



August 7, 2018

BY EMAIL

Secretary
U. S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549
rule-comments@sec.gov.

Re: Release No. IA-4889; File No. S7-09-18: Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation

Dear Mr. Secretary:

As the voice of the venture industry, the National Venture Capital Association (NVCA)¹ appreciates the opportunity to comment on the Commission's "Interpretation Release" and the proposed "enhancements" in investment adviser regulation.

Venture capitalists serve as general partners in capital funds. In 2008, the Dodd-Frank amendments to the Advisers Act mandated that private equity and hedge funds become registered investment advisors (RIAs) but created the "Venture Capital Adviser Exemption" from registration for those who solely advise venture capital funds. Since the SEC created the Exempt Reporting Advisor (ERA) regime in 2011, many venture capital firms have constrained their investment activities so that they qualify for the venture capital exception in order to avoid the unnecessary cost and distraction of registration under the Act. As ERAs, venture capitalists are better able to invest in the small and innovative companies that drive economic growth and play an important role in expanding opportunities for American workers than they would be as registered investment advisors (RIAs).

¹ Venture capitalists are committed to funding America's most innovative entrepreneurs, working closely with them to transform breakthrough ideas into emerging growth companies that drive U.S. job creation and economic growth. As the voice of the U.S. venture capital community, the National Venture Capital Association (NVCA) empowers its members and the entrepreneurs they fund by advocating for policies that encourage innovation and reward long-term investment. As the venture community's preeminent trade association, the NVCA serves as the definitive resource for venture capital data and unites its member firms through a full range of professional services.

However, due to several factors, including taking on too many secondary investments, investing in other venture capital funds, or making cryptocurrency investments, a number of venture capital firms have found themselves either forced to become RIAs or actively manage their nonqualifying basket so as not to trip registration, including foregoing important venture investment opportunities. Furthermore, venture firms' collective experience as both ERAs and RIAs, combined with the straightforward patient equity-based investment model of the industry, has reinforced the view that the cost of Adviser Act regulation of venture capital firms exceeds any perceived benefits.

We recognize that the Interpretation and proposals in Release IA-4889 are part of an important package of proposals aimed at addressing legitimate concerns regarding retail customers of broker dealers and investment advisers.² Indeed, we commend the Commission for its focus on the interests of retail investors.

Venture capital firms are advisers to funds and have no relationships with "retail customers." Therefore, we will not comment on the vast majority of the proposals in the Commission's Releases of April 18, 2018.

We are concerned the proposed "enhancements" to the Investor Adviser Act regulation³ in the Interpretation Release may not be explicitly limited to investment advisers with retail clients. Therefore, we feel compelled to respond to these several suggestions and recommendations that would be difficult and costly to apply to venture capital firms and would result in significant costs and zero benefits for venture capital investors.

Investment Advisers' Fiduciary Duty

This section of the Release appears to be based in the context of an individual investor as the client. Since venture capital funds don't include retail investors, the relationship between retail investors and their investment advisers is beyond our expertise. However, some experts have suggested that application of elements of this Interpretation to the fund-as-client context could significantly increase compliance costs for venture capital funds.⁴ Specific concerns arise in the context of the ability for a fund manager to infer consent from a fund client.

We note that Part III of the Release, "Economic Considerations"⁵ is based on the belief that "investment advisers [that] currently understand the practices necessary to comply with their

² "Retail Customer means a person, or the legal representative of such person, who: (A) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer, or a natural person who is an associated person of a broker or dealer; and (B) Uses the recommendation primarily for personal, family, or household purposes." Release 34-83062, Pages 405-407.

³ Release No. IA-4889, pp. 27-38.

⁴ See e.g., Susan I. Gault-Brown, Hillel T. Cohn, Lloyd S. Harmetz, and Kelley A. Howes, "The SEC's Standard of Conduct Proposals Would Raise the Bar on Investment Advisers," available at <https://www.mofo.com/resources/publications/180426-sec-standard-of-conduct.pdf?>; Morgan Lewis, "SEC Proposes Interpretation of Standard of Conduct for Investment Advisers" (June 14, 2018). Available at <https://www.morganlewis.com/pubs/sec-proposes-interpretation-of-standard-of-conduct-for-investment-advisers>

⁵ Release, pp. 20-27.

fiduciary duty to be different from the standard of conduct in the Commission’s interpretation” are “not a significant portion of the market.”⁶ Therefore, either this economic analysis is inadequate or the final Interpretation should clarify the Commission’s view on client consent so as to avoid the risk of unnecessary additional costs to venture fund advisers. Furthermore, any consideration of the resolution of conflicts or other nuanced aspects of the fiduciary duty of fund advisers should take particular notice of the structure of venture capital funds and the policy considerations that led to the creation of the Venture Capital Adviser Exemption.

Federal Licensing, Continuing Education, Provision of Account Statements and Financial Responsibility

We are responding to the request for comments at pages 27-38 because it does not specify that the scope of these staff proposals is limited to advisers to retail customers. Of course, the context of this rulemaking is the retail investor who cannot distinguish between broker-dealers and investment advisers, and the differing standards to which each is held. Furthermore, the origin of these potential new requirements is the SEC’s Section 913 Study, which was mandated by Congress to evaluate current regulations regarding “personalized investment advice and recommendations about securities to retail customers.”⁷ The 913 Study notes that its Staff recommendations “includes suggestions for considering harmonization of the broker-dealer and investment adviser regulatory regimes, with a view toward enhancing their effectiveness in the retail marketplace.”⁸

Therefore, we hope the Commission agrees that neither the Release nor the 913 Study provide any basis for consideration of this proposal beyond the retail scope. Furthermore, we urge that any Commission consideration of these proposals beyond the retail scope would include thoughtful analysis of the large differences in the nature of private fund management and the provision of investment advice to retail customers.

Conclusion

As noted earlier, venture capitalists are general partners in their funds, with their limited partners generally being institutional investors, corporations, and family offices. As such they do not advise “retail customers.”

Therefore, these comments are precautionary in nature. We expect that the Commission and the Staff are aware of these important distinctions and merely wish to note them for the Rulemaking record.

⁶ *Id.* p. 21.

⁷ Study of Investment Advisers and Broker-Dealers (January 2011) p. i. [emphasis supplied]. “[T]he Study describes the considerations, analysis and public and industry input that the Staff considered in making its recommendations, and it includes an analysis of difference in legal and regulatory standards in the protection of retail customers relating to the standards of care for broker-dealers, investment advisers and their associated person for providing personalized investment advice about securities to retail customers.” *id.* p. ii.[emphasis supplied.]

⁸ *Id.* [emphasis supplied].

Sincerely,

Bobby Franklin

Bobby Franklin
President and CEO