American Federation of Labor and Congress of Industrial Organizations

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Sent via electronic mail: rule-comments@sec.gov

January 24, 2011

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

RE: ***File # S7-37-10 Exemptions for Certain Advisors—Title IV Provisions of the Dodd-Frank Act***

Dear Ms. Murphy:

On behalf of the AFL-CIO, thank you for the opportunity to comment on the proposed rule, "Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than $150 Million in Assets Under Management, and Foreign Private Advisers" ("Proposed Rule"). The AFL-CIO has been a strong proponent on the Dodd-Frank Wall Street Reform and Consumer Protection Act and, particularly, the provisions that will require the managers of private funds to register with the Securities and Exchange Commission. While the AFL-CIO supported all private funds being required to register with the Commission, we believe venture capital funds are a distinct category of private funds that can and must be clearly distinguished from hedge funds and leveraged buyout or private equity funds.

The AFL-CIO supports a very narrow definition of "venture capital fund" to ensure that the SEC has the ability to oversee as many private fund advisers as possible, consistent with Congressional intent. We strongly support the SEC's Proposed Rule because we believe that it succeeds in clearly defining those private funds that will be exempt and ensures those funds that Congress intended to be included will not be able to evade regulation.

The AFL-CIO is the country's largest labor federation and represents 12.2 million union members. Union-sponsored pension and employee benefit plans hold more than $480 billion in assets. Union members also participate in the capital markets as individual investors and as participants in pension plans sponsored by corporate and public-sector employers. The interplay between the public financial markets and shadow financial markets, including hedge funds and private equity, and the impact on our members' retirement savings as well as the broader economy has long been a concern for the AFL-CIO.

New Rule 203(l)-1: Definition of Venture Capital Fund

New Rule 203(l)-1 sets up a six-part test for determining whether a private fund is a "venture capital fund." The SEC's proposed definition would "define a venture capital fund as a private fund that: (i) invests in equity securities of private companies in order to provide operating and business expansion capital (i.e., 'qualifying portfolio companies,' which are discussed below) and at least 80 percent of each company's securities owned by the fund were acquired directly from the qualifying portfolio company; (ii) directly, or through its investment advisers, offers or provides significant managerial assistance to, or controls, the qualifying portfolio company; (iii) does not borrow or otherwise incur leverage (other than limited short-term borrowing); (iv) does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; (v) represents itself as a venture capital fund to investors; and (vi) is not registered under the Investment Company Act and has not elected to be treated as a BDC."

We believe that the SEC has chosen the correct factors to distinguish a venture capital fund from a private equity fund and has generally provided appropriate definitions for each of the factors. The test laid out captures Congress's intent to exempt private funds that provide seed funding, growth capital, and managerial assistance for small businesses and start-ups that create jobs while ensuring that advisers to funds with riskier investment strategies will be regulated by the SEC.

The AFL-CIO supports the definition of a "qualifying portfolio company" and is pleased that the SEC has made clear that a qualifying portfolio company may not be publicly traded and cannot "incur leverage in connection with the investment by the private fund". We urge the Commission to clarify that a qualifying portfolio company must not have ever been publicly traded and that reorganizations and recapitalizations of publicly traded companies or business units within publicly traded companies will not make those companies qualifying portfolio companies. This will ensure that the exemption for venture capital fund advisers is truly limited to those advisers that provide growth capital for start-ups and small companies.

SEC staff ask whether a venture capital fund should be permitted to provide follow-on funding once a portfolio company has gone public. We believe this should not be permitted. The clear intention of Congress in allowing an exemption for venture capital fund advisers was to exempt advisers that manage funds that provide capital for small, start-up companies. Once a company has gone public it can access capital in the public markets and no longer needs access to venture capital funding. Permitting exempt venture capital funds to make follow-on investments after a portfolio company goes public would clearly blur the distinction between venture capital and other types of private capital funds and thus would contradict the intention of Congress.

Under the Proposed Rule a qualifying portfolio company would not be permitted to "borrow, issue debt obligations or otherwise incur leverage in connection with the venture capital fund's investments." We believe this limitation on leverage is a good starting point but should be expanded to not be limited to leverage incurred pursuant to contractual obligations. Qualified portfolio companies should also be prohibited from taking on leverage for the purpose of paying dividends or fees to venture capital funds or their advisers.

In addition, the Proposed Rule would limit the amount of leverage a venture capital fund could incur to 15 percent of a fund's capital contributions and uncalled committed capital. Including uncalled committed capital in the calculation of permissible leverage may result in a venture capital fund taking on excessive leverage. For example, if investors have committed to invest a total of $100 in a venture capital fund and the venture capital fund has called in $5, the venture capital fund would still be permitted to borrow up to $15 dollars. In this example, the venture capital fund would have $1 of capital for every $3 of borrowed money. Given Congress' stated view that one of the key factors distinguishing hedge funds and private equity funds from venture capital funds was the use of leverage, allowing venture capital funds to incur this level of leverage would contradict Congressional intent. The AFL-CIO urges the SEC to limit the amount of leverage a venture capital fund may incur to 15 percent of the fund's capital contributions, and exclude uncalled committed capital from the calculation.

New Rule 203(m)-1: Exemption for Investment Advisers Solely to Private Funds with Less Than $150 Million in Assets Under Management

The "private fund adviser exemption" exempts fund advisers with less than $150 million in assets under management from the requirement to register under the Advisers Act. We support the SEC's proposal to require funds to use a uniform standard to calculate their assets under management and agree that it is important that the calculation account for asset appreciation. In addition, the assets under management reported to the SEC for purposes of determining whether an investment adviser is required to register under the Advisers Act should be the same as the assets under management calculated by the adviser for purposes of determining management fees that investors pay. If these numbers differ, this should be viewed by the SEC as cause to investigate whether the adviser is evading regulation or inflating asset values to extract excessive fees from investors.

Foreign Private Advisers

Proposed rule 202(a)(30)-1 defines terms in section 202(a)(30) of the Advisers Act, which exempts "foreign private advisers" from registration under the Act. [1] The AFL-CIO supports the SEC's proposed rule, in particular, we support the provision that would require advisers to "look through" the private funds they manage to determine the number of beneficial owners for purposes of counting their "investors" and determining their eligibility for the foreign private advisers exemption. This requirement is key to preventing fund advisers from concocting elaborate legal structures to evade registration and oversight by the SEC.

Conclusion

For many years, the AFL-CIO has advocated proposals that would give the SEC authority to oversee the advisers of private investment funds. In general, the AFL-CIO believes that all private fund advisers should be required to register with the SEC and that there should not be exemptions based on investment strategy. Given the SEC's mandate under Dodd-Frank, we strongly support the Proposed Rule because we believe that it clearly defines those private funds that will be exempt and ensures those funds that Congress intended to include will not be able to evade regulation.

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[1] §202(a)(30) Defines a foreign private adviser as any investment adviser that: "(i) Has no place of business in the United States; (ii) has, in total, fewer than 15 clients in the United States and investors in the United States in private funds advised by the investment adviser; (iii) has aggregate assets under management attributable to clients in the United States and investors in the United States in private funds advised by the investment adviser of less than $25 million; and (iv) does not hold itself out generally to the public in the United States as an investment adviser."

Thank you for the opportunity to submit comments on behalf of the AFL-CIO. If you have any questions, please contact Heather Slavkin at (202) 637-5318 or Hslavkin@aflcio.org.

Sincerely,

Damon A. Silvers
Director of Policy & Special Counsel

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