial and operational globalization.** Capital can flow around the world to find its most valued use. Financial globalization has increased significantly as countries have removed barriers to capital flows and new tools have facilitated cross-border investments. Some international firms could choose to list in the United States, responding to the relatively attractive investor base and favorable valuation terms.[96] Other international firms may alter their U.S. IPO plans or withdraw from U.S. listings when adverse conditions emerge.[97] Aside from discussions of financial globalization (i.e., flow of money), research of operational globalization (i.e., markets for goods and services) indicates that there are fewer publicly listed firms than expected given the size of the U.S. economy.[98] The researchers assert that operational globalization has led to decreases in domestic IPOs, especially small-firm IPOs.[99]

In response to issues relating to public offerings, policymakers are considering further expansion of EGC benefits as well as other regulatory relief proposals, including amendments to disclosure requirements and the expansion of certain preemptions to state "blue sky" laws. The following sections analyze several of these proposals.

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[91] Elizabeth Fontenay, "The Deregulation of Private Capital and the Decline of the Public Company," *Duke Law School Public Law and Legal Theory Series* No. 2017-33, April 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2951158.

[92] Ritter, Gao, and Chu, "Where Have All the IPOs Gone?"

[93] Analyst coverage matters to stock performance. Cem Demiroglu and Michael Ryngaert, "The First Analyst Coverage of Neglected Stocks," *Financial Management*, vol. 39, no. 2 (summer 2010), http://www.jstor.org/stable/40732449.

[94] Ritter, Gao, and Chu, "Where Have All the IPOs Gone?"

[95] SEC, *Final Report of the Advisory Committee on Smaller Public Companies to the United States Securities and Exchange Commission*, April 23, 2006, https://www.sec.gov/info/smallbus/acspc/acspc-finalreport.pdf.

[96] PWC, "Capital Markets 2024 Midyear Outlook," https://www.pwc.com/us/en/services/consulting/deals/us-capital-markets-watch.html.

[97] McKinsey and Company, "How They Fell: The Collapse of Chinese Cross-Border Listings," December 1, 2013, https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/how-they-fell-the-collapse-of-chinese-cross-border-listings.

[98] M. Vahid Irani et al., "Globalization and the Decline of IPOs," November 2, 2023, https://clsbluesky.law.columbia.edu/2023/11/02/globalization-and-the-decline-of-ipos.

[99] Irani et al., "Globalization and the Decline of IPOs;" and M. Vahid Irani et al., "Globalization and Capital Markets: Evidence from the Decline in IPOs," April 14, 2024, https://ssrn.com/abstract=4570849.

Expansion of "IPO On-Ramp"—Emerging Growth Company Status

As noted previously, the JOBS Act of 2012 created a scaled-down alternative to standard IPOs for smaller companies that meet the criteria to be deemed EGC issuers. This streamlined process is referred to as the IPO On-Ramp.

The IPO On-Ramp is a widely used JOBS Act provision. Around 87% of firms filing for IPOs after April 2012 were EGCs, meaning that only a small portion of all IPOs since April 2012 were still subject to the conventional IPO process.[100] Key EGC features—for example, the option to obtain confidential SEC review prior to public disclosure and elect for reduced disclosure of audited financials—are features adopted by the majority of IPO firms through the EGC status.

Proponents of regulatory relief stated that the EGC regime has enabled deeper capital formation without sacrificing investor protection. Further, they argue that many private companies are still reluctant to go public and suggest further action.[101] Some proponents believe the EGC program serves as a model for additional capital-formation-related regulation.[102] As mentioned in the "Raising Capital Through Securities Offerings" section of the report, the test-the-waters and confidential review features of the EGC framework can be particularly valuable for companies in industries where stock valuation is uncertain and the timing of the IPO depends on regulatory or other approval. For example, biotechnology and pharmaceutical industries reportedly have especially benefited from the EGC status.[103]

Critics point to the EGC regulatory standards as presenting undue risk on top of other disclosure-related investor protection risks. They characterize EGC as a regulatory label indicating lighter standards for listing. The EGC regime, they argue, appears to have enabled many relatively financially weak companies to conduct IPOs. The opponents believe that EGC companies tend to be lower in quality from a listing and investment perspective. In addition, these companies experienced underpricing relative to similarly sized companies prior to the JOBS Act.[104] Underpricing refers to IPOs that are issued at below market value, leaving less money to fund company growth.

Disclosure Requirements

SEC registration and disclosure are at the core of securities regulation. They are also central components of securities valuation and price discovery. Firms need capital and investors need information to evaluate investment conditions. Issuers have incentives to disclose information if they are to compete successfully for funds. Consistent with this understanding, early research shows that voluntary disclosure reduces firms' cost of capital. Early evidence also shows that

[100] Department of the Treasury, *A Financial System that Creates Economic Opportunities*: *Capital Markets*, October 2017, https://home.treasury.gov/system/files/136/A-Financial-System-Capital-Markets-FINAL-FINAL.pdf.

[101] Testimony of Edward Knight, Executive Vice President, Nasdaq, before the U.S. House of Representatives Subcommittee on Capital Markets, Securities, and Investment, March 22, 2017, https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-eknight-20170322.pdf.

[102] Testimony of Thomas Quaadman, Executive Vice President, U.S. Chamber of Commerce, before the U.S. House of Representatives Subcommittee on Capital Markets, Securities, and Investment, March 22, 2017, https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-tquaadman-20170322.pdf.

[103] Testimony of Brian Hahn, CFO of GlycoMimetics, on behalf of the Biotechnology Innovation Organization, before the U.S. House of Representatives Subcommittee on Capital Markets, Securities, and Investment, March 22, 2017, https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-bhahn-20170322.pdf.

[104] Testimony of Andy Green, Managing Director of Economic Policy, Center for American Progress, before the U.S. House of Representatives Subcommittee on Capital Markets, Securities, and Investment, March 22, 2017, https://financialservices.house.gov/uploadedfiles/hhrg-115-ba16-wstate-agreen-20170322.pdf.

firms voluntarily disclose significant amounts of information beyond what is mandated by securities regulators.[105] Given the benefit of some level of disclosure identified in earlier research, current debates about disclosure are more focused on disclosure costs and information overload. Ideally, from an economic perspective, the securities disclosures would be neither so restrictive that they omit essential information nor so voluminous that they create information overload or exhaust resources on irrelevant information.

As discussed previously, issuers currently have to provide a significant amount of disclosure of company information throughout the SEC registration process. Column three of **Table 1** presents these disclosure requirements. The disclosure-based approach is not without drawbacks. Some question the efficacy of disclosures and suggest they could be so exhaustive as to be counterproductive.[106] Concerns also exist regarding whether both retail and institutional investors could comprehend the disclosed information.

Disclosure "Materiality"

Some companies struggle to determine precisely what information must be disclosed as part of the registration process. A general standard governing information to be disclosed under securities laws is the concept of "materiality." *Materiality* pertains generally to the likely importance of a disclosure to a reasonable investor. SEC Rule 405 states, "When used to qualify a requirement for the furnishing of information as to any subject, [materiality] limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."[107] There is also significant case law concerning the concept of "materiality" in the courts, and the term is generally defined in terms of whether a reasonable investor would have viewed the undisclosed information as having "significantly altered the total mix of information available."[108]

The concept of materiality has always posed challenges for regulators and issuers, as it is often difficult to apply consistent standards for determining materiality at the level of individual companies. Certain discretion has been given to companies through a principle-based approach, which means the companies would have some flexibility to provide disclosures that they believe are material to reasonable investors.[109] A principle-based approach may provide additional flexibility for companies to make decisions about materiality on a case-by-case basis, which is also how the courts generally assess materiality, but the lack of a "bright line" about what exactly must be disclosed can make it difficult for both investors and companies. One example is that different companies interpreted the threshold for disclosing material cyber breaches vastly differently.[110] There is generally no bright-line approach on materiality. It is difficult, if not

[105] Robert Romano, "Empowering Investors: A Market Approach to Securities Regulation," Yale Law School, January 1, 1998, http://digitalcommons.law.yale.edu/cgi/viewcontent.cgi?article=2976&context=fss_papers.

[106] Omri Ben-Shahar and Carl E. Schneider, *More Than You Wanted to Know: The Future of Mandated Disclosure* (Princeton, NJ: Princeton University Press, 2016).

[107] 17 C.F.R. §230.405.

[108] See Basic v. Levinson, 485 U.S. 224 (1988).

[109] Keith Higgins, SEC Director, Division of Corporation Finance, "Shaping Company Disclosure: Remarks Before the George A. Leet Business Law Conference," October 2014, https://www.sec.gov/news/speech/2014-spch100314kfh#_edn3.

[110] Megan Gordon and Daniel Silver, "The Equifax Hack, SEC Data Breach, and Issuer Disclosure Obligations," Harvard Law School, October 2017, https://corpgov.law.harvard.edu/2017/10/05/the-equifax-hack-sec-data-breach-and-issuer-disclosure-obligations/.

impossible, to provide a clean-cut approach as to materiality for all situations. Thus, companies reportedly struggle to know when to disclose and when to hold back.[111]

Disclosure Costs and Readability

Public offerings generally face more rigorous and costly disclosure requirements relative to private offerings. Public company disclosure starts with an initial registration statement that includes a detailed description of the business, the security offered, and the management team, as well as audited financial statements, among other things. The reporting continues with the ongoing disclosure of quarterly and annual financials as well as the disclosure of key operational changes and corporate-governance-related information and events for shareholder voting.[112]

Although disclosure requirements and related costs have increased over time, readability of disclosed information has become a regulatory concern in recent years. One of the most cited examples is the size of Walmart's IPO prospectus in 1970, which totaled less than 30 pages.[113] This compares to the hundreds of pages commonly expected of today's IPO filings. Studies show that the median text length of certain key SEC filings doubled between 1996 and 2013, yet the readability and the mix of "hard" information (which refers to the informative numbers in the text) have decreased.[114] According to former SEC Chair Mary Jo White, most of this evolution was due to increased SEC rules and guidance that have required increasingly specific and detailed disclosures. This development eventually triggered regulatory discussions regarding "information overload," a term for the high volume of disclosure that can make it difficult for investors to find the most relevant information.[115]

The issue is further complicated when considering the types of investors to which the disclosed information is tailored. The majority of outstanding publicly traded U.S. company stocks are held by institutional investors. Their informational needs and preferences may differ from those of retail investors.[116] For example, more sophisticated institutional investors may find detailed reporting useful, whereas retail investors may have a harder time navigating the information overload and find "plain English" an easier way to comprehend investment disclosures. Some of these divergent preferences could be too costly to reconcile, because the current disclosure regime does not require different versions of disclosure by investor type.[117] As such, the investor type that should serve as the benchmark for disclosure and reporting requirements continues to be a topic of debate. For more on SEC disclosure, see CRS In Focus IF11256, *SEC Securities Disclosure: Background and Policy Issues*, by Eva Su.

[111] Emily Chasan, "Definition of Materiality Depends Who You Ask," *Wall Street Journal*, November 3, 2015, https://blogs.wsj.com/cfo/2015/11/03/definition-of-materiality-depends-who-you-ask.

[112] SEC, *Researching Public Companies Through EDGAR: A Guide for Investors*, https://www.sec.gov/oiea/Article/edgarguide.html.

[113] Wal-Mart IPO prospectus, 1970, http://ruckercapitaladvisors.com/member/wallmart_ipo.

[114] Travis Dyer and Mark Lang, "The Evolution of 10-K Textual Disclosure: Evidence from Latent Dirichlet Allocation," *Journal of Accounting and Economics*, August 19, 2017, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2741682.

[115] Former SEC Chair Mary Jo White, "The Path Forward on Disclosure," October 15, 2013, https://www.sec.gov/news/speech/spch101513mjw.

[116] Alicia Davis, "A Requiem for the Retail Investor?," *Virginia Law Review*, vol. 95, no. 4 (2009).

[117] Davis, "A Requiem for the Retail Investor?"

Preemption of State "Blue Sky" Laws

Another source of compliance costs for issuers is the fact that certain securities offerings have to navigate both federal- and state-level regulations. Although the SEC regulates and enforces federal securities laws, each state has its own securities regulator that enforces "blue sky" laws. These laws cover many of the same activities the SEC regulates, such as the sale of securities and those who sell them, but are confined to securities sold or persons who sell them within each state.[118]

The SEC and the states differ in their approach to securities regulation. SEC securities regulation requires disclosure of information about securities and their issuers, whereas the majority of states adopt "merit-based" securities regulation.[119] Merit-based regulation generally refers to the authority to deny registration to an offering on the grounds that it is substantively unfair or presents excessive risk to investors.[120] In other words, merit regulation prohibits specific conduct upon review. The issuers have to convince the states that the offerings are fair to investors.

State securities laws predate the first federal securities statute, the Securities Act of 1933, by a couple of decades. Although some federal statutes preempt state securities laws, state regulators retain the ability to police their own jurisdictions. In addition, there is said to be a separate line of tension between federal securities laws and state corporate law.[121] For example, companies' bylaws of incorporation, which affect their corporate governance practices, are traditionally regulated through state corporate law. Some argue that certain federal provisions relating to executive compensation and shareholder voting, among other provisions, have challenged the decisionmaking authority of state regulation.[122]

Public offerings trading on one of the national exchanges—the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX),[123] or Nasdaq—received preemption of state registration through the National Securities Markets Improvement Act of 1996 (P.L. 104-290), a milestone for "covered securities," which are preempted from blue sky laws' registration and qualification requirements. Under the law, covered securities generally include securities (1) listed, or from a listed issuer, on certain national securities exchanges; (2) issued by a registered investment company; (3) sold only to SEC-defined qualified purchasers; or (4) that meet certain exemptions.[124]

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[118] SEC, "State Securities Regulators," https://www.sec.gov/fast-answers/answersstatesecreghtm.html.

[119] The North American Securities Administrators Association (NASAA) coordinates the review of Regulation A offerings for different states. NASAA identifies 29 merit review jurisdictions out of a total of 49 jurisdictions of application. The rest of the states either adapt to disclosure review or are disclosure based, but they reserve the right to make comments consistent with the coordinated review protocol. See NASAA, "Application for Coordinated Review of Regulation A Offering: Form CR-3(b)," http://www.nasaa.org/wp-content/uploads/2014/05/Coordinated-Review-Application-Sec-3b.pdf.

[120] American Bar Association, "State Merit Regulation of Securities," *The Business Lawyer*, vol. 41, no. 3 (May 1986), pp. 785-852, https://www.jstor.org/stable/40686730.

[121] Donald Langevoort, *Selling Hope, Selling Risk: Corporations, Wall Street, and the Dilemmas of Investor Protection* (Oxford, UK: Oxford University Press, 2016).

[122] Jill Fisch, "Leave It to Delaware: Why Congress Should Stay Out of Corporate Governance," *Delaware Journal of Corporate Law*, vol. 37 (2013), http://www.djcl.org/wp-content/uploads/2014/07/LEAVE-IT-TO-DELAWARE-WHY-CONGRESS-SHOULD-STAY-OUT-OF-CORPORATE-GOVERNANCE.pdf.

[123] AMEX was acquired by NYSE in 2008. SEC, "NYSE Euronext to Acquire the American Stock Exchange," January 17, 2008, https://www.sec.gov/Archives/edgar/data/1368007/000119312508008825/dex991.htm.

[124] See more details on 17 C.F.R. §230 at https://www.sec.gov/rules/final/2017/33-10428.pdf; P.L. 104-290; and Thomson Reuters Practical Law Glossary, "Covered Securities," https://content.next.westlaw.com/Document/If661d2bef4ae11e498db8b09b4f043e0/View/FullText.html?contextData=(sc.Default)&transitionType=Default.

Public offerings that do not meet the criteria for covered securities may have to comply with certain state-level regulations. Some argue that state laws adversely affect securities offerings that are not part of the covered securities universe. States have regulatory responsibility and expertise over small and local securities. However, an issuer operating in multiple states without preemption of state regulation would have to meet different regulatory requirements in each state, increasing operational complexity and costs. On the other hand, proponents argue that state regulations prevent fraud or manipulation of securities offerings locally. Apart from arguments related to the relative costs and benefits, observers assert that state regulations are difficult to eliminate because of various political reasons.[125] Some policymakers have proposed to alter the preemption of state blue sky laws.[126]

Facilitating Private Offerings

The vast majority of American businesses are operating as private companies. There are more than 30 million businesses in the United States, but fewer than 5,000 are publicly traded.[127] Some research indicates that around 2,800 publicly traded companies have annual revenue greater than $100 million, while around 18,000 private businesses are of that size (**Figure 5**).[128]

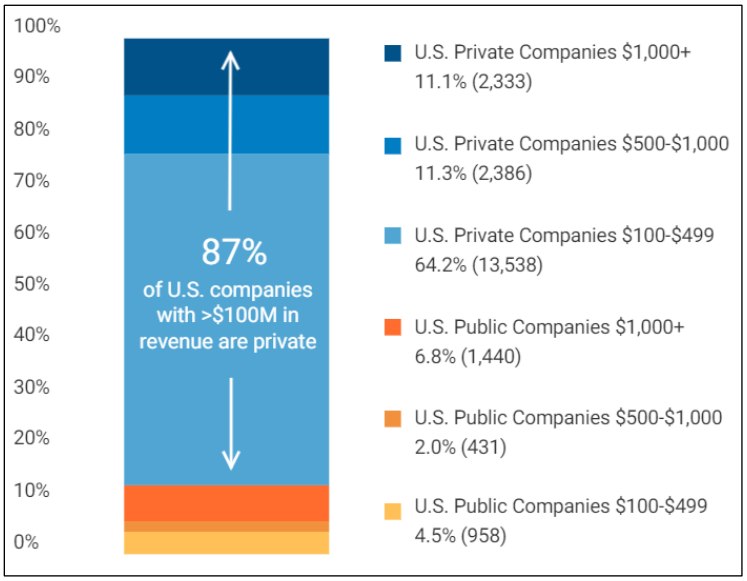
[125] Rutheford Campbell Jr., "The Case for Federal Pre-Emption of State Blue Sky Laws," Heritage Foundation, February 28, 2017, https://www.heritage.org/markets-and-finance/report/the-case-federal-pre-emption-state-blue-sky-laws.

[126] The National Securities Exchange Regulatory Parity Act (H.R. 4546 in the 115th Congress) is an example of a legislative proposal that would have affected blue sky laws. Under current law, in order to be exempt from state registration requirements, a security is generally listed, or authorized for listing, on specific national securities exchanges, generally through public offering. The bill would have instead required that a security be listed, or authorized for listing on any national securities exchanges that the SEC has approved. This amendment would allow public offerings to trade on other exchanges, in addition to the currently specified three, to be potentially exempt from state registration. Although the bill was generally considered a technical fix, opponents believe that it creates confusion and encourages a race to the bottom, as exchanges could potentially lower listing standards to compete for business. See the CRS bill summary at https://www.congress.gov/bill/115th-congress/house-bill/10; and House Financial Services Committee (Democrats), "Minority Views on H.R. 5421: The 'National Securities Exchange Parity Act of 2016,'" https://democrats-financialservices.house.gov/uploadedfiles/mv_hr_5421_signed.pdf.

[127] U.S. Small Business Administration, "Frequently Asked Questions About Small Business, 2023," March 7, 2023, https://advocacy.sba.gov/2023/03/07/frequently-asked-questions-about-small-business-2023.

[128] Hamilton Lane, "Private Market Investing: Staying Private Longer Leads to Opportunity," April 14, 2022, https://www.hamiltonlane.com/en-us/insight/staying-private-longer.

Figure 5. Private and Public Companies with Annual Revenue Exceeding $100 Million as of January 2022

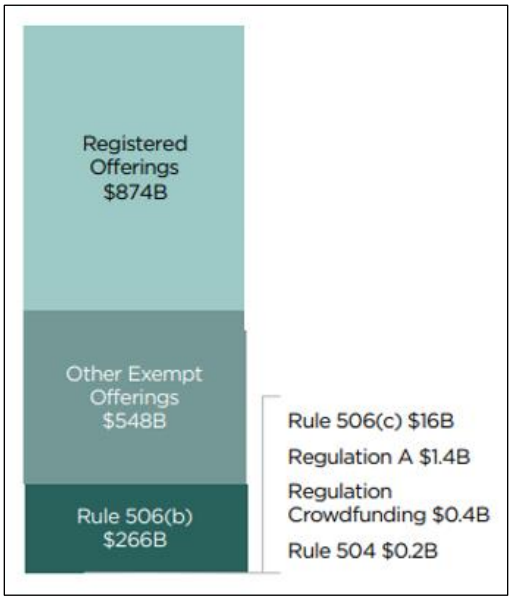


Source: Hamilton Lane, "Private Market Investing: Staying Private Longer Leads to Opportunity," April 14, 2022, https://www.hamiltonlane.com/en-us/insight/staying-private-longer.

While not every private company needs to issue securities offerings, private securities offers are significant sources of funding for many companies that need money to operate and grow. As **Figure 6** illustrates, after excluding offerings by pooled funds—which are asset management vehicles—companies received nearly comparable amounts of funding through public offerings (registered offerings of $874 billion) and private offerings ($832 billion) in FY2023.[129] In addition, while private companies cannot issue public securities offerings, publicly traded companies could issue both public and private securities offerings. **Figure 6**'s calculation of private offerings includes the offerings from both public and private companies.

[129] The calculation used data for FY2023 from July 1, 2022, to June 30, 2023.

Figure 6. Company Fundraising by Securities Offering Type (Excluding Pooled Funds)



Source: SEC Office of the Advocate for Small Business Capital Formation, *Annual Report Fiscal Year 2023*, https://www.sec.gov/files/2023-oasb-annual-report.pdf#page=20.

Notes: FY2023 data from July 1, 2022, to June 30, 2023. The calculation excludes public and private securities offerings at pooled funds.

As private securities offerings become increasingly important, going public is arguably less of a necessity for certain private companies to raise capital.[130] As private markets are getting larger and companies are staying private for longer, some argue that these results were derived from relaxed securities regulation instead of natural market developments.[131] The related policy concerns include (1) market transparency for purposes of investor protection and systemic risk monitoring in light of less standardized information disclosure in private markets; (2) valuation challenges because of the illiquid nature of private markets that have led to limited price discovery, thus experiencing widening price gaps between private assets and their publicly traded counterparts, especially during market distress;[132] and (3) large private issuers locking up capital for long periods of time through private securities offerings, limiting capital availability to smaller businesses, as some observers argue.[133]

Other concerns persist that smaller companies face difficulties accessing capital. Private offerings are especially important for smaller companies, as they are traditionally viewed as the funding

[130] Morgan Stanley, "Public to Private Equity in the United States: A Long-Term Look," August 4, 2020, https://www.morganstanley.com/im/publication/insights/articles/articles_publictoprivateequityintheusalongtermlook_us.pdf; and McKinsey and Company, "Private Markets Rally to New Heights," March 2022, https://www.mckinsey.com/~/media/mckinsey/industries/private%20equity%20and%20principal%20investors/our%20insights/mckinseys%20private%20markets%20annual%20review/2022/mckinseys-private-markets-annual-review-private-markets-rally-to-new-heights-vf.pdf.

[131] SEC Commissioner Allison Lee, "Going Dark: The Growth of Private Markets and the Impact on Investors and the Economy," October 12, 2021, https://www.sec.gov/newsroom/speeches-statements/lee-sec-speaks-2021-10-12.

[132] Chris Flood, "Private Equity Investment Trust Discounts Widen," *Financial Times*, May 26, 2023, https://www.ft.com/content/572e8bf3-00dd-4278-b800-cc0cfa3537e8.

[133] SEC Commissioner Caroline Crenshaw, "Big 'Issues' in the Small Business Safe Harbor: Remarks at the 50th Annual Securities Regulation Institute," January 30, 2023, https://www.sec.gov/newsroom/speeches-statements/crenshaw-remarks-securities-regulation-institute-013023.

tool for smaller, pre-IPO firms. Some argue that the JOBS Act has not revived public capital access for smaller companies with relatively small market capitalization.[134] Smaller companies' relative difficulty accessing capital through public offerings has encouraged the use of private offerings as an alternative funding source. All else equal, the increased use of private offerings could reduce companies' need to go public. It is within this context that policy debates and legislative proposals have been focusing on a scaled regulatory approach that would ease firms' access to private offerings. These proposals fall into several categories: (1) the expansion of investor access to private offerings, (2) the increase in the upper limit and issuer eligibility for Regulation A+, (3) the creation of a new exemption for micro offerings, and (4) the expansion of Regulation Crowdfunding.

In addition, with the existence of many different securities offerings funding venues, some observers have also expressed concerns about small businesses' capabilities to "navigate our very complex securities laws that are often written in very inaccessible jargon."[135]

Investor Access to Private Offerings

As shown in **Table 1**, private offerings are often limited in the kinds of investors to which they can be offered. One approach to expanding capital access for private offerings is to expand investor eligibility. As explained below, policymakers could expand (1) the type of eligible investors by widening the accredited investor definition, (2) the number of eligible investors by increasing the number of nonaccredited investors allowed to participate in private offerings, or (3) the communication to eligible investors by allowing broader outreach.

As mentioned in the "Capital Formation and Investor Protection" section of the report, investor protection concerns are generally viewed alongside capital formation needs in a policy context. Some have argued that increasing investor access would improve capital formation by creating a larger eligible investor pool for certain securities offerings and would "democratize" investment opportunities by permitting a wider array of investors to participate. However, there are concerns regarding investor protection. Some argue that, unlike offerings registered with the SEC, certain unregistered offerings lack disclosure of material information, thus exposing investors to higher risk.[136]

Accredited Investors

As mentioned earlier, generally only "accredited" investors are allowed to invest in private offerings. According to federal securities regulations, accredited investors are institutional or individual investors who are generally financially sophisticated and have the wherewithal to sustain financial losses.[137]

The purpose of the accredited investor concept is to identify entities and persons who can bear the economic risk of investing in unregistered securities and to protect ordinary investors from excess risk and potential fraud. According to the SEC, an accredited investor, in the context of an individual, is defined using a number of income and net worth measures: (1) earned income that exceeded $200,000 (or $300,000 together with a spouse) in each of the prior two years and can

[134] Davidoff, "A Dearth of IPOs."

[135] SEC, *Report on the 42nd Annual Small Business Forum*, April 2023, https://www.sec.gov/files/2023_oasb_annual_forum_report_508.pdf#page=48.

[136] Crenshaw, "Big 'Issues' in the Small Business Safe Harbor."

[137] 17 C.F.R. §230.501.

reasonably be expected to be the same for the current year; or (2) net worth over $1 million, either alone or together with a spouse (excluding the value of the person's primary residence).

Any institution can qualify as an accredited investor if it owns more than $5 million in *investments*. Corporations, partnerships, trusts, nonprofits, employee benefit plans, and family offices holding more than $5 million in *assets* could also qualify. Moreover, a number of entities—such as banks, insurance companies, SEC-registered broker-dealers, SEC-registered investment companies, and business development companies—automatically qualify as accredited investors.

Qualifying as an accredited investor is significant because accredited investors may participate in investment opportunities that are generally not available to nonaccredited investors, such as investments in private companies and offerings by hedge funds, private equity funds, and venture capital funds.

The income- and net-worth-based definition of *accredited investor* has generated criticism, as it arguably suggests that higher net worth equates to investing sophistication. The definition also generates concerns about its sufficiency in capturing those who need investor protection. Some question, for example, whether a widow who relies on her existing net worth for financial security should be eligible for higher-risk investing.

The application of the accredited investor definition faces additional challenges. A definition relying on numeric thresholds provides a clear criterion or guideline for implementation that could produce predictable and consistent results in application. By reading the definition, investors would know if they are accredited investors or not. This approach, however, poses a challenge, because certain measures of financial sophistication cannot be easily tracked through standardized numerical approaches or be determined based on income or wealth.

In addition, the income- and net-worth-based thresholds have not been adjusted for inflation since 1982. The SEC's calculations in **Table 2** indicates that while 1.8% of U.S. households qualified as accredited investors in 1983, the share went up to 18.5% in 2022.

Table 2. Households Qualifying Under Accredited Investor Financial Criteria

Qualifying Households as % of U.S. Households

Basis for Qualifying as Accredited Investor	1983	2022
Individual income threshold of $200,000	0.5%	13.8%
Joint income threshold of $300,000	N/A	7.5%
Net worth threshold of $1 million	1.7%	12.5%
Overall number of qualifying households	1.8%	18.5%

Source: CRS using data from SEC, *Review of the "Accredited Investor" Definition under the Dodd-Frank Act*, December 14, 2023, https://www.sec.gov/files/review-definition-accredited-investor-2023.pdf.

Threshold Rule

The SEC Threshold Rule (Section 12(g) of the Securities Exchange Act of 1934) restricts the maximum number of nonaccredited investors allowed to participate in private securities offerings. It establishes the thresholds at which an issuer is required to register a class of securities with the SEC.[138] Prior to the JOBS Act, the Securities Exchange Act of 1934 required a private company

[138] 15 U.S.C. §78l.

to register securities with the SEC if it had total assets exceeding $10 million and shares held by 500 or more shareholders, without regard to nonaccredited investor status.[139] Effective in 2012, the JOBS Act raised the shareholder registration threshold to either 2,000 persons or 500 persons who are nonaccredited investors.[140] In addition, to address the "Facebook problem"—when companies were forced to go public because the number of shareholders triggered threshold requirements for registration—employee compensation plan holders were no longer considered holders of record.[141]

General Solicitation

Issuers often market their private offerings at promotional events. The events are often sponsored by angel investors (early-stage investors, mostly high-net-worth individuals), venture capital associations, nonprofits, or universities and are used to communicate that a company is interested in, if not actively seeking, investor financing. Certain types of general promotion or advertising were banned for Regulation D private offerings prior to the JOBS Act to prevent nonaccredited investors from inadvertently investing. The JOBS Act created a new private offering category under Regulation D, wherein issuers are allowed to engage in general solicitations to accredited investors while taking "reasonable steps" to verify their accredited status.[142]

Some market participants have advocated for a further removal of certain general solicitation restrictions, a move welcomed by trade groups that would benefit from reduced compliance costs and reduced uncertainty. Critics of these efforts, however, raise concerns about investor protection, especially given the potential participation of nonaccredited investors in promotional events intended for accredited investors.[143]

"Mini-IPO"—Regulation A+

Another way that some propose to facilitate capital formation is the further expansion of Regulation A+, or "Mini-IPO," a private exemption to facilitate private offering capital access for small- to medium-sized companies. A mini-IPO is like a regular IPO in the sense that it has no resale restrictions and could potentially list on public stock exchanges. But unlike an IPO, it is subject to offering size limits and certain investment limits on nonaccredited investor access, as summarized in **Table 1**. Regulation A+, which expanded the existing Regulation A, became effective on June 19, 2015, a few years after the signing of the JOBS Act in 2012. Regulation A was a little-used regulatory regime prior to the JOBS Act. Starting from the enactment of Regulation A+, the offerings have significantly expanded as measured by the number of total qualified offerings and the aggregate qualified offerings amounts sought.

Regulation A+ provides two tiers of offerings:[144]

[139] Securities Exchange Act Section 12(g), 15 U.S.C. §78l.

[140] For issuers who are not banks or bank holding companies.

[141] Facebook's and Microsoft's IPOs are two examples widely cited by the media. Microsoft's 1986 IPO was reportedly triggered by the shareholder threshold despite the fact that the company had no capital needs at the time. Facebook, on the other hand, was said to have established a special purpose vehicle (SPV) to pool investor funds and purchase shares from former employees and early investors. If each individual investor in the SPV were counted as a holder of record, instead of counting the SPV as a single holder, registration concerns would be triggered.

[142] SEC, "General Solicitation—Rule 506(c)," https://www.sec.gov/smallbusiness/exemptofferings/rule506c.

[143] For more details, see CRS Insight IN10632, *H.R. 79, Section 452 of H.R. 10, and Section 913 of H.R. 3280: Helping Angels Lead Our Startups*, by Gary Shorter.

[144] SEC, "Updated Investor Bulletin: Regulation A," April 14, 2021, https://www.sec.gov/resources-for-investors/investor-alerts-bulletins/ib_regulationa.

- Tier 1 allows securities offerings of up to $20 million in a 12-month period. Tier 1 is subject to both state and federal registration and qualification requirements. Tier 1 financial statements do not have to be audited.
- Tier 2 allows securities offerings of up to $75 million in a 12-month period. Certain qualified purchasers of Tier 2 offerings are exempt from state securities law registration and qualification requirements. Tier 2 financial statements must be audited.

Despite the regime's perceived high potential and upward trend, some contend that it has fallen short of expectations.[145] Concerns about Regulation A+ include the following:

- **Capital raised is relatively low.** Regulation A+'s aggregate capital raised in qualified offerings was $1.5 billion in FY2023, which seems low compared to the $3 trillion in Regulation D offerings.[146]
- **Public trading is rare.** Although securities issued under Regulation A+ have traded on public exchanges in a few cases, the entering of Regulation A+ into public trading platforms is still uncommon.[147]
- **The financial industry is the heaviest user so far.** The program is not broadly adopted: Around 79% of Regulation A+ proceeds went to finance, insurance, and real estate companies.[148]

Some have proposed expanding the upper limit of Regulation A+, arguing that in its current form it still faces hurdles in gaining market acceptance because such offerings cost more than a traditional private placement but tend not to attract major underwriters, broker-dealers, and research coverage, because the deal sizes are small relative to a traditional IPO.[149] Some believe that further lifting the upper limit would potentially alleviate size-related concerns for market intermediaries.[150] Proponents also argue that thousands of SEC reporting companies are currently not able to access Regulation A+. By allowing more companies to use Regulation A+, it would enhance capital formation.[151]

Others consider the expansion of Regulation A+ to potentially reduce incentives for companies to go public, thus undermining public securities markets.[152] This could be to the detriment of both investors and markets, as public offerings provide greater investor protection and liquidity for

[145] Bill Alpert, Brett Arends, and Ben Walsh, "Most Mini-IPOs Fail the Market Test," *Barron's*, February 13, 2018, https://www.barrons.com/articles/most-mini-ipos-fail-the-market-test-1518526753.

[146] SEC, Office of the Advocate for Small Business Capital Formation, *Annual Report Fiscal Year 2023*, https://www.sec.gov/files/2023-oasb-annual-report.pdf#page=18.

[147] SEC, *Regulation A Lookback Study and Offering Limit Review Analysis*, March 4, 2020, https://www.sec.gov/files/regulationa-2020.pdf.

[148] SEC, *Regulation A Lookback Study*, p. 18.

[149] For example, there were legislative proposals in the 115th Congress to further expand Regulation A+'s upper limit (H.R. 4263) and to broaden its eligible issuer base (H.R. 2864).

[150] Tom Zanki, "House Panel Approves Bill Lifting Reg A+ IPO Limit to $75M," *Law360*, November 16, 2017, https://www.law360.com/articles/986052/house-panel-approves-bill-lifting-reg-a-ipo-limit-to-75m; and SEC, "39th Annual Small Business Forum," https://www.sec.gov/info/smallbus/sbforum.shtml.

[151] OTC Markets Group, "Petition for Rulemaking to Amend Regulation A to Make SEC Reporting Companies Eligible Issuers and Permit at the Market Offerings," June 6, 2016, https://www.sec.gov/rules/petitions/2016/petn4-699.pdf.

[152] Americans for Financial Reform, letter to Congress, November 13, 2017, http://ourfinancialsecurity.org/wp-content/uploads/2017/11/AFR-Letter-Re-HFSC-11-14-Markup.pdf.

trading.[153] Some observers argue against immediate expansion, raising concerns that the regime is still in its early stages and that demand and participation have not yet stabilized. In 2015, the upper limit for Regulation A+ was increased 10 times, from $5 million to $50 million. The SEC has the discretion to change the size limit under the current rule.[154] The SEC raised the maximum offering amount under Tier 2 to $75 million from $50 million in November 2020.[155]

Micro Offering

There is considerable demand for seed and startup capital for U.S. small businesses, some of which may be at the forefront of technological innovation and job creation. Yet some companies may be too small to realistically issue private offerings under existing exemptions. For example, a 2023 survey of more than 1,500 small business participants shows that small business owners faced difficulty accessing capital and that this challenge has adversely affected their businesses.[156] Proposals related to what are referred to as *micro offerings* are intended to assist small businesses that are deemed to have insufficient capital access. Specifically, some propose a new private offering that would exempt certain micro funding from federal registration as well as state blue sky laws.[157]

Proponents believe it would more easily allow small businesses and startups to raise limited amounts of capital from their personal network of family and friends without running afoul of federal and state securities laws.[158] Business trade groups have stated that the micro offering legislation would "appropriately scale" federal rules and regulatory compliance for small businesses.[159]

Opponents, however, raise investor protection concerns stemming from reduced disclosures and the absence of provisions to disqualify "bad actors" with criminal records, among other things. One point of contention is that micro offerings would not be subject to resale restrictions, meaning they could be immediately sold off to other qualified investors. The lack of a resale restriction for unregistered securities could expose investors to potential "pump and dump"

[153] Americans for Financial Reform, letter to Congress.

[154] Sections 3(b)(2)-(5) of P.L. 112-106 specifies mandatory terms and conditions for such exempt offerings and also authorize the commission to adopt other terms, conditions, or requirements as necessary in the public interest and for the protection of investors. 17 C.F.R. §§200, 230, 232, 239, 240, 249, and 260.

[155] SEC, "SEC Harmonizes and Improves 'Patchwork' Exempt Offering Framework," press release, November 2, 2020, https://www.sec.gov/newsroom/press-releases/2020-273.

[156] Goldman Sachs, "New Survey Data: Small Business Owners Raise Alarms Over Difficulty Accessing Capital," press release, September 12, 2023, https://www.goldmansachs.com/citizenship/10000-small-businesses/US/voices/news/september-12-2023-press-release.html.

[157] For example, the Micro Offering Safe Harbor Act (H.R. 2201, 115th Congress).

[158] House Majority Leader Kevin McCarthy, "The House Helps Small Businesses Get Off the Ground," press release, November 9, 2017, https://www.majorityleader.gov/2017/11/09/micro-offerings.

[159] Several small business advocacy organizations have endorsed the Micro Offering Safe Harbor Act, including the National Small Business Association as well as the Small Business and Entrepreneurship Council, which stated, "The legislation would appropriately scale federal rules and regulatory compliance for small businesses, thus providing another practical option for entrepreneurs to raise the capital they need to startup or grow their firms." Rep. Tom Emmer, "Emmer Introduces Micro Offering Safe Harbor Act," press release, March 23, 2016, https://emmer.house.gov/media-center/press-releases/emmer-introduces-micro-offering-safe-harbor-act.

schemes,[160] a form of securities fraud that involves artificially boosting the price of a security in order to sell it for more.[161]

The Congressional Budget Office has estimated that only a relatively small number of securities transactions would be covered under certain expanded exemptions that are not currently covered by other existing exemptions.[162]

Securities-Based Crowdfunding

Crowdfunding generally refers to a financing method in which money is raised through soliciting relatively small individual investments or contributions from a large number of people.[163] Four kinds of crowdfunding exist: (1) donation crowdfunding, where contributors give money to a campaign and receive in return—at most, an acknowledgment; (2) reward crowdfunding, where contributors give to a campaign and receive in return a product or a service; (3) peer-to-peer lending crowdfunding, where investors offer a loan to a campaign and receive in return their capital plus interest; and (4) equity crowdfunding, where investors buy stakes in a company and receive in return company stocks.[164] Generally, equity crowdfunding and certain peer-to-peer lending crowdfunding could be subject to SEC regulation if they conform to the legal definition of *security*.

Title III of the JOBS Act created a new exemption from registration for internet-based securities offerings of up to $1 million (inflation-adjusted) over a 12-month period. Title III intends to help small and startup businesses conduct low-dollar capital fundraising from a broad and mostly retail investor base over the internet. The JOBS Act includes a number of investor protection provisions, including investment limitations, issuer disclosure requirements, and a requirement to use regulated intermediaries. The crowdfunding final rule became effective on May 16, 2016.[165] In November 2020, the SEC expanded the Regulation Crowdfunding offering limit to $5 million from $1 million and removed accredited investor investment limits, among other changes.[166]

Between 2016 and 2022, there were 5,969 Regulation Crowdfunding offerings by 5,211 businesses, raising a total of $1.4 billion in proceeds.[167] Between 2016 and 2022, Regulation Crowdfunding offerings were increasingly large in the number of offerings, amounts raised, and funding success rates, but the total size and influence remain small relative to other securities offerings (**Table 3**).

[160] H.Rept. 115-383.

[161] SEC, "Pump and Dump Schemes," https://www.investor.gov/protect-your-investments/fraud/types-fraud/pump-dump-schemes.

[162] Congressional Budget Office, *Cost Estimate of* H.R. 2201, *Micro Offering Safe Harbor Act*, October 30, 2017, https://www.cbo.gov/system/files/115th-congress-2017-2018/costestimate/hr2201.pdf.

[163] SEC, *Updated Investor Bulletin: Crowdfunding for Investors*, October 14, 2022, https://www.sec.gov/oiea/investor-alerts-bulletins/ib_crowdfunding-.html.

[164] Garry Gabison, *Understanding Crowdfunding and Its Regulations*, European Commission, 2015, http://publications.jrc.ec.europa.eu/repository/bitstream/JRC92482/lbna26992enn.pdf.

[165] Vladimir Ivanov and Anzhela Knyazeva, *U.S. Securities-Based Crowdfunding Under Title III of the JOBS Act*, SEC, February 28, 2017, https://www.sec.gov/dera/staff-papers/white-papers/RegCF_WhitePaper.pdf.

[166] SEC, "SEC Harmonizes and Improves 'Patchwork' Exempt Offering Framework."

[167] Melody Chang, *Women and Minority-Owned Businesses in Regulation Crowdfunding*, SEC, May 2024, https://www.sec.gov/files/oasb-women-minority-businesses-crowdfunding-report.pdf.

Table 3. Regulation Crowdfunding Offerings and Outcomes

Year	Number of Offerings	Amount Raised ($Millions)	Median Amount Raised per Offering ($Thousands)	Percentage Funded
2016	178	26	197	48%
2017	495	69	116	62%
2018	735	87	94	61%
2019	685	130	119	66%
2020	1,133	264	143	70%
2021	1,350	449	154	78%
2022	1,393	412	115	81%

Source: CRS using data from Melody Chang, *Women and Minority-Owned Businesses in Regulation Crowdfunding*, SEC, May 2024, https://www.sec.gov/files/oasb-women-minority-businesses-crowdfunding-report.pdf#page=7.

New Capital Access Venue and the "Wisdom of the Crowd"

Crowdfunding allows investors and entrepreneurs to connect directly, potentially creating access to new investment opportunities and allowing investors to tap into "the wisdom of the crowd."[168] These new opportunities could provide much-needed seed capital to entrepreneurs who would otherwise lack capital access. The issuers of securities-based crowdfunding tend to be small, new, prerevenue, and not profitable.[169] Some research indicates positive effects of crowdfunding facilitating business growth.[170]

The total amount of reported securities-based crowdfunding is small relative to the estimated global crowdfunding volume and the size of other capital market venues. The SEC tracks crowdfunding volume using data taken from issuers filing Regulation Crowdfunding Forms C-U, but not all securities issuers initiated the filings. In addition, a large portion of current online peer-to-peer funding activities are generally not considered "securities-based" crowdfunding subject to SEC regulation. Non-securities-based crowdfunding campaigns do not necessarily involve profit-seeking businesses, and ones that do may have a project-specific nature, thus not conforming to the SEC's definition of *securities*.[171] Peer-to-peer lending, if not considered a security, may still be under the oversight of banking regulators for consumer banking and related regulations.[172] As

[168] Garry Bruton et al., "New Financial Alternatives in Seeding Entrepreneurship: Microfinance, Crowdfunding, and Peer-to-Peer Innovations," *Entrepreneurship Theory and Practice*, vol. 39, no. 1 (2014), pp. 9-26, http://onlinelibrary.wiley.com/doi/10.1111/etap.12143/abstract.

[169] Vladimir Ivanov and Anzhela Knyazeva, *U.S. Securities-Based Crowdfunding Under Title III of the JOBS Act*, February 28, 2017, https://www.sec.gov/dera/staff-papers/white-papers/RegCF_WhitePaper.pdf, and Chang, *Women and Minority-Owned Businesses in Regulation Crowdfunding*.

[170] Video and highlights from SEC-NYU Dialogue on Securities Crowdfunding, February 2017, https://www.sec.gov/files/Highlights%20from%20the%20SEC-NYU%20Dialogue%20on%20Securities-Based%20Crowdfunding.pdf; and Rudi Palmieri, Chiara Mercuri, and Sabrina Mazzali-Lurati, *Persuasive Reasons in Crowdfunding Campaigns: Comparing Argumentative Strategies in Successful and Unsuccessful Projects on Kickstarter* (London: Routledge, 2024), https://www.taylorfrancis.com/chapters/oa-edit/10.4324/9781003481171-16/persuasive-reasons-crowdfunding-campaigns-comparing-argumentative-strategies-successful-unsuccessful-projects-kickstarter-rudi-palmieri-chiara-mercuri-sabrina-mazzali-lurati.

[171] Ivanov and Knyazeva, *U.S. Securities-Based Crowdfunding*. For more details on the definition of *security*, see chapter 2 of Robert Rosenblum, *Investment Company Determination Under the 1940 Act: Exemptions and Exceptions*, American Bar Association, 2003.

[172] For a summary of consumer credit regulation, see Morrison Foerster, *Practice Pointers on P2P Lending Basics:*
(continued...)

of FY2023, Regulation Crowdfunding offerings totaled $352 million through small amounts from many investors.[173] The average size of an individual investment was $1,578 in 2022.[174]

Potential Benefits and Drawbacks

Crowdfunding's expansion of capital access and "wisdom of the crowd" characteristics are widely cited as benefits of the funding method. Some academic research of selected types of crowdfunding finds that crowdfunding democratizes access to funding, allows the crowd to look for signals of quality, and is "remarkably free" from fraud, even though a large percentage of projects ultimately deliver but typically past the date on which it was expected.[175] Others argue that crowdfunding, perhaps more than any other funding method, shows real-world demand for a company's product or service. Crowdfunding signals may reduce the need for disclosures, some have argued, because a successful crowdfunding campaign itself could be a positive signal of company quality, thus making the process more affordable to entrepreneurs.[176] On the other hand, the disclosure process clarifies and codifies terms and conditions of an offering. Regulation Crowdfunding (see **Table 1**), for example, lists the financial statements and other information required for SEC filings.

Regarding equity crowdfunding's balance between capital access and investor protection,[177] some caution that investor protection that is too strong "may harm small firms and entrepreneurial initiatives."[178] Yet others fear investor protection is too weak given low levels of compliance among many early companies that raised money through crowdfunding and offered "bad terms" to investors.[179]

There are also a number of perceived regulatory concerns, including the following:

- **High risk and low liquidity.** Crowdfunding's securities-based offerings generally have high risk given the types of prerevenue businesses seeking capital[180] and the need for disclosure[181] and transparency.[182] Other concerns include the lack of liquidity through secondary markets, the professional

How It Works, Current Regulations and Considerations, https://www.lexology.com/library/detail.aspx?g=45b4559e-c157-46d5-bf37-ba4af325b463.

[173] SEC, Office of the Advocate for Small Business Capital Formation, *Annual Report Fiscal Year 2023*.

[174] SEC, Office of the Advocate for Small Business Capital Formation, *Annual Report Fiscal Year 2023*.

[175] Wharton School of Business, "Crowdfunding Research," https://crowdfunding.wharton.upenn.edu/research.

[176] Darian Ibrahim, "Crowdfunding Signals," *Georgia Law Review*, vol. 53, no. 197 (2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068323.

[177] See item one of the "Policy Issues" section of the report for more details on capital formation versus investor protection.

[178] Lars Hornuf and Armin Schwienbacher, "Should Securities Regulation Promote Equity Crowdfunding?," August 15, 2016, https://ssrn.com/abstract=2412124.

[179] Nathaniel Popper, "Doubts Arise as Investors Flock to Crowdfunded Start-Ups," *New York Times*, January 24, 2017, https://www.nytimes.com/2017/01/24/business/dealbook/crowdfunding-fraud-investing-startups.html.

[180] As discussed earlier, the issuers are mostly prerevenue establishments that may have a high possibility of failure.

[181] Regulation Crowdfunding has a scaled disclosure approach, with higher offering amounts having to disclose more information. The disclosure requirements are generally minimized (although necessary to submit when available, audited financial statements are not required) for offerings of $107,000 or less. For more details, see SEC, "Regulation Crowdfunding: A Small Entity Compliance Guide for Issuers," https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm#3.

[182] Referring to transparency by both issuer and platforms.

guidance and corporate governance structure, investor protection, and platform operations and due diligence.[183]

- **Funding portals.** The JOBS Act established an exemption to permit securities-based crowdfunding as well as a new type of entity—funding portals. The act allows these internet-based platforms or intermediaries to facilitate the offer and sale of securities without having to register with the SEC as brokers.[184] As of August 29, 2024, there were 90 funding portals that were registered with the SEC and members of FINRA.[185] Funding portals also drew investor protection concerns regarding the strength of their due diligence processes.[186] The SEC has also charged crowdfunding portals with fraud.[187] This may challenge the conception of funding portals as reliable gatekeepers for these transactions.

Some legislative proposals would lessen crowdfunding restrictions for both issuers and funding portals. Proponents state the intention to further improve small businesses' access to capital and to provide more investment opportunities for investors of all kinds. Opponents assert that the proposals would "deregulate" crowdfunding offerings that are funding riskier startups and, in so doing, would increase investor access while reducing investor protections, such as public disclosures.[188]

Digital Assets and Initial Coin Offerings

Digital assets and their use in capital markets are a growing presence in the financial services industry's development. They raise policy questions, including whether new digital-asset-related practices have outgrown or are sufficiently overseen by the existing regulatory system, how the regulatory frameworks can achieve a level playing field where the same businesses and risks could be subject to the same regulation, and how to protect investors without hindering innovation.

Businesses raise funding from capital markets through securities offerings, including digital asset securities. Initial coin offerings (ICOs) are a new fundraising mechanism in which projects sell their digital tokens in exchange for fiat currency (e.g., dollars) or cryptocurrency (e.g., Bitcoin).[189] A typical ICO transaction involves the issuer selling new digital "coins" or "crypto tokens" to individual or institutional investors. Investors pay for these tokens with either cryptocurrencies or traditional currencies. ICOs are often compared with IPOs of the traditional financial world because both are methods by which companies acquire funding. The main

[183] CFA Institute, *Issue Brief: Investment-Geared Crowdfunding Sourcing Equity and Debt Funding from the Crowd: Developing a Regulatory Framework*, March 2014, https://www.cfainstitute.org/-/media/documents/issue-brief/issue-brief-investment-geared-crowdfunding.pdf; Marc Sharma, Chief Counsel, SEC Office of the Investor Advocate, speech at SEC-NYU Dialogue on Securities Crowdfunding, February 28, 2017, https://www.sec.gov/dera/announcement/dera_event-022817_securities-crowdfunding-in-the-us.html.

[184] SEC, "Regulation Crowdfunding Fact Sheet," https://www.sec.gov/news/pressrelease/2015-249.html.

[185] FINRA, "Funding Portals We Regulate," August 29, 2024, https://www.finra.org/about/funding-portals-we-regulate.

[186] SEC Commissioner Kara Stein, "SEC-NYU Dialogue on Securities Market Regulation: U.S. Securities-Based Crowdfunding—Closing Remarks," February 28, 2017, https://www.sec.gov/news/statement/stein-closing-remarks-sec-nyu-dialogue.html.

[187] SEC, "SEC Charges Crowdfunding Portal, Issuer, and Related Individuals for Fraudulent Offerings," press release, September 20, 2021, https://www.sec.gov/newsroom/press-releases/2021-182.

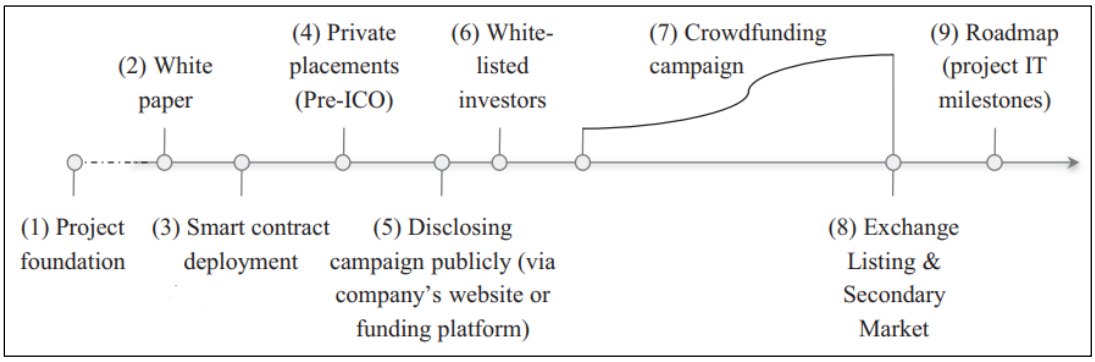
[188] Americans for Financial Reform, letter to Members of Congress, June 7, 2017, http://ourfinancialsecurity.org/wp-content/uploads/2017/06/AFR-Floor-Vote-Letter-CHOICE-Act-07-07-17.pdf.

[189] SEC, "Investor Bulletin: Initial Coin Offerings," July 25, 2017, https://www.sec.gov/oiea/investor-alerts-and-bulletins/ib_coinofferings.

difference is that ICO investors receive digital assets in the form of virtual tokens or the promise of future tokens, unlike IPO investors, who receive equity stakes representing company ownership. These coins or tokens are new digital currencies each company creates and sells to the public. Coin purchasers could redeem the coins for goods or services from crypto enterprises or hold them as investments, hoping the coins increase in value.

Figure 7 illustrates the process of an ICO in practice. In this example, an ICO uses a *white paper* to detail its project and future plans.[190] The project could deploy certain technological features, such as smart contracts, which are self-executing computer programs to carry out contracts.[191] ICO investors who are committed to purchasing tokens could subscribe to *whitelists*, which give them priority during allotment. The ICO listings take place on crypto exchanges that are either centralized or decentralized.[192] To access the proceeds, ICO issuers may need to meet the milestones in the roadmaps that are embedded in the smart contracts.[193]

Figure 7. Example of the Initial Coin Offering Process



Source: Pablo Andres et al., "Challenges of the Market for Initial Coin Offerings," *International Review of Financial Analysis*, vol. 79 (January 2022), November 2021, https://ssrn.com/abstract=3413117.

[190] For more on white papers, see Shadi Samieifar and Dirk Baur, "Read Me If You Can! An Analysis of ICO White Papers," *Finance Research Letters*, vol. 38 (January 22, 2021), https://www.sciencedirect.com/science/article/abs/pii/S1544612319310219.

[191] IBM, "What Are Smart Contracts?," https://www.ibm.com/topics/smart-contracts.

[192] For more on decentralization, see CRS Insight IN11709, *Decentralized Finance (DeFi) and Financial Services Disintermediation: Policy Challenges*, by Eva Su.

[193] For detailed description of the process, see Pablo Andrés et al., "Challenges of the Market for Initial Coin Offerings," *International Review of Financial Analysis*, vol. 79 (January 2022), https://ssrn.com/abstract=3413117.

Although there were early debates about whether ICOs are generally securities offerings,[194] industry practitioners have come to recognize ICOs as *security token offerings*.[195] This change of terminology reflects the industry's acceptance that many ICOs are securities offerings and thus subject to securities laws and regulations.[196] Securities laws require all securities offers and sales to either be registered under their provisions (as public offerings) or qualify for an exemption from registration (as private offerings). ICOs can take many forms. They can be listed on national exchanges as public offerings or be issued pursuant to the private securities offering exemptions. Operational and regulatory conditions—including investor access, maximum offering amounts, and filing requirements—differ depending on the type of offering an ICO selects. ICOs could potentially use any of the existing securities offering venues. They have already reportedly been issued under several of the private exemptions (e.g., Regulation D, Regulation Crowdfunding, and Regulation A+).[197] Although public offering ICOs are possible, as of August 2024, no ICOs have yet issued under this method. The previously discussed policy issues relating to regulatory oversight and investor protection associated with traditional public and private securities offerings also apply to ICOs.

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[194] For more on ICO legal background, see CRS Report R45301, *Securities Regulation and Initial Coin Offerings: A Legal Primer*, by Jay B. Sykes.

[195] Roger Aitken, "After 'Crypto's Winter', ICOs Growing Less but Maturing with Shift to STOs," *Forbes*, March 8, 2019, https://www.forbes.com/sites/rogeraitken/2019/03/08/after-cryptos-winter-icos-growing-less-but-maturing-with-shift-to-stos/#3e666a687bcf.

[196] Terminologies change or evolve relatively rapidly in the digital assets industry. Other illustrative examples include initial exchange offerings, which are ICOs launched exclusively on digital trading platforms. William Hinman, Director, SEC Division of Corporate Finance, "Digital Asset Transactions: When Howey Met Gary (Plastic)," speech delivered at Yahoo Finance All Markets Summit: Crypto, San Francisco, CA, June 14, 2018, https://www.sec.gov/news/speech/speech-hinman-061418.

[197] Paul Vigna, "SEC Clears Blockstack to Hold First Regulated Token Offering," *Wall Street Journal*, July 10, 2019, https://www.wsj.com/articles/sec-clears-blockstack-to-hold-first-regulated-token-offering-11562794848; and Smith Gambrell Russell, "Initial Coin Offerings (ICOs): SEC Regulation and Available Exemptions from Registration," https://www.sgrlaw.com/initial-coin-offerings-icos-sec-regulation-and-available-exemptions-from-registration.

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