

MEMORANDUM

TO: File on Title IV of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”)

FROM: Christian L. Broadbent
Counsel to Commissioner Elisse B. Walter

DATE: October 27, 2010

RE: Meeting with Members and Representatives of the National Venture Capital Association (“NVCA”)

On October 27, 2010, Christian Broadbent of Commissioner Walter’s office met with the representatives and members of NVCA below, and discussed generally exemptions for certain advisers under Title IV of the Dodd-Frank Act. An agenda and other materials provided for the meeting are attached to this Memorandum.

Kate Mitchell, Managing General Partner, Scale Venture Partners and Chairman,
Board of Directors, National Venture Capital Association
Josh Green, General Partner, Mohr, Davidow Ventures
Mary Kuusisto, Partner, Proskauer; Counsel to NVCA
Jennifer Connell Dowling, Vice President for Federal Policy, NVCA

Agenda: NVCA meeting with SEC

October 27, 2010

Discussion Topic: The SEC's mandate to define venture capital for purposes of the Dodd-Frank Act

- Why is venture capital important to the U.S. economy?
- How does venture capital work?
- Why did Congress exempt venture capital from registration?
- How does venture capital differ from other types of equity investing?

***Venture Capital &
Adviser Registration
October 2010***



Today, We'll Address These Topics

- Why is venture capital important to the U.S. economy?
- How does venture capital work?
- Why did Congress exempt venture capital from registration?
- How does venture capital differ from other types of equity investing?

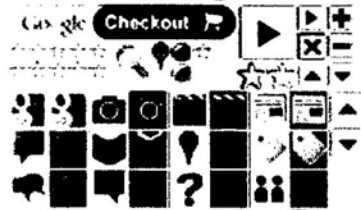


Why is Venture Capital Important to the U.S. Economy?

Venture Capital Builds Companies From Scratch...

Web

◀ Google ▶



Google

ebay

YAHOO!

amazon.com

You Tube
Broadcast Yourself

AOL



PayPal

MasterCard

VISA

BANK

facebook

High tech

Sun

ORACLE

CISCO



intel

Retail/Services



FedEx

STAPLES

that was easy.™

Life science

Genentech
IN BUSINESS FOR LIFE

Allscripts™



health

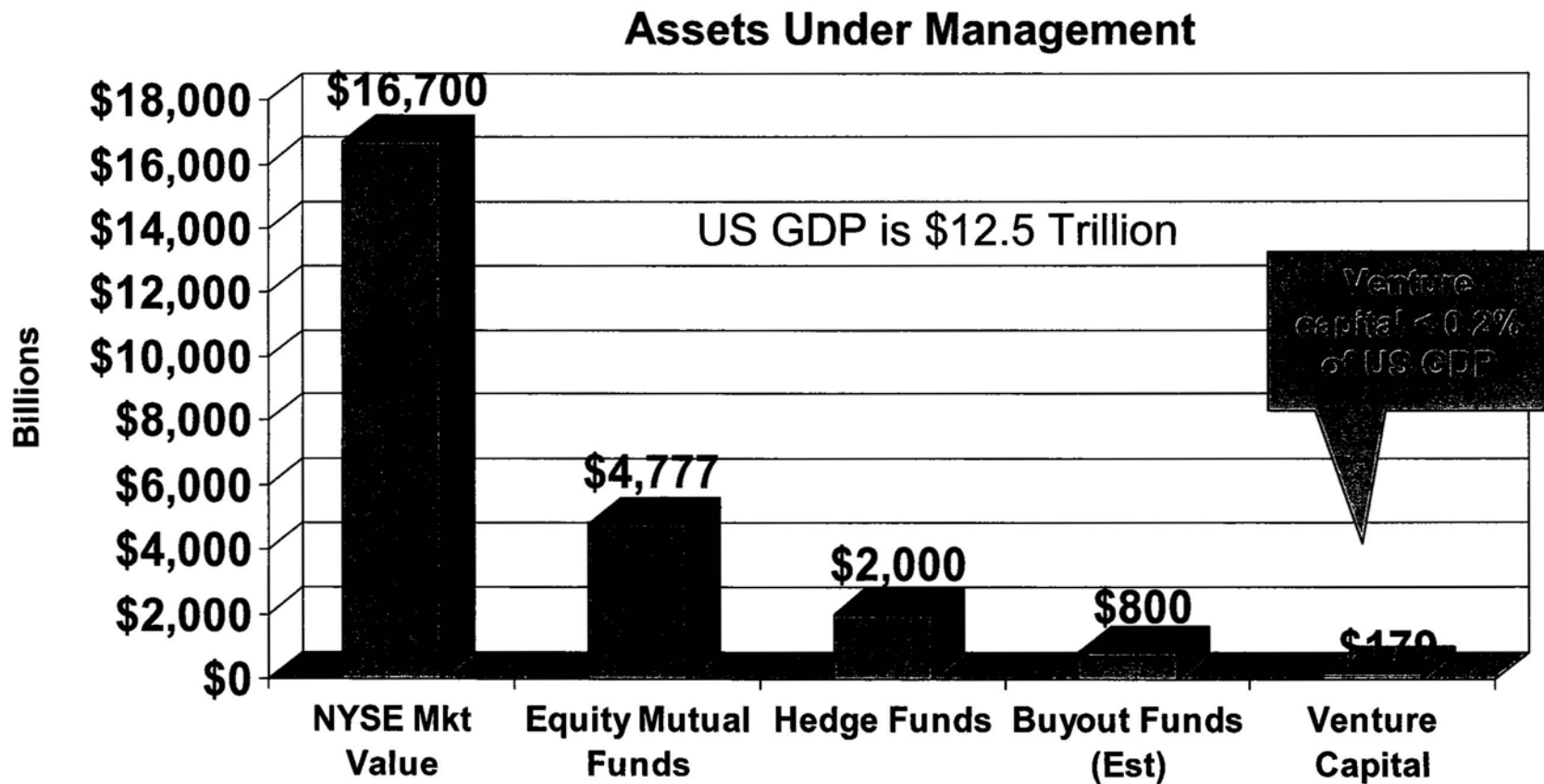
Cleantech

A123
SYSTEMS



evergreen solar

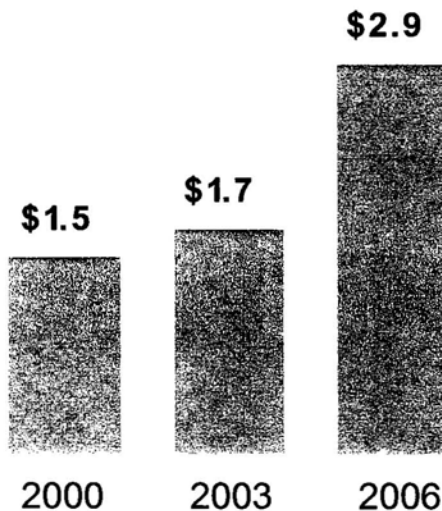
...With Relatively Tiny Amounts of Capital



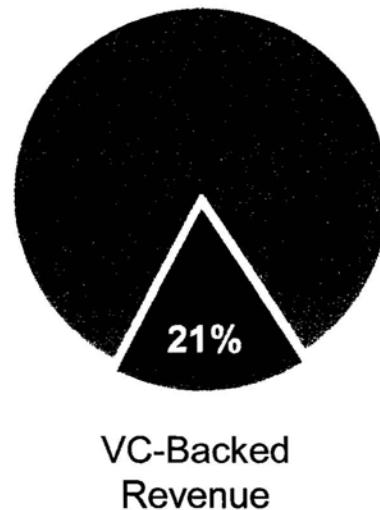
Source: AIMA, Investment Company Institute, NYSE.com, Thomson Reuters, NVCA
Annual Venture Investing <\$20B per annum vs. \$12.5T GDP

Venture-Backed Companies Create Jobs...

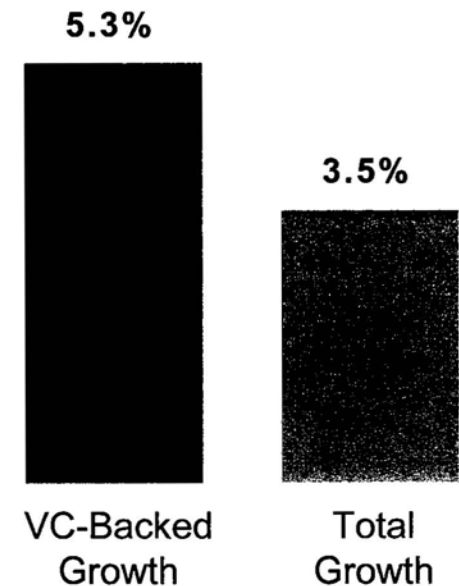
**VC-Backed U.S. Revenues
(Trillions)**



**As a % of Total U.S. GDP
in 2008**



**Outpaces 2006-2008:
Total U.S. Sales Growth**

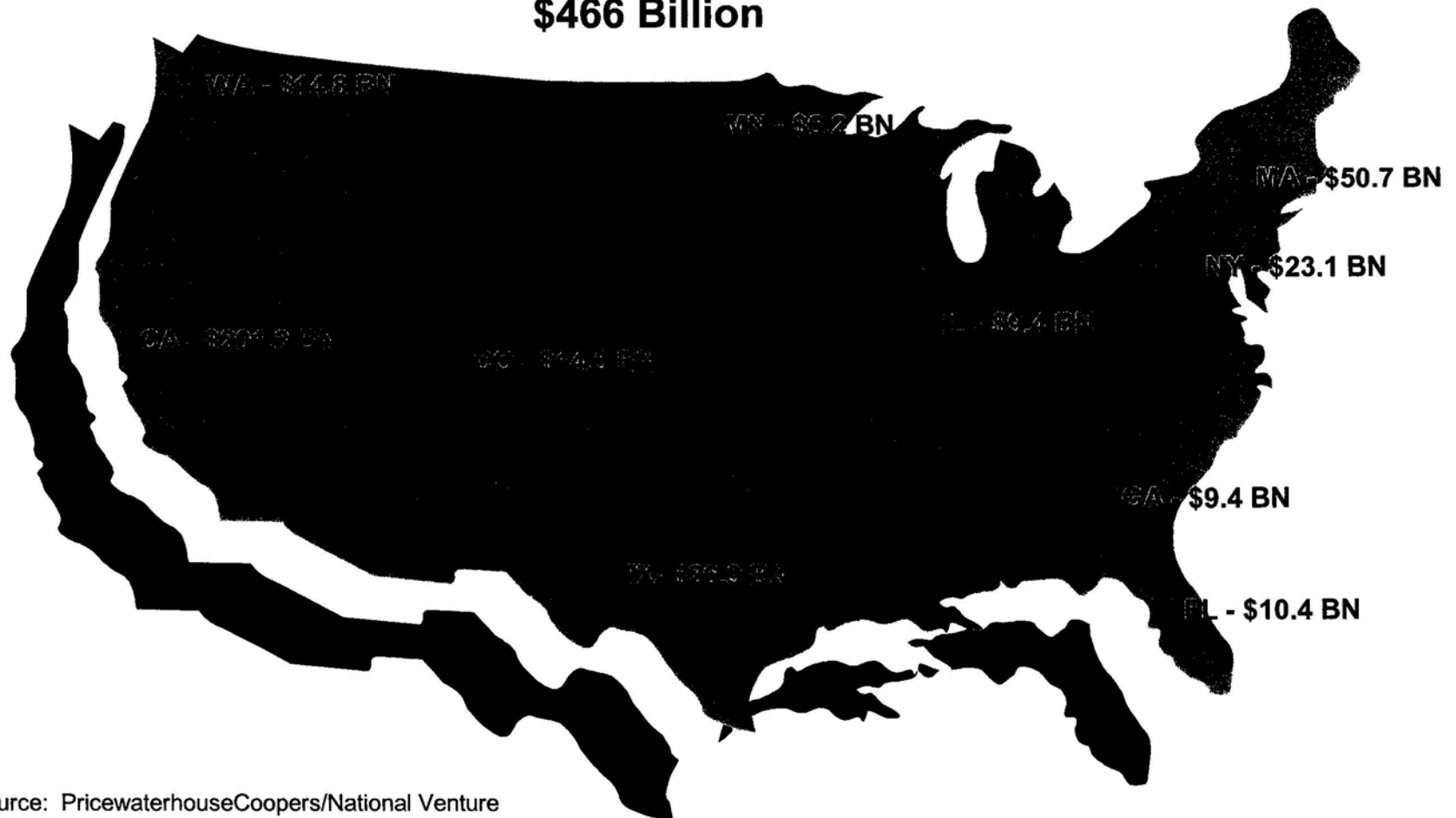


**Venture Backed Companies Have Significant Economic Impact
Even Though Venture is Historically < 0.2% of GDP**

Source: Venture Impact 2007, 2008 & 2009 by Global Insight

...All Over The United States

Venture Capital Investment 1970 - 2008 \$466 Billion



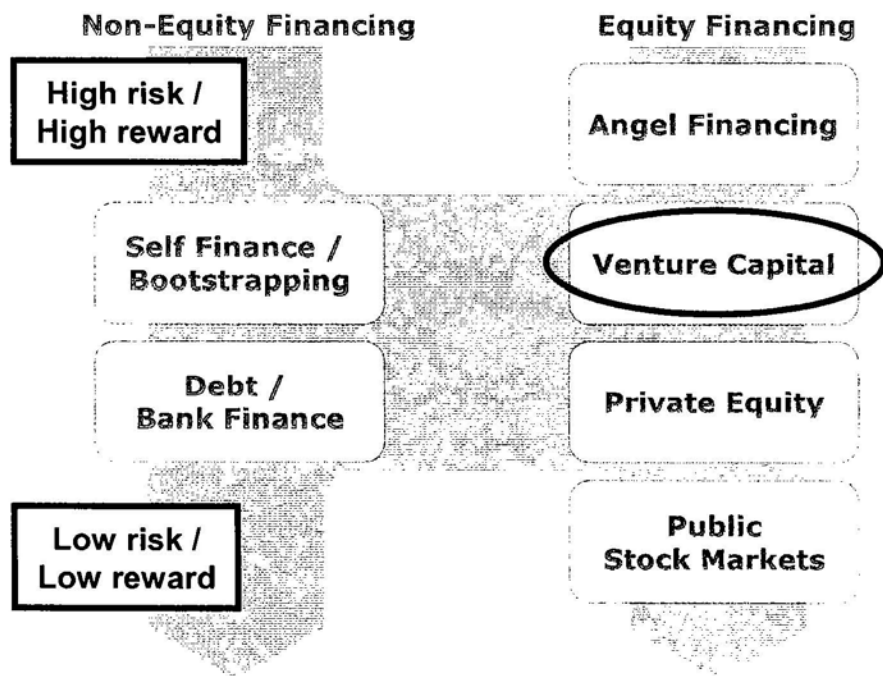
Source: PricewaterhouseCoopers/National Venture
Capital Association MoneyTree™ Report, Data:
Thomson Reuters



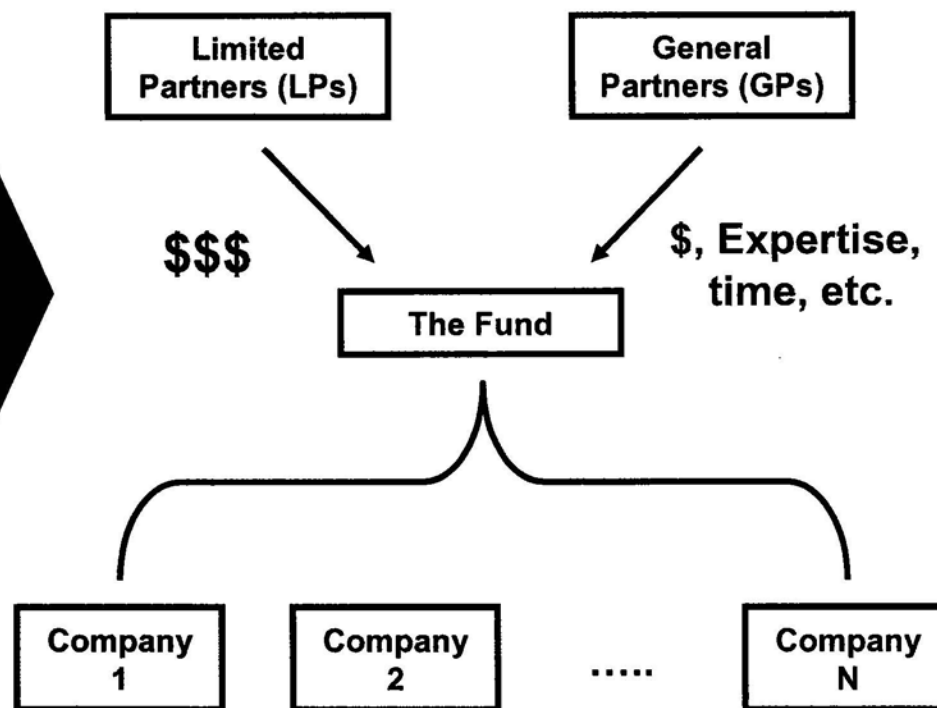
How Does Venture Capital Work?

Venture Capital Combines Money With Expertise

Many ways to fund a business...



...of which venture is one.





Our LPs Are Professionals Who Invest Long-Term

- Typically pension funds, endowments, foundations
- Institutional investors – no retail investors
- Typical fund term is 10 years with possible year-long extensions
- LP investments cannot be redeemed except for extraordinary circumstances
- GPs invest ~1-5% of a fund alongside their LPs, so their incentives are aligned



We Are Company Managers, Not Money Managers

- We are awarded Board seats
- We manage our companies actively
- Many of us are former entrepreneurs who have built successful businesses
- We provide strategic counsel to CEOs & provide access to our networks
- We build sizable companies over 5-10+ years and often take them public
- We are financially incentivized to help our companies succeed and to provide capital gains for our investors alongside the companies' founders



Venture Capital Builds New Companies By...

- Using the same, simple financial instruments over the last 40 years
- Investing primarily in originally issued stock in start-up companies so cash is used to build the company
- Aligning ourselves with our CEO's and our LP's. We only distribute proceeds when companies are sold or go public
 - May hold public stocks post IPO to deliver full value to LP's
 - Distribute capital first to repay LP's capital including fund operating expenses
 - Only distribute "carried interest" gains to GP's once LP's interests satisfied

[illegible]



Venture Firms Vary Greatly in Size, Stage, & Strategy

- Firms may manage as little as \$50M; a few have more than \$1B in a single fund
- Firms may have as few as 2 FTEs
- Firms may invest in early or growth stage companies, or both
- Firms may invest in different regions of the country exclusively, or may have broader focus
- All venture firms, however, share these common features:
 - Invest equity in privately-held companies
 - Distribute capital gains only when companies grow significantly
 - Do not use leverage to drive returns
 - Do not individually take a majority ownership stake in companies



Why Did Congress Exempt Venture Capital From Registration?

Venture Firms Were Granted Exemption From Registration By Congress Because...

- We present no systemic risk to the financial system:
 - We invest tiny amounts of capital
 - In traditional, long term financial instruments
 - That do not result in counterparty risk
- Our investors are long term, sophisticated institutional investors. Therefore, there is minimal concern about investor protection.
- We only succeed when our companies and investors succeed.
- We are distinct from buyout and hedge funds.
- The direct and indirect economic costs of registration would be highly burdensome and expensive.
- We build companies with competitive technologies that create lasting jobs and bolster the U.S. economy.



Why Venture Capital Does Not Pose Systemic Risk

- VC is not interconnected with broader financial system
 - ☐ No redemption; no liquidity or carried interest until company is sold or goes public
 - ☐ Investment into originally issued stock, not public markets
- VC does not use leverage; no cascading effect if fund fails or portfolio companies fail (expected to happen)
 - ☐ If LP invests \$1m, can only lose \$1m
- VC does not have counter-party obligations
 - ☐ Cash for equity transactions; no complex financial instruments



Features of Venture Fund that Provide Investor Protection

- LPs conduct extensive due diligence on VC fund and venture principals before committing capital
 - 6-18 month process includes site visits, background checks, GP interviews, cash flow & returns analysis, off list reference calls with LP's & CEO's
- No Retail Investors – outside parties are accredited investors or qualified purchasers
- Ultimate valuation set by the market
 - Value of portfolio company established with liquidity event – priced by IPO or by acquirer not by venture capitalist



How Does Venture Capital Differ From Other Forms of Equity Investing?

Venture Capital and Buyout Firms Are Both Private Equity, But Have Little Else In Common

Venture capital

- Starts companies from seed stage
- Drives returns by growth, not debt
- Takes minority ownership stakes
- Has modestly sized funds with single purpose
- Invests in next generation technologies
- Creates jobs

Buyout

- Invests in established companies with predictable cash flows
- Drives returns by financial leverage and cost cutting
- Takes majority ownership stake
- Has big funds, often with multiple investment vehicles (e.g. sub debt, hedge, etc.)
- Invests in old-line businesses
- Often eliminates jobs

Venture Capital and Hedge Funds Are Mutually Exclusive, Unrelated Investment Vehicles

Venture capital

- Mostly sophisticated institutional investors (90+%)
- Most interests in fund sold directly to LPs
- Hold positions for 5-10 years on avg; no short-term liquidity
- No investor control over liquidity
- Invest in stock of small number of private companies
- Very limited participation in public markets (e.g. PIPEs) with no systemic influence
- Do not advise investors

Hedge funds

- Mostly “qualified” individual investors
- Interests often sold to investors by a broker
- Designed to meet short-term liquidity needs
- Investor has control over liquidity
- Invest in variety of vehicles and markets; short & long
- Actively participate in and can affect public markets
- Can advise investors
- Can receive carried interest on unrealized profits



A Few Things Venture Capital Does Not Do...

- Incur long-term debt or use leverage to drive returns
- Provide short-term liquidity at the option of its investors
- Pull meaningful dividends out of companies
- Charge transaction fees to its portfolio companies
- Take short positions
- Buy meaningful amount of public securities or derivatives
- Generate any counterparty risk
- Market itself through brokers to retail investors or act as a publicly-held entity



So What Does Venture Capital Do?

**Venture Capital creates jobs while
building a competitive America.**



For more information please contact

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