Overview

Access to capital is the lifeblood to realizing the power of disruptive ideas and new company formation. Young companies, many of which are supported by venture capital investment, create an average of three million new jobs a year and have been responsible for most net new job creation in the U.S. in the last forty years, according to data from the U.S. Department of Labor and the U.S. Census Bureau. In order to expand opportunities and fuel economic growth, promising companies need efficient and timely access to capital. NVCA advocates for a policy agenda that will reopen the public markets to small capitalization companies and expand opportunities for capital formation to more regions of the country.

NVCA is supportive of the Developing and Empowering Aspiring Leaders Act, sponsored by Representative Trey Hollingsworth (R-IN), which would provide regulatory relief by updating the definition to include some secondary investments as qualifying investments.

Policy Recommendations

Capital market reforms to support small cap companies

Healthy and accessible capital markets are critical to the entrepreneurial ecosystem and the U.S. economy. But today’s public markets are no longer welcoming to innovative, small-capitalization companies. Policymakers should focus on solutions that will encourage more startups and Emerging Growth Companies (EGCs) to become public companies in order to provide economic growth and create more economic opportunities for American families going forward.

The U.S. has been averaging less than half the number of initial public offerings (IPOs) since 2000 than in either the 1990s or 1980s. As a consequence, there are about half the total number of public listed companies than there were twenty years ago. This lack of new public companies has been a significant factor in the reduced
access to opportunity the country has experienced. In fact, a more conservative estimate of the consequences of a lack of IPOs indicates a loss of about 2 million jobs.

Small cap companies are struggling because, as the cost of being a public company has increased, the infrastructure, and the economics that historically supported small cap companies have disappeared. At the same time, a culture of short-termism has become more prevalent.

There are numerous explanations for why this has happened, but it is important to remember that the U.S. capital markets have undergone a number of significant changes since 2000. The move to decimalization, the passage of Sarbanes Oxley and a number of other regulatory changes, the 2003 global settlement, the computerization of the markets and the rise of high-frequency trading, the disappearance of adequate economic incentives for investment banks to sponsor growth companies in the public markets, and the consolidation among major investment institutions, all have occurred since 2000.

The 2012 JOBS Act was a great first step to reopening our public capital markets by addressing the risks, costs and regulatory burdens faced by startups and small cap companies fighting to succeed. The challenge today is that the JOBS Act helped build an on-ramp but the freeway still needs significant work. Simply put, the public markets need to be a more attractive place for companies, not to just get to, but to also stay in.

**Exempt bank investment into venture capital funds from Volcker Rule**
The Volcker Rule’s prohibition on financial institution investment into venture capital creates an unnecessary roadblock for capital formation, particularly in underserved areas where raising capital for venture capital investment tends to be more difficult.

Despite the fact that investment in venture capital poses no systemic risk to the financial system, venture capital was inadvertently swept into the definition of prohibited investments under the Volcker Rule. This prohibition does nothing to improve the health of the banking system, something acknowledged even by then-Senator Chris Dodd (D-CT), one of the architects of the Volcker Rule, who said, “properly conducted venture capital investment will not cause the harms at which the Volcker Rule is directed.”

But by limiting the pool of possible limited partner investors into venture capital funds, the Volcker Rule currently reduces the amount of capital available to American entrepreneurs. Perhaps most critical among these are entrepreneurs in emerging ecosystems, many of which are in economically distressed areas of the
country. The more challenging reality of venture fundraising in emerging ecosystems tends to require investment from a more diverse set of limited partners. In fact, removing the three most significant states for venture capital activity (CA, NY, MA), the median size venture capital fund size in the U.S. is about $20 million, simply too small for many institutional investors that provide capital to private funds.

Before the passage of the Volcker Rule, banks were an important source of investment for a number of small and regional venture capital funds. NVCA supports efforts to reform the Volcker Rule so banks can once again invest in venture capital, and put their capital to work building startup communities around the country.

Modify the venture capital exemption definition under the Investment Advisors Act

NVCA is grateful for the exemption provided by statute that was intended to exempt all venture capital funds from the costs and challenges associated with the Registered Investment Advisor (RIA) regulatory requirements under Dodd-Frank. However, the definition of venture capital fund promulgated by the Securities and Exchange Commission was too narrow and did not meet the statutory obligations of a full venture capital exemption. The definition leaves out broad swaths of growth equity and fund-of-funds venture capital firms, constrains the investment activity of some Exempt Reporting Advisors (ERAs) who must actively avoid the regulatory morass of registration, and imposes unnecessary compliance burdens on other firms who participate in venture capital.

Unfortunately, this definition ignores critical elements of the entrepreneurial ecosystem that must be included to ensure that the venture capital definition most fully benefits economic growth and expanded economic opportunity. NVCA recommends the following modifications:

- Investments in Emerging Growth Companies (EGCs), whether public or private companies, should be considered qualifying investments. In addition, the purchase of qualifying investments on the secondary market should not be disqualified.
- Investments in other venture capital funds, including fund-of-funds investments should be considered qualifying investments.
- The leverage limitations should be modified to allow for leverage up to the sum of total unfunded commitments, with a term of indebtedness up to 365 days.
There should be a simple and timely deregistration process for currently registered venture capital funds who would be exempt due to these modifications.

**Pass the HALOS Act**

NVCA supports the HALOS Act, a bipartisan piece of legislation that works to remove a potential regulatory complication currently encountered during Demo Days, encouraging greater participation for entrepreneurs and investors. Demo Days are fundamental to supporting startups, where entrepreneurs pitch their ideas to investors and also help educate the broader startup ecosystem.

**Pass the Fostering Innovation Act**

NVCA also supports the Fostering Innovation Act, sponsored by Representatives Kyrsten Sinema (D-AZ), Thom Tillis (R-NC), Gary Peters (D-MI), and David Perdue (R-GA); Representatives Trey Hollingsworth (R-IN) and Ben McAdams (D-UT), which provides emerging growth companies with an additional five-year exemption from certain regulatory requirements of public companies. Lowering the costs of being a public company can encourage more IPOs and allow small firms to use time and resources focused on growing innovation.