

January 21, 2011

VIA E-MAIL: rule-comments@sec.gov



Elizabeth M. Murphy
Secretary
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: *Release No. IA-3111; File No S7-37-10, Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers (the Proposed Rules)*

Dear Ms. Murphy:

I'm writing to commend you on the excellent work you've done in creating the Proposed Rules pursuant to the Dodd-Frank Act regarding the definition of a Venture Capital Fund ("VCF"). I would like to suggest several refinements. I believe these refinements will make the Rules more relevant and reflective of current, legitimate industry practices that are an important part of our value creation process for the U.S. economy and job growth.

For twenty-two years, I have been a general partner at InterWest Partners, a venture capital firm established in 1979. As the COO of our firm, I have participated in hundreds of venture transactions. I am also a director of the National Venture Capital Association ("NVCA") and the International Private Equity and Venture Capital Valuation Guidelines Board ("IPEV"). IPEV has a monitoring role and gives guidance on the application of valuation guidelines to all stakeholders in the private equity and venture capital industry, including practitioners, investors, regulators and auditors. In addition, I am a founding member of both the Financial Accounting Standards Board's (FASB) Small Business Advisory Committee and the Private Equity Industry Guidelines Group (PEIGG). PEIGG's mission is to promote increased reporting consistency and transparency while at the same time improving operating efficiency in the transfer of information among market participants by establishing a set of standard guidelines for the content, formatting and delivery of information in the private equity industry.

Based on this experience, I believe the refinements I am proposing should better enable the SEC to comply with Congress's intent of excluding VCFs from becoming registered investment advisors, while not introducing additional systemic risk to the U.S. financial system. Further, the refinements should ensure that the economy's significant benefits derived from VCFs will not be compromised.

My proposed refinements are:

1. The SEC's Proposed Rules would force a VCF to register as an investment advisor if at any time it has a single "Non-Qualifying Activity" in any amount. I recommend the creation of a modest "bucket" for Non-Qualifying Activities as a safe harbor for VC funds. This bucket would be in the range of 15% to 20% of a fund's committed capital. I believe this is a reasonable amount, properly reflecting the broad diversity of our industry, while not sacrificing the intent of Congress or imposing systemic risk on the U.S. financial markets. This refinement assures continued substantial compliance with the Rules by VCFs while not being unreasonably harsh or punitive for a minor level of Non-Qualifying Activities.
2. Although the SEC's Proposed Rules state that its intent is not to restrict portfolio company borrowing in the normal course of its business, the Proposed Rules could be very problematic for the company and/or a VCF. This problem could easily be solved if the Rules were refined to make it very clear that a VCF does *not* become tainted by a Non-Qualifying Activity if the portfolio company borrows money, provided the VCF does NOT REQUIRE the company to use the borrowed money to either return capital to the fund or to purchase stock held by shareholders. Often a VCF does not control what a portfolio company does; it would not be appropriate to penalize a VCF if the portfolio company enters into a transaction that was not mandated by the VCF. If this refinement is made, I do not believe that it would create a significant "loophole" that buyout and hedge funds could take advantage of, so there is little downside risk.
3. The Proposed Rules regarding public company investments by VCFs really need to be refined. Otherwise, many of America's most promising young public, but still-cash-flow-negative, companies will not be able to raise the capital that they desperately need to stay in business, grow, and create new jobs. Instead, the companies will be forced to go out of business or be acquired at distress valuations. Jobs will be lost. We invest in both Life Science and Information Technology companies, with the initial investments nearly always being made when the company is very young and privately held. We frequently make several additional follow-on investments to support a company's development efforts, if merited, while it is still a private company. If a young company makes substantial and tangible business progress, it eventually may be able to raise money from the public. However, often it still must look to VCFs to supply additional capital to fuel its continued growth. Frequently, when one of our public companies raises another round of money from the public, we are still shareholders of the company and we are expected to invest in this new public financing round. Otherwise, new-to-the-company shareholders will say: *"If those VCF shareholders aren't going to bet their own money in this financing round, then I'm not going to make the bet either."* I apologize for this rather long explanation, but it really is crucial that we get this right in the Rules. I propose that the Rules would state that it is a "Qualifying Activity" for a VCF to invest in the public issuance of a portfolio company's stock so long as the VCF still

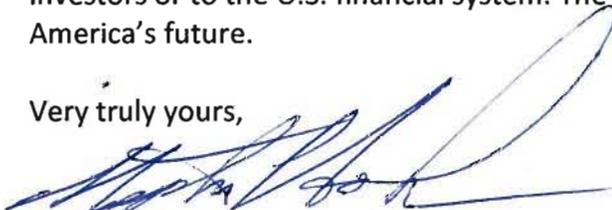
owns at least half of the investment it made in the portfolio company when it was privately held.

4. Finally, the Rules need to be refined to better reflect the current reality where VCFs occasionally buy a private company's stock, not directly from the company, but rather from selling shareholders such as founders and employees. These purchases provide vital liquidity and motivation to those people directly involved in the company's success—its founders and employees. The Rules should define these purchases by a VCF as a "Qualifying Activity" provided that the VCF does not invest more than approximately 20% of its committed capital in such transactions, in the aggregate, rather than on a company-by-company basis. Some quantitative limitation is appropriate so that most of a VCF's capital goes directly to companies to support their operations and growth. I think 20% is a reasonable limit, looking at the VCF's portfolio companies together, while providing an important incentive to company employees and founders, which also benefits the portfolio company. The appropriate percentage to provide the proper incentive in any particular situation might vary from company to company and an aggregate test is more appropriate and relevant.

The preceding four suggestions address my most important concerns regarding the Proposed Rules. However, I would like you to know that I fully support all of the suggestions contained in the 17-page comment letter submitted by the NVCA.

Thank you for taking the time to read my suggestions. I believe that they do not involve major conceptual changes to the Proposed Rules, but rather, they will help to more fully and accurately define the U.S. venture capital industry. These enhancements are very much aligned with the intent of Congress to encourage job creation while not adding material risk to investors or to the U.S. financial system. The continued productivity of this industry is vital to America's future.

Very truly yours,



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