March 21, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20548-1090

Re: Proposed Amendments to Form PF
File No. S7-01-22

The National Venture Capital Association ("NVCA") is pleased to comment on the proposed amendments to Form PF and related rules under the Investment Advisers Act of 1940 ("Advisers Act") ("Proposed Amendments").[1]

The NVCA represents the U.S. venture capital (VC) and startup community. In 2021, VCs invested $332 billion in U.S. companies.[2] Our members provide the capital empowering the next generation of American companies that will fuel the economy of tomorrow. As the voice of the U.S. venture capital and startup community, NVCA advocates for public policy that supports the American entrepreneurial ecosystem.

Interests of Venture Capital Advisers

Form PF must be filed only by advisers registered with the Commission. Most advisers to venture capital funds are not registered in reliance on the exemption in Section 203(*l*) of the Act for advisers to venture capital funds. Congress provided for this exemption in 2010 specifically because it did not view the management of venture capital funds as involving systemic risk.[3] However, NVCA estimates that approximately 20-25% of its members are

[1] *Amendments to Form PF to Require Current Reporting And Amend Reporting Requirements for Large Private Equity Advisers and Large Liquidity Funds*, Investment Advisers Act Rel. No. 5950 (Jan. 26, 2022).

[2] NVCA 2022 Yearbook, data provided by PitchBook; a*vailable at* https://nvca.org/pressreleases/startups-in-400-congressional-districts-received-vc-funding-last-year-globally-u-s-accounted-for-less-than-50-of-vc-dollars-and-40-of-deal-count/.

[3] S. CONF. REP. NO. 111-176, at 2-3 (2010) at 74 ("The Committee believes that venture capital funds…do not present the same risks as the large private funds whose advisers are required to register with the SEC under this title. Their activities are not interconnected with the global financial system, and they generally rely on equity

registered and that number continues to grow. Venture firms are registering because Rule 203(*l*)-1 under the Advisers Act, which defines the term "venture capital fund," has not kept up with market developments since it was adopted in 2011.[4] Consequently, a growing number are directly affected by the rule proposal, often because they invest in securities purchased in the secondary market as part of a growth equity venture capital strategy.

Background on Venture Capital

Venture capital (VC) has enabled the United States to support its entrepreneurial talent by turning ideas and basic research into products and services that have transformed the world. Examples of venture-backed companies include Moderna, Genentech, Zoom, SpaceX, Ebay, and Amazon. Venture capitalists create partnerships with institutional investors to combine the capital held by pension funds, endowments, foundations and others with their talent and expertise to make high-risk, long-term equity investments into innovative young companies.

Venture funds are generally partnerships that last ten to fifteen years, building investments far longer than any other asset class. VCs do not simply pick winners; they actively work to develop startups into successful companies. VCs work alongside the entrepreneurs, often taking board seats, providing strategic advice and counsel, opening their contact networks, and generally doing whatever they can to help their portfolio companies succeed.

A recent survey of companies backed by venture capital showed that four out of five respondents spent at least 70 percent of their total expenses on two activities: wages and compensation and research and development. This statistic highlights the extent to which venture capital finances job creation and innovation despite the risks inherent in funding companies expected to operate in revenue loss positions for years.[5]

Economic Impact of Venture Capital Investment

Despite the long odds, venture capital is a major economic engine of job growth, spurs innovation, and creates new business models that change the world. New research found that employment at VC-backed companies between 1990 and 2020 grew 960 percent, whereas total private sector employment during that same period grew only 40 percent. VC-backed jobs are distributed broadly across the entire U.S. with 62.5 percent of VC-backed jobs outside the states

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funding, so that losses that may occur do not ripple throughout world markets but are borne by fund investors alone.").

[4] For example, secondary investments, investments in another venture capital fund, and coin offerings in which venture capital funds invest are not treated as a "qualified investment" for purposes of rule 203(*l*)-1, and thus are only permitted to the extent there is room in the "20% basket" available for investments that are not qualified. Rule 203(*l*)-1(a)(2). NVCA submitted a letter to the Division of Investment Management in November 2018 suggesting several changes in the rule to modernize its provisions.

[5] *Venture Capital Investment at Work*, American Startups and Job Growth Coalition (April 2021), *available at* https://nvca.org/venture-capital-investment-at-work/.

of California, Massachusetts, and New York.[6] This illustrates a fundamental trend in the modern economy: the path to greater economic opportunity for American workers runs through technological progress and long-term investment.

Companies backed by venture capital are responsible for over half of companies that undergo initial public offerings (IPOs) each year (including 40 percent of climate technology companies),[7] around half of new FDA-approved cures, and are causally responsible for the rise of one-fifth of the current largest 300 U.S. public companies.[8]

Registered Venture Capital Fund Advisers and Form PF

An adviser registered under the Advisers Act must file Form PF if it has more than $150 million of "private fund assets under management."[9] Venture capital funds are private funds and thus a registered adviser must aggregate its venture capital funds' assets along with the assets of other private funds it advises to determine whether it must file Form PF.[10] An adviser that advises only a venture capital fund (as defined in Rule 203(*l*)-1) is required only to file Section 1 of Form PF because the form treats a venture capital fund as neither a hedge fund (Section 2), a liquidity fund (Section 3), nor a private equity fund (Section 4). Section 1 of Form PF would be unaffected by the Proposed Amendments.

An adviser to a venture capital fund may be registered under the Advisers Act for many reasons, including because it advises private equity funds. Acquisition of secondary shares, often from company founders or angel investors, is the most common reason why venture capital funds are forced to become RIAs. If one or more of its venture capital funds fails to meet the definition of "venture capital fund" in Rule 203(*l*)-1, Form PF treats the fund as a "private equity fund," and it must respond to Section 4 of Form PF with respect to the venture capital fund if the adviser has more than $2 billion of private equity fund assets under management ($1.5 billion under the Proposed Amendments).[11]

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[6] *An Analysis of Employment Dynamics at Venture-Backed Companies Between 1990 and 2020*, NVCA, Venture Forward, and the University of North Carolina Kenan Institute of Private Enterprise (February 2022), *available at* https://nvca.org/wp-content/uploads/2022/02/Employment-Dynamics-at-Venture-Backed-Companies_FINAL.pdf

[7] *Initial Public Offerings: Updated Statistics*; Professor Jay Ritter, University of Florida; *available at* https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf.

[8] *The Economic Impact of Venture Capital: Evidence from Public Companies;* Illya A. Strebulaev, Stanford University Graduate School of Business and Will Gornall, University of British Columbia Sauder School of Business (July 2021); *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841.

[9] Rule 204(b)-1(a).

[10] Instruction 1.C. The term "private fund assets under management" is defined to include the assets of all private funds. *See* Form PF Glossary.

[11] Rule 204(b)-1(a).

Our comments are thus limited to certain of the Proposed Amendments that would or could apply to venture capital advisers if one or more of their venture capital funds is treated as a private equity fund.

Proposed Current Reporting Requirements

The Commission proposes to require advisers to private equity funds to file a "current report" on Form PF within one business day of three events identified in a new Section 6. These events include (i) an adviser-led secondary transaction, (ii) general partner or limited partner clawback, and (iii) the removal of a general partner, the termination of an investment period or termination of a fund.

1. One Day Filing Requirement

In light of the nature of the information that would be collected in a Section 6 report, NVCA urges the Commission to require quarterly reporting.

The Proposed Amendments would require a current report pursuant to Section 6 ("Section 6 Report") within one business day of the occurrence of a reporting event. NVCA respectfully submits that the requirement to file within one business day of a "current event" is unnecessary inasmuch as the information requested in Section 6 supports the Commission's oversight and regulatory program rather than FSOC's monitoring of systemic risk.

Some of the items require reports on events that are specifically planned for in fund limited partnership agreements, and often involve significant negotiation with participants. Some may be viewed as indicating a potential conflict of interest (partner buy-back), a business conflict (removal of a general partner), or a change of business plans (termination of a fund or investment period) but these are matters internal to the partnership and do not affect the broader markets.[12]

We understand that the Commission may have a regulatory interest in being able to better monitor these events, but it is not reasonable or necessary to require near "real time reporting." The Commission does not have the resources to engage in real-time compliance oversight, and a short delay in learning about them will not diminish the Commission's ability to investigate and, if appropriate, bring enforcement actions. In other words, the Commission does not need this information a day after a reporting event occurs.

[12] The explanations in the proposing release as to why these events "may" have systemic implications are implausible and unsupported. Moreover, they are unnecessary (and puzzling) because the Commission's authority under the Advisers Act to require advisers to collect information from private funds on Form PF is not limited to collecting information for monitoring systemic risk. *See* Section 204(b)(1)(A) of the Advisers Act (SEC may require advisers registered with the Commission to maintain records the Commission determines to be necessary and appropriate in the public interest and for the protection of investors, or for the assessment of systemic risk).

NVCA suggests that, instead of requiring current reports, the rule require an adviser to private equity funds to submit a Section 6 report quarterly, and only if there is an event to report.[13]

2. General Partner Clawback

NVCA recommends that the Commission (i) limit reports on general partner clawbacks to those that are in excess of 10% of the fund's aggregate capital commitments, and (ii) clarify that the practice of "recycling" distributions does not trigger the reporting requirements.

The Proposed Amendments would require advisers to private equity funds to submit a Section 6 Report upon implementation of any general partner clawback or a limited partner clawback (or clawbacks) in excess of 10% of a fund's aggregate capital commitments. The proposing release suggests that the 10% threshold is designed to screen out insignificant clawbacks. These can occur at the end of the fund's life and provide the fund with resources to satisfy liabilities that exceed any reserve that had been established.

NVCA believes that the Commission should similarly provide for a threshold for general partner clawbacks, which typically occur as a result of the operation of the fund's carry provisions. These provisions are typically idiosyncratic to the particular carry arrangement or the fund portfolio and have no consequences beyond the fund itself. Even if these clawbacks are of some interest to the Commission, surely the smaller the clawback the less of interest it would be, and the more likely it would be to serve as a meaningless burden on venture capital funds without providing useful and operative information for the Commission. We urge that the Commission provide for a 10% threshold similar to the one proposed for limited partner clawbacks.

Finally, we recommend that the Commission clarify that the practice of "recycling" distributions, *i.e.*, reinvesting them in new portfolio assets, would not be treated as a clawback for purpose of Section 6. Recycling arrangements are typically provided for in fund limited partnership agreements and provide for reinvestment of distributions after they are made to limited partners. They are the functional equivalent of dividend reinvestment options for mutual fund investors and are becoming more common among venture capital funds. Their operation should be of no regulatory or systemic interest to the Commission.

3. Termination of Investment Period

NVCA requests that the Commission clarify that a Section 6 Report is not required when a fund terminates by operation of the terms of the limited partnership agreement or other fund governing documents.

[13] This would align with the quarterly reports that Large Hedge Fund Advisers are required to report on Form PF. We recommend that quarterly Section 6 reports be required to be filed within 60 calendar days after the end of each quarter. *See* Instruction 9 to Form PF.

The Proposed Amendments would require a Section 6 Report when investors elect to terminate a fund. We request that the Commission confirm that the termination of the fund pursuant to the terms of its organizational documents (*e.g.*, limited partnership agreement) would be an ordinary course business event not required to be reported on a Section 6 report.

Reduction in Threshold for Large Private Equity Advisers

The Commission is proposing to reduce the threshold for private equity fund advisers to report on Section 4 of Form PF from $2 billion to $1.5 billion of private equity fund assets under management. NVCA recommends that the Commission exclude assets of venture capital funds, used for venture investing activity, distinct and different from private equity activity, from the calculation of the threshold for reporting as a Large Private Equity Adviser and not require them to be reported if the adviser meets the threshold.

The Proposed Amendments would amend Section 4 to revise the threshold at which advisers to private equity funds must submit more detailed information about the private equity funds they advise from $2 billion to $1.5 billion of private equity funds.

NVCA understands the Commission's and FSOC's assertion that they need additional information about systemically important private equity funds. Both Congress and the Commission have recognized, however, that venture capital funds do not involve systemic risks.[14] Yet because of a quirk in the definition of "venture capital fund" in Rule 203(*l*)-1 in some cases large private equity advisers are required to report information about venture capital funds they advise, corrupting the data collected about private equity funds and diminishing its usefulness.

The quirk arises because Form PF treats a venture capital fund as a private equity fund if it fails to meet the definition of "venture capital fund" in Rule 203(*l*)-1 even if the fund has the identical risk profile of a venture capital fund that is not treated as a private equity fund. This arises in two circumstances that concern our members.

First, the fund may have acquired the securities of an issuer in a secondary market transaction, *i.e.*, from a company founder or an investor in an earlier round of financing of the portfolio company that it could have bought from the issuer, oftentimes in conjunction with shares acquired directly from the issuer. Securities not purchased from the issuer are not "qualified securities" under Rule 203(*l*)-1 and thus will cause the fund to fail to meet the definition of "venture capital fund" if the value of such securities and all other securities that are not qualified securities exceed 20% of the value of the assets of the venture capital fund.[15]

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[14] S. CONF. REP. NO. 111-176, at 2-3 (2010) *supra, note* 3 at 74, *See Exemption for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million of Assets Under Management, And Foreign Private Advisers,* Advisers Act Rel. No. 3111 (Nov. 19, 2010) (proposing rules implementing private fund exemptions) at 11-12.

[15] Rule 203(*l*)-1(3)(i).

Second, the fund may acquire an interest in another venture capital fund. Rule 203(*l*)-1 specifically excludes from the definition of "venture capital fund" a fund that invests in another private fund, such as a venture capital fund.[16] This practice is increasingly occurring in the venture capital industry to seed diverse fund managers, both in terms of racial background and geography.[17]

NVCA submits that under these two circumstances the fund will pose no different systemic risks than a venture capital fund that does not have to be reported in Form PF because it meets the definition in Rule 203(*l*)-1. In the first circumstance, the reporting obligation turns merely on the person from whom the fund has purchased a portfolio security. These securities may be bought from one of the founders or investors in an earlier round of private financing and could be held without triggering a reporting requirement if purchased from the issuer. Thus the fund has, in every respect, the same systemic risk profile as it would be if it had purchased the securities from the issuer.

In the second circumstance, the fund will have purchased securities from another venture capital fund, which itself must hold securities eligible for a venture capital fund. The fund could invest entirely in other venture capital funds, in which case the fund would be a "venture capital fund of venture capital funds." Regardless of how much of its investments are made in other venture capital funds, it would be inherently a venture capital fund with an investment strategy that lacks systemic risk.

Treating such a fund as if it is a private equity fund (i) pollutes the private equity fund data the SEC and FSOC collects with venture capital fund data and (ii) imposes unnecessary burdens on venture capital funds. These burdens would be increased if the Proposed Amendments are adopted because certain advisers to venture capital funds would be required to report expanded information to the Commission on Form PF as a result of their funds being mischaracterized as private equity funds.

NVCA therefore urges the Commission to correct this result by amending the definition of "venture capital fund" in Form PF to include a fund that would be a "venture capital fund" under rule 203(*l*)-1 but for the fund's investment in securities that are not "qualifying investments" solely (i) because they were not purchased directly from the issuer or (ii) are issued by private funds that are venture capital funds. Such an amendment would have two effects.

- It would permit a registered private fund adviser to exclude the value of assets attributable to venture capital funds (as re-defined for purpose of Form PF) from the calculation of whether the private fund adviser is a large private equity adviser required to file Section 4 Reports with the Commission.

- It would not require an adviser that is a large private equity adviser (because it advises real private equity funds) to submit a Section 4 Report for venture capital

[16] Rule 203(*l*)-1(3)(iii).

[17] U.S. Securities and Exchange Commission Small Business Capital Formation Advisory Committee to Chair Gary Gensler, May 21, 2021, https://www.sec.gov/spotlight/sbcfac/encouraging-small-regional-funds-043021.pdf.

funds (as re-defined for purposes of Form PF) because they would no longer be deemed to be private equity funds.

We appreciate the Commission's consideration of our comments on these proposals and would be pleased to provide any additional information that may be helpful.

Sincerely,

Bobby Franklin
President & CEO