MEMORANDUM

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

FROM: Jennifer B. McHugh

DATE: November 3, 2010

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

On October 27, 2010, Jennifer B. McHugh, Senior Advisor to the Chairman, met with the representatives of the NVCA identified below to discuss the nature of venture capital funds and the treatment of advisers to venture capital funds under Title IV of the Dodd-Frank Act. The NVCA provided the attached materials for the meeting.

- 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 B. Kuusisto, Partner, Proskauer; Counsel to NVCA
- Jennifer Connell Dowling, Vice President for Federal Policy and Political Advocacy, 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

NVCA

National Venture Capital Association

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 Checkout

Google

ebY

YAHOO!

amazon.com

YouTube

Broadcast Yourself

AOL

PayPal

MasterCard VISA BANK

facebook

High tech

Sun

ORACLE

cisco

intel

Retail/Services

STARBUCKS COFFEE

FedEx

STAPLES

that was easy.

Life science

Genentech

IN BUSINESS FOR LIFE

Allscripts

health

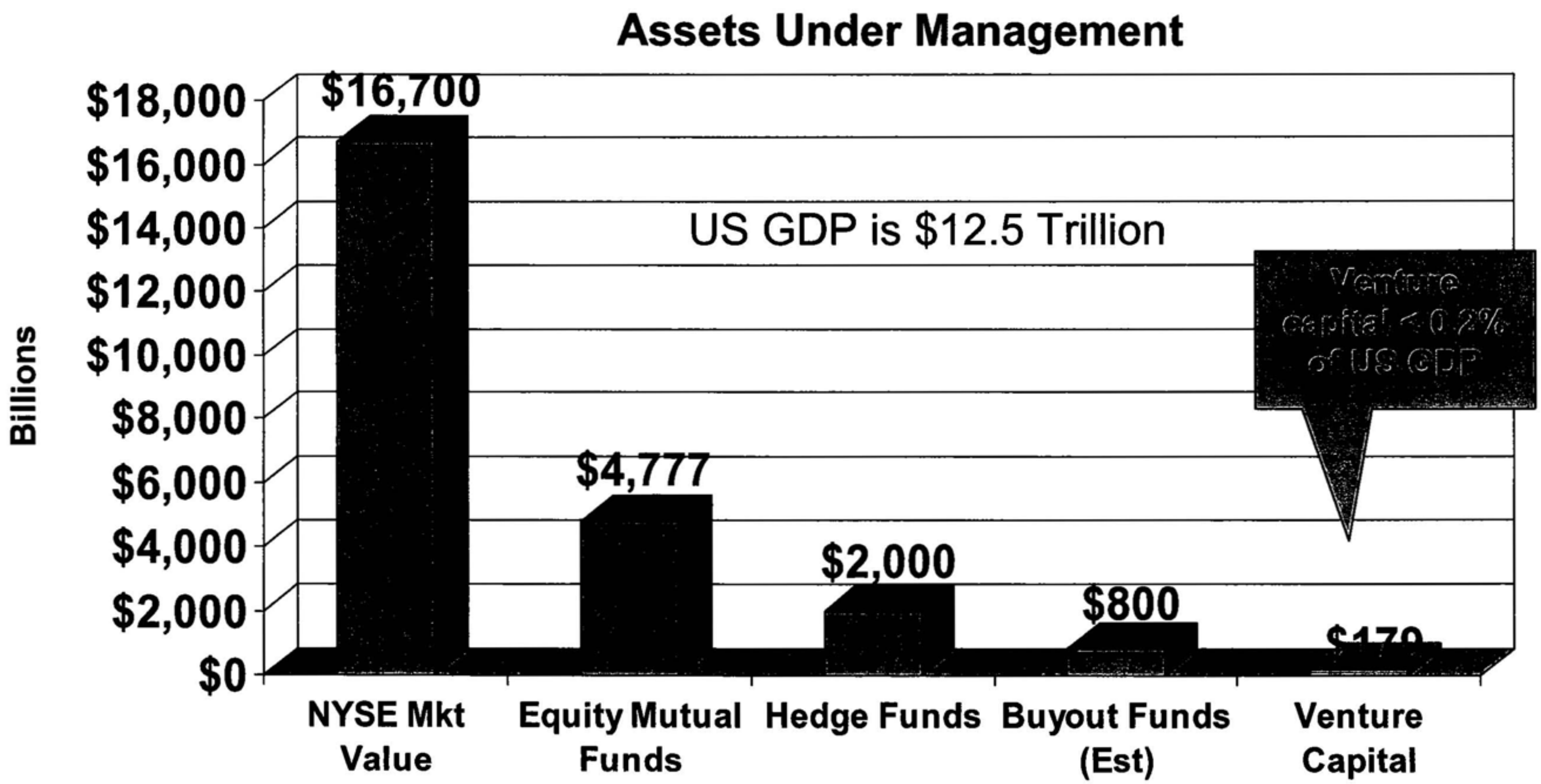
Cleantech

A123 SYSTEMS

TESLA

evergreensolar

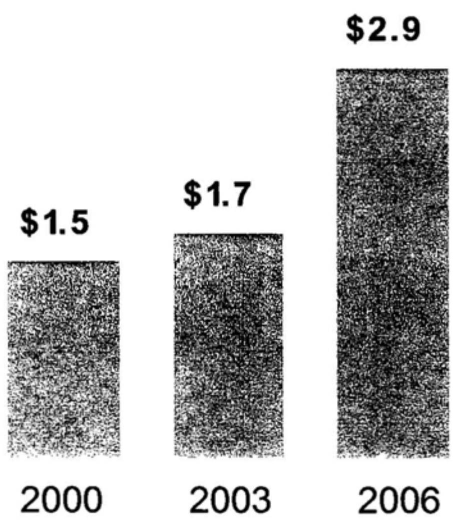
…With Relatively Tiny Amounts of Capital

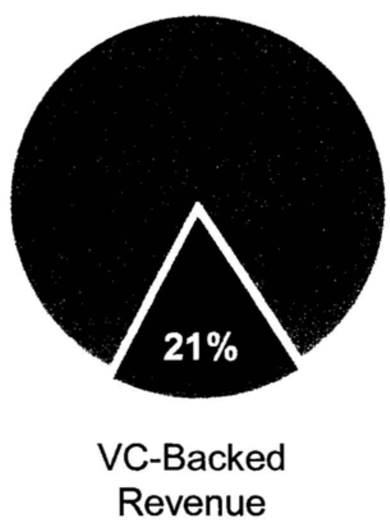


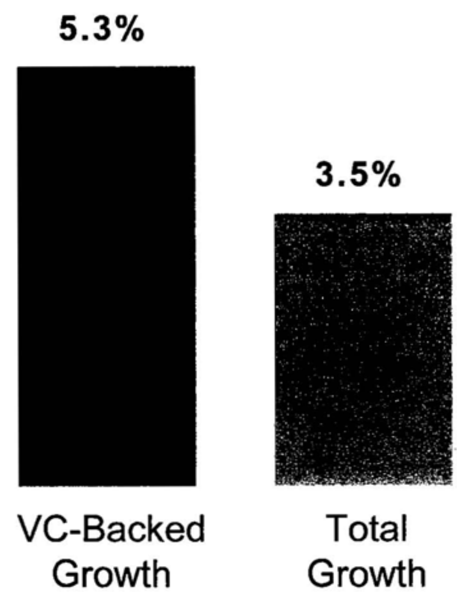
Source: AIMA, Investment Company Institute, NYSE.com, Thomson Reuters, NVCA
Annual Venture Investing <$20B per annum vs. $12.5T GDP

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





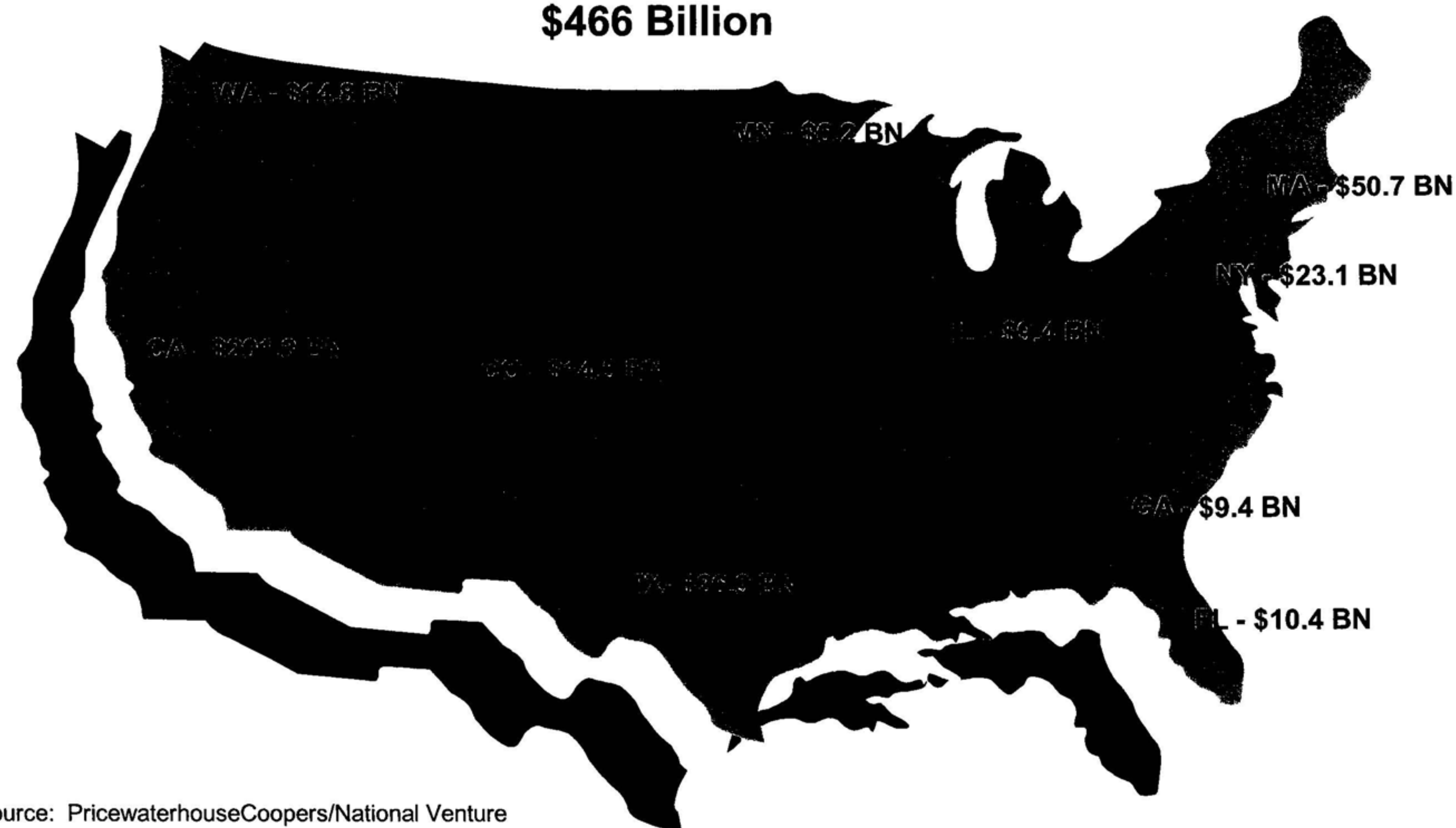


Venture Backed Companies Have Significant Economic Impact
Even Though Venture is Historically < 0.2% of GDP

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

…All Over The United States

Venture Capital Investment
1970 - 2008
$466 Billion

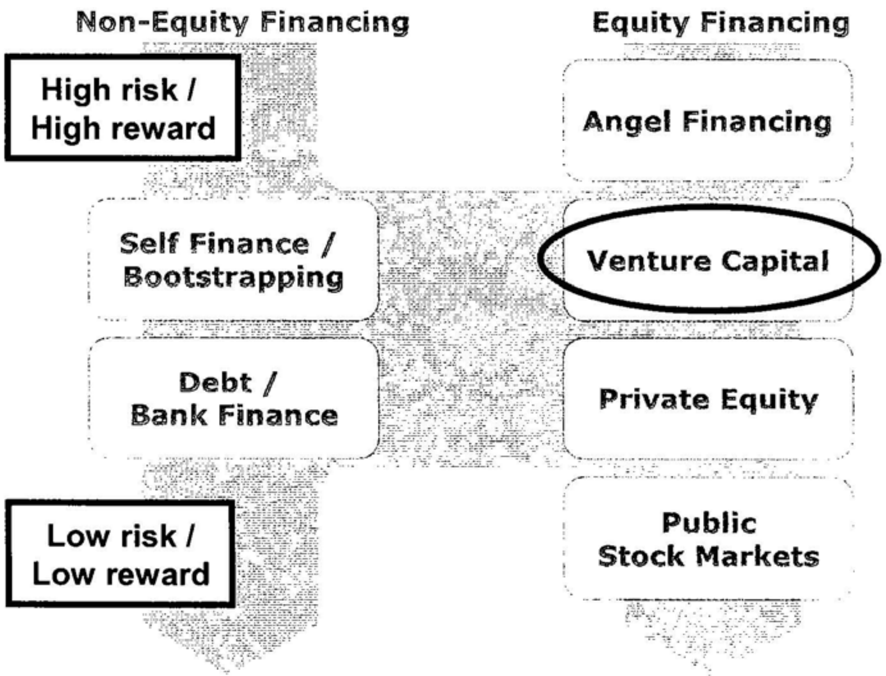


Source: PricewaterhouseCoopers/National Venture Capital Association MoneyTree™ Report, Data: Thomson Reuters

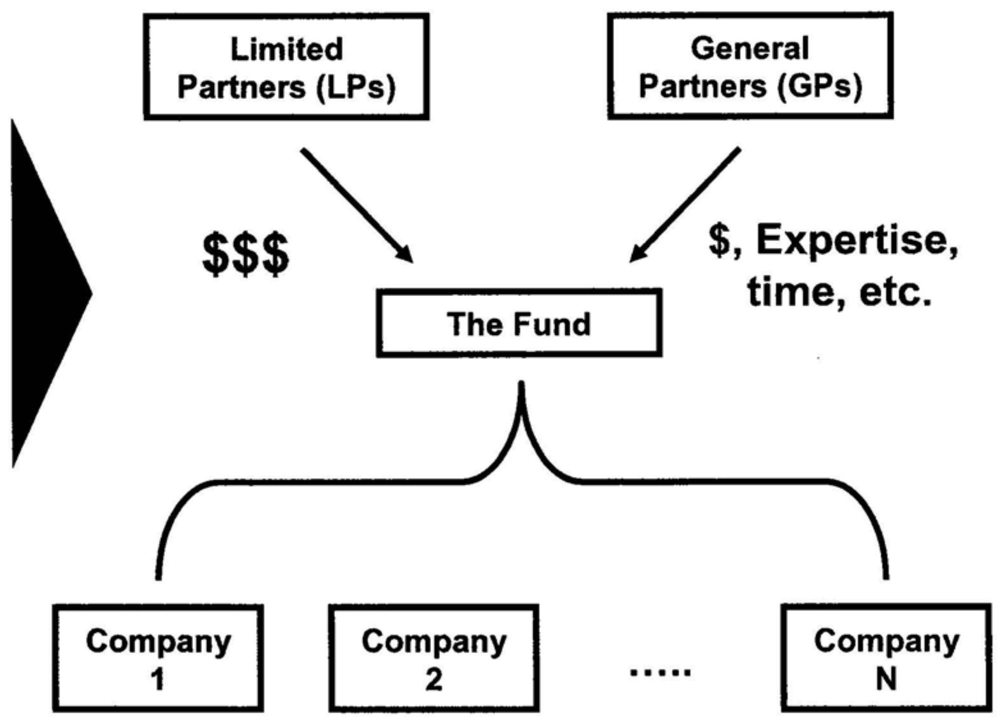
How Does Venture Capital Work?

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, <u>Not</u> Money Managers

- We are awarded Board seats
- We manage our companies <u>actively</u>
- 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 <u>used to build the company</u>
- 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

Venture Capital Is High Risk & Reward... LPs Know That A Few Exits Account For Most Returns

[redacted]			
Base Case Outcomes	40%	3.0x	1.2x
[redacted]			
Gross Return – Net of Losses			3.4x

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
- <u>All venture firms</u>, however, share these common features:
  - Invest equity in privately-held companies
  - Distribute capital gains only when companies grow significantly
  - Do <u>not</u> use leverage to drive returns
  - Do <u>not</u> 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 <u>no</u> 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 <u>Not</u> 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 <u>*Does*</u> Venture Capital Do?

Venture Capital creates jobs while building a competitive America.

For more information please contact

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