THE WALL STREET JOURNAL.

SEC Chairman Wants to Let More Main Street Investors In on Private Deals

Jay Clayton outlines overhaul plans in interview, says changes could happen 'pretty quickly'

By *Dave Michaels* Updated Aug. 30, 2018 4:54 p.m. ET

NASHVILLE, Tenn.—The Securities and Exchange Commission wants to make it easier for individuals to invest in private companies, including some of the world's hottest startups, the agency's chairman said in an interview.

SEC Chairman Jay Clayton, a Trump appointee wrestling with how to boost flagging interest in public markets, said the commission also wants to take steps to give more individual investors a shot at companies that have been out of their reach because they haven't gone public.
Companies including Uber Technologies Inc. and Airbnb Inc. have shunned the public markets in favor of private investors such as venture capitalists. For decades, regulators have typically walled off most private deals from smaller investors, who must meet stringent income and net-worth requirements to participate because of the added risk private investing holds.

Mr. Clayton said the SEC is now weighing a major overhaul of rules intended to protect mom-and-pop investors, with the goal of opening up new options for them.

"The private markets are awash in capital these days," Mr. Clayton said Wednesday in Nashville, where he spoke to groups of entrepreneurs and business-school students. "The question is, who is participating?"

Private firms have grown outside the glare faced by public companies such asTesla Inc., whose founder Elon Musk recently set off a firestorm by tweeting that he planned to take his company private. Mr. Musk has complained that public markets encourage short-term thinking and routinely sparred with short sellers betting against his company's stock. His plan, which has since been abandoned, has triggered an SEC probe into whether his tweet was misleading. Mr. Clayton declined to discuss Tesla.

President Trump also has pressured the SEC to consider the balance between public and private markets, using Twitter two weeks ago to call on the SEC to study letting public firms report earnings every six months, instead of quarterly.

“I’m not wedded to a particular result, but I think we should look at it,” Mr. Clayton said in the interview, conducted Wednesday. He said that the commission is studying the move, and added that even if companies reported earnings less frequently they would still update investors on important trends.

Private securities, mostly off the radar of federal regulators, are usually sold to sophisticated investors such as venture capitalists. There is typically less information available about the firms, increasing risks for investors.

Those markets also have traditionally been a major source of fraud afflicting small investors. Securities firms with a higher number of troubled brokers are more likely to sell private stakes in companies, often targeting seniors, an analysis this year by The Wall Street Journal found. Rules aim to protect individual investors from riskier private deals. Only those who meet certain wealth or income standards—such as household income of $300,000—can participate.

Adjusting the rules could offer Mr. Clayton, a former Wall Street deals lawyer, a way to make good on his goal to help small investors access more high-quality investments for retirement or other needs.

The SEC plans to issue a lengthy paper in the coming months—known as a “concept release”—that will seek public comment on how to revamp the capital-raising process, including by expanding access to private stock sales. After that, “I think you could move pretty quickly on this kind of thing,” Mr. Clayton said.

If more retail investors got access to companies before they launched an initial public offering, the move would create another alternative for companies that already have ample access to private cash, and a possible new avenue for brokers’ commissions.

A NEW LOOK AT FUNDRAISING

The SEC plans to issue a white paper in the coming months that will explore:

- Whether there should be broader access to investing in privately held companies, perhaps by adjusting restrictions on which types of sophisticated investors can buy stakes
- How to streamline rules that govern private fundraising by smaller companies
- How to simplify other fundraising channels that let companies raise limited amounts of money through less-regulated public offerings
- Whether technology firms with business models built around the “gig economy” should have an easier way to compensate their workers by giving them stock in the company

One sign of how much the private market has ballooned: In 2013, tech company SurveyMonkey touted its plans to raise $800 million via debt and equity as “one of the largest capital raises by a privately held U.S. internet company.”

Since then, the market has seen an influx of funds targeting later-stage private companies. SoftBank Group Corp. , for instance, continues to pour money into unicorns—startups worth more than $1 billion—through its $92 billion tech-focused Vision Fund.

In the U.S., more than $1.7 trillion was raised in 2017 through private stock and debt sales.

To be sure, public market activity has grown this year after several slow years. This year, 158 companies have gone public on U.S. exchanges, raising $43.1 billion—up 36% from last year, when 112 companies raised $31.6 billion, according to Dealogic.

A move to allow more participants in private markets could benefit regions of the U.S. where venture capitalists are fewer in number. “There is a massive capital gap in the middle of the country,” said Patrick Henshaw, a vice president at Cincinnati public-private partnership Cintrifuse who attended a Nashville conference where Mr. Clayton spoke.

The chance to devote part of an individual portfolio to private companies would provide an investor more diversification and the chance to benefit when firms go public, said Lonne Jaffe, a managing director at Insight Venture Partners, a venture-capital and private-equity firm.

Mr. Clayton noted the attraction of private offerings at several stops in Nashville, where he spoke to a conference of entrepreneurs at the Wildhorse Saloon, a live-music venue that typically hosts country-music bands and line-dance lessons.

“There are complex offerings where you need a lawyer of the type that I was in the private sector, but you shouldn’t have to hire a high-powered Wall Street lawyer to conduct every private placement,” Mr. Clayton told Launch Tennessee’s 36|86 Entrepreneurship Festival, named for the coordinates of Nashville.

Investors in private deals must be given lengthy questionnaires and disclosures, steps that promising startups typically find too cumbersome given the limited dollars typically offered by a single person. Instead, startups can tap much more money at one time by targeting a few venture capitalists or corporations.

The SEC hopes to streamline that process and create more “accredited” investors, such as by allowing in people who don’t meet income or wealth thresholds but have professional licenses or advanced education, Mr. Clayton said.

Mr. Clayton said his thinking about private markets evolved as he spent more time at the SEC. He said the changes wouldn’t take away investor protections and would result in people getting access to higher-quality deals.

“It came from doing the job and recognizing that for retail investors the opportunity set beyond the public market is pretty low and pretty costly. And pretty risky,” he said. “But people want that.”