January 19, 2005

VIA Email

Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, NW
Washington, D.C. 20549-0609
rule-comments@sec.gov

Re: Comment of the National Venture Capital Association (NVCA) on Release No. 34-50896; File Nos. SR-NYSE-2004-12; SR-NASD – 2003-140; Relating to the Prohibition of Certain Abuses of the Allocations and Distributions of Shares in Initial Public Offerings (IPOs), (December 20, 2004).

Dear Mr. Katz:

The National Venture Capital Association (NVCA)[1] is pleased to comment on these proposed rules. NVCA believes that all efforts to improve both the actual fairness and the perception of fairness of the IPO process for the average investor are important. Over the past several years, nearly one-half of all IPO issuers were venture-backed companies. The IPO market directly affects the success of venture investing and the virtuous economic cycle of liquidity and re-investment into new ventures. Consequently, the NVCA shares with the SEC, the NYSE and the NASD an ongoing interest in the fairness and efficiency of the IPO market.

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[1] The National Venture Capital Association (NVCA) represents approximately 450 venture capital and private equity firms. NVCA's mission is to foster greater understanding of the importance of venture capital to the U.S. economy, and support entrepreneurial activity and innovation. The NVCA represents the public policy interests of the venture capital community, strives to maintain high professional standards, provide reliable industry data, sponsor professional development, and facilitate interaction among its members. For more information about the NVCA, please visit www.nvca.org.

Venture funding is a major factor promoting innovation and entrepreneurial businesses. In 2004, venture capital (VC) funds invested $20.8 billion in more than 2800 companies, the fifth largest amount ever in the history of venture capital. Eighty-five percent of these companies were in information technology, medical/health or life sciences. The success of venture investing is encouraging greater capital flow to these types of companies. At the end of 2003, VC firms had an estimated $258 billion under management, up from $32 billion in 1990.

NVCA represents the vast majority of venture capital under management. Our perspective on the IPO market comes from the multi-faceted relationships that venture capitalists have with pre-IPO and post-IPO issuers. Venture capital funds are large shareholders of many pre-IPO companies and a representative of the managing general partner of the fund usually sits on a venture-backed company's board. As a board member the venture capitalist may participate in the choice of underwriters for initial offerings and participate in the IPO pricing decision.

Shares owned by the venture capital fund -- which are not sold in the initial offering -- are usually subject to 180-day underwriter lock-ups. Therefore, a venture capitalist, fulfilling his or her fiduciary responsibility as a board member, has a duty to the issuer to maximize the IPO share price. In addition, the venture capitalist has a fiduciary duty to the investors in the venture capital fund to help ensure a deep, liquid secondary market for the company's stock so that the fund's investors receive the maximum return when the VC fund eventually sells its shares.

We see these duties as compatible because the goals of maximizing issuer proceeds and venture capital fund returns are mutually supportive. The long-term success of the issuer, as a publicly traded company, depends on both the depth and liquidity of the secondary market for its stock and the cash proceeds of the initial offering. The proper pricing of IPO shares is the key decision supporting both of these goals.

NVCA believes that the IPO market could be improved in three key areas: eliminate or disclosure conflicts of interest, improve information flow to the issuer in the IPO underwriting process and increase competition for IPO underwriting business.

NVCA supports the changes proposed in this Release and commends NASD and the NYSE for the thoroughness of their review process and their thoughtful analysis of comments received, including NVCA's comments and recommendations. We view implementation of these new rules as useful steps. We hope that these changes are part of an ongoing process whereby the IPO market and IPO process will be subject to continuous review and evaluation for fairness and efficiency. While we believe that additional regulatory steps may be appropriate, we are also hopeful that further development of alternatives to book-building in IPO underwriting will enhance the fairness and efficiency of the IPO market through competition.

NVCA's Previous Comments

NVCA supported the August 2002 version of Proposed NASD Rule 2712, which was intended to specifically prohibit allocation abuses such as spinning and laddering. For the same reasons, we generally supported the amendments proposed by NASD in the Notice to Members 03-72, Part 1, implementing the IPO Committee recommendations by our letter dated January 16, 2004 ("2004 comment"), especially those aimed at promoting more effective issuer involvement in the IPO pricing process. Therefore our 2004 comment urged the NASD (and the NYSE) to:

- Require fuller disclosure of indications of interest at various prices in a timely manner and a useful format; and

- Require disclosure of final allocations in detail, to include holding periods of purchasers and relationships between purchasers and underwriters.

NVCA also supported efforts to enhance the integrity of the offering process by:

- Requiring that unallocated returned shares benefit the offering rather than the underwriter;

- Broadening application of lock-ups; and

- Requiring advance public disclosure of lock-up exceptions for all holders subject to lock-ups.

Our 2004 comment also urged that any conflict of interest that could not be eliminated should be clearly disclosed.

NVCA Supports the Proposed New Rules

Disclosures of Indications of Interest and Final Allocations

Our 2004 comment recommended further enhancements to requirements for underwriters to provide information about demand for IPO shares in a form, and at a time, which will be useful to issuer representatives. We believe that the final rules support these goals.

NVCA supported changes that would give issuers greater information leverage in the IPO pricing decision and supported the proposed requirement that underwriters regularly report useful information regarding the market for the offering. We recommended that information on retail investor demand be provided as well as institutional interest; therefore, we support the requirement for underwriters to provide aggregated retail interest in their communications to issuers.

We also urged specific requirements as to the timeliness of underwriter reports on market demand. We appreciate the explanation in the Release regarding the meaning of “regular” reports, i.e., the requirement that underwriter reports be “regular” means as often as appropriate, including “when a material change occurs, or in connection with certain meetings with the issuer or its pricing committee, and always as frequently as requested by the issuer or its pricing committee.” Release No. 34-50896, p. 32. We anticipate that NASD and the NYSE will examine underwriter practices to ensure they conform to this standard.

Allocation of Returned Shares

We note that this Release contains no requirement that net profits from returned shares be allocated to the issuer, an NASD proposal we supported in our 2004 comment. However, the rule as proposed still accomplishes the most important purpose – to eliminate an underwriter’s use of these shares for the benefit of favored customers. Therefore, in light of Regulation M concerns with the earlier proposal, we support the requirement to allocate such returned shares to unfilled orders on a random basis. This change will enhance the integrity of the IPO allocation process.

Rules Related to Lock-ups

NVCA supported the proposal to require that lock-ups applicable to pre-IPO shares held by officers and directors apply equally to shares purchased under "friends and family" programs and other issuer-directed shares. We also supported public disclosure of lock-up waivers.

Evaluation of Possible Additional Requirements for Unseasoned Issuers

We appreciated the earlier opportunity to comment through NASD Notice to Members 03-72 on the concepts for additional requirements on unseasoned IPO issuers. Our comments generally described problems with each concept and we note in the Release an indication that the comments of others cited additional potential problems. Nevertheless, we appreciate the NASD's effort to educate itself and other interested parties on the question of what additional requirements on IPO issuers could assist in pricing the offering. We also appreciate the cautious approach that the NASD and the NYSE have taken in this area where there is a risk of over-regulation and burdensome additional cost for IPO companies. Generally, as we stated in our 2004 comment, we believe that providing better and more timely information to issuers' boards and removing potential distortions in underwriters' incentives are the most appropriate steps.

Developing Alternatives to Bookbuilding in IPO Underwriting

We remain hopeful that competitive forces will improve service and reduce the overall cost for IPO issuers. We, therefore, appreciate the decisions of the SROs to propose no new mandates in this area. However, we encourage NASD and the NYSE to continue to evaluate the level of competition in the IPO underwriting business.

Conclusion

NVCA is pleased to support the proposed rules. We will continue to monitor development in the IPO market and the going-public process. We look forward to continuing to work with the Commission, NASD and the NYSE toward ensuring the fairness and enhancing the efficiency of the IPO market.

Sincerely yours,
Mark G. Heesen
President

cc
All Commissioners
Mary Schapiro, Vice-Chairman and President, Regulatory Policy and Oversight, NASD
Richard G. Ketchum, Chief Regulatory Officer, NYSE