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SEC COMMISSIONER CALLS FOR INCREASED DISCLOSURES BY PRIVATELY HELD COMPANIES

Recent financial headlines have been inundated with stories of privately held companies, such as WeWork, Theranos and FTX, raising significant amounts of capital, only for investors to find out that the projections and promises they had received had no basis in fact. With the rise of “unicorns” (companies valued at more than \$1B) and “decacorns” (companies valued at more than \$10B), private capital markets have outpaced the public markets over the past decade.¹ Moreover, with larger checks being written to privately held companies, many have delayed, or completely eschewed, going public, which would increase disclosure requirements.

In a recent **keynote address** at the Securities Regulation Institute, United States Securities and Exchange Commission (SEC) Commissioner Caroline Crenshaw highlighted this and the fact that current regulations regarding disclosure for privately held companies – both when raising funds and generally – are much less burdensome than for their publicly owned counterparts. This lack of oversight

could be fostering an environment of deception for private companies, to the detriment of investors.

When Regulation D under the Securities Act of 1933, as amended (“Regulation D”) – the legal regulation that currently governs disclosure requirements for privately held companies and provides the primary exemption for private companies to raise capital – was enacted four decades ago the landscape of the private market for capital was much different than the current reality. At the time, the private capital market was a relatively minor marketplace predominantly comprised of small businesses raising funds from either insiders or large financial institutions. Regulation D was intended to facilitate the growth of small business through increased access to capital. With the proliferation of high-net-worth individuals, venture capital, private equity and other forms of investors, the private capital market has grown significantly since Regulation D’s inception, but the attendant safeguards have lagged behind.

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¹ See, e.g., **McKinsey & Co., Private Markets Come of Age: McKinsey Global Private Markets Review** 6 (2019). See generally **McKinsey & Co., Private Markets Rally to New Heights: McKinsey Global Private Markets Review** (2022); Joan Farre-Mensa & Michael Ewens, *The Evolution of the Private Equity Market and the Decline in IPOs*, Harv. L. Sch. F. Corp. Governance (Sept. 28, 2017); Morgan Stanley, *Public to Private Equity in the United States: A Long-Term Look* (Aug. 4, 2020) (“[C]ompanies have raised more money in private markets than in public markets in each year since 2009”) (citing Scott Bauguess, Rachita Gullapalli, and Vladimir Ivanov, *Capital Raising in the U.S.: An Analysis of the Market for Unregistered Securities Offerings, 2009-2017*, Division of Economic and Risk Analysis, U.S. Securities & Exchange Commission (August 1, 2018)).

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Commissioner Crenshaw views this as a problem because the SEC, and in turn prospective investors, do not gain access to the same level of information and disclosure regarding privately held companies as is required for their public counterparts. In response, she proposes requiring additional levels of disclosure for privately held companies.

Currently, companies that rely on Regulation D to complete a private offering only have to file a Form D with the SEC within 15 calendar days following the date of first sale. The Form D requires minimal basic information about the issuer (e.g., company name, address, industry type, company revenue range and issuance size), and even permits the company to decline to disclose certain information. Moreover, if a company does not timely file a Form D, there are very limited repercussions. Commissioner Crenshaw proposes to revise the Form D filing to increase the information required to include the size of the company (by assets, investors and employees), its operations, its management structure, its financial condition and revenue, and the size and type of securities offerings, and to require that such filing be signed and certified by an executive officer who would be accountable for the information submitted. Additionally, she recommends that the Form D be filed prior to any solicitation for investment, which would allow potential investors the opportunity to access the newly required information before they make an investment decision.

Finally, in order to ensure compliance, Commissioner Crenshaw recommends that if a company fails to file a Form D, such company would be precluded from relying on Regulation D exemptions in the future.

In addition to the updated Form D filing requirements, Commissioner Crenshaw proposes a two-tiered framework for heightened disclosure obligations for privately held companies based upon the size of the company, including market cap, value or the size of the investor base. Under this proposal, companies that meet the definition of a “large private issuer” would have additional disclosure obligations, including providing prospective and committed investors with financial statements audited in accordance with generally accepted accounting standards (GAAS), along with auditor opinion letters, confirming the adequacy of the company’s internal controls over financial reporting, while the small businesses that Regulation D was intended to benefit would be exempt from such additional obligations.

While Commissioner Crenshaw’s views do not necessarily represent those of the SEC or the other Commissioners, as one of five Commissioners of the SEC, Commissioner Crenshaw’s words certainly carry weight, and indicate that reforming the private capital market may be a focus of the SEC in the near future and something that companies raising capital in the private markets should monitor.