July 10, 2018

The Honorable Jeb Hensarling
Chairman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Maxine Waters
Ranking Member
House Committee on Financial Services
4340 Thomas P. O’Neill Federal Office Building
Washington, DC 2024

Dear Chairman Hensarling and Ranking Member Waters,

On behalf of our nation’s venture capital investors and the entrepreneurs they support, I write to express our strong support for the Developing and Empowering our Aspiring Leaders (DEAL) Act, sponsored by Representative Trey Hollingsworth (R-IN), and to thank the committee for its consideration. This legislation would encourage capital formation for startups by directing the Securities and Exchange Commission (SEC) to include investments in emerging growth companies (EGCs) as qualifying investments for purposes of the definition of a venture capital (VC) fund. The DEAL Act would allow VC funds to continue to follow their portfolio companies along their growth path without fear of triggering a significant regulatory burden. Modernizing the SEC’s definition of VC fund to more accurately reflect the industry has become one of the most significant regulatory priorities facing the startup ecosystem. We are extremely grateful for the leadership of Representative Hollingsworth on this critical issue and we stand ready to assist the committee’s efforts as you work to advance this legislation.

The definition of a venture capital fund in Rule 203(l)-1 of the Advisers Act was enacted as part of the Dodd-Frank Act in 2010, which mandated that private equity and hedge funds become Registered Investment Advisors (RIAs) but allowed VC funds to become Exempt Reporting Advisors (ERAs) to provide relief from the costs and complexities encountered by RIAs. By reducing the costs and challenges of the regulatory requirements of the Advisers Act, the exemption contributes to the ability of venture capital funds to invest in small and innovative companies. These companies are the drivers of economic growth and play an important role in expanding opportunities for American workers.

To be eligible, VC funds must ensure that more than 80 percent of their activities are in qualifying investments and they adhere to all other aspects of the definition. The SEC defined a qualifying investment only as direct investments into private companies. VC’s are facing challenges because their so-called “baskets” of nonqualifying activities are filling up, primarily with secondary shares of their portfolio companies. Because the pain of registration is so severe, the general reaction is to manage the basket to ensure it doesn’t exceed 10-15 percent of nonqualifying investments. Once this level is reached, VC’s must manage their basket activity and oftentimes pass up investment opportunities to avoid facing the burdens of registration. This is creating
disruption in the venture financing model, forcing some VCs out of portfolio company financing rounds while causing others to avoid potential investments in new portfolio companies.

The DEAL Act would alleviate this pressure by making investments in EGCs qualifying investments. This would allow VCs to continue providing equity investment to more of their portfolio companies, encourage patient capital investment, and long-term company growth. The modification would be limited in scope to equity investment by venture capital funds, activity that is generally a bipartisan priority.

NVCA and its member firms look forward to working with you to pass this legislation into law and improve the capital formation process for American startups. Thank you for your consideration of this important issue.

Sincerely,

Bobby Franklin
President and CEO