September 10, 2019

The Honorable Maxine Waters
Chairwoman
House Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Patrick McHenry
Ranking Member
House Committee on Financial Services
4340 Thomas P. O'Neill Federal Office Building
Washington, DC 20024

Dear Chairwoman Waters and Ranking Member McHenry,

On behalf of our nation's venture capital (VC) investors and the entrepreneurs they support, I write to express our strong concerns regarding the *Private Securities Transparency and Reform Act*, as well as to comment on issues regarding capital formation and accessing the public markets for venture-backed companies. This bill would impose a new regulatory burden by requiring information on a potential financing event prior to the transaction being completed. In the startup ecosystem, private financings are inherently uncertain event. Furthermore, the penalty for non-filers is the loss of exemption for that offering. The loss of an exemption from registration could unwind the financing of a startup, potentially putting that company out of business and costing American workers their jobs. I urge you to reconsider imposing an unnecessary new regulatory burden and avoid using such a draconian penalty against our nation's startups.

As background, venture capitalists (VCs) create partnerships with institutional investors to combine the capital held by pension funds, endowments, foundations and other sophisticated investors with their talent and expertise to make high-risk, long-term equity investments into innovative startups. VCs typically invest early in the promise of an idea, then support a company with multiple investment rounds spanning between five and ten years, sometimes longer. While being actively backed by venture capital, companies usually remain private and so rely on an exemption from the securities laws for these financing rounds. The ultimate goal is generally an initial public offering (IPO), though it is more common that VC-backed portfolio companies are acquired by larger companies or liquidated.

Entrepreneurship is a risky endeavor, but it is vital to society's progression and innovation. Research continues to show that new businesses are the engine of job creation in the United States, creating an average of about 3 million new jobs each year and accounting for virtually all net new job creation, according to data from the U.S. Department of Labor and the U.S. Census Bureau. A recent research paper produced by Stanford University finds that of the 1,339 companies that have gone public between 1974 and 2015, a full 42 percent can trace their roots to venture capital. Those venture-backed companies account for an astounding 85 percent of all research and development spending by companies that have gone public since 1974.

Concerns Regarding the *Private Securities Transparency and Reform Act*

The vast majority of venture capital is invested in startups while they are still private companies. Regulation D is the primary exemption that startups rely on during this period to raise capital. Various policy changes over recent decades have reduced friction between institutional pools of capital and startups in need of investment, improvements which our society has benefitted from through well-paying jobs, innovation and economic competitiveness.

The *Private Securities Transparency and Reform Act* would impose a new regulatory burden on startups by requiring a filing announcing a financing round before the potential financing event occurs. As a result, the bill would require startups to publicly file financing plans and provide the Securities and Exchange Commission (SEC) with information that may or may not be correct depending on the outcome of the financing round. Companies may hope to meet certain objectives in their fundraising, but issues such as the amount of money raised, valuation, and makeup of investors are all uncertain until the transaction is complete. Requiring this information to be filed and publicly disclosed on the front-end is simply a best guess.

Furthermore, at a time when policymakers are increasingly worried about business consolidation in the United States, the *Private Securities Transparency and Reform Act* would unintentionally provide a tool to entrenched incumbents and other competitors to interfere with the growth efforts of startups seeking to challenge their dominance. This is not mere speculation. It is important to remember that raising capital is a particularly vulnerable period in a startup's lifecycle. For instance, there are stories of startups experiencing increased pressure from patent assertion entities around financing rounds. These entities apply pressure strategically because they understand that requiring disclosure of patent litigation damages a startup's ability to raise capital, regardless of the merit of the suit. This bill could encourage the rise of whisper campaigns and other manipulative efforts, similar to so-called "short and distort" schemes wielded against many venture-backed companies in the public markets today, in the private markets.

Most concerning is the penalty for failure to file, which is entirely disproportionate to the error. The *Private Securities Transparency and Reform Act* would require the SEC to punish a failure to make either the pre-sale filing or the post-sale filing with a loss of the exemption from registration for the offering. Most venture-backed startups rely on multiple fundraising rounds to finance operations and growth activities, namely hiring and research and development. The need to raise capital is thus existential to their ability to remain ongoing concerns. By threatening the exemption from registration, this legislation therefore proposes to penalize a failure to file error with the potential destruction of the company, an outcome which hurts far more than just company management and may be without precedent in terms of proportion to the error.

Comments on the Decline of IPOs
Healthy and accessible capital markets are critical to the entrepreneurial ecosystem and the U.S. economy. Venture capital invests in less than one percent of all new businesses but back nearly half the companies that go public. Simply put, this industry builds the product for the IPO pipeline. Unfortunately, today's public markets are generally less welcoming to innovative, small-capitalization companies. As the cost and complexity of being a public company has increased, the infrastructure and the economics that historically supported small cap companies have disappeared and our markets have grown more inclined to short-termism. The U.S. now averages less than half the number of IPOs per year than in either decade before 2000. As a result, there are now roughly half the total number of public companies than there were twenty years ago.

There are some who argue that a number of pro-capital formation rule changes in recent decades have caused the drop in IPOs, but this theory fails a basic logic test. It is true that there is more capital in the private markets today. But the theory ignores the fact that more startups *never* become public companies, choosing to sell rather than go public. Venture-backed companies cannot stay public in perpetuity. Even if the robust private capital markets allow startups to stay private longer, the company's choice between going public or selling itself must still be made at some point. The fact is, these companies have increasingly chosen to sell themselves rather than experience the challenges faced by today's public companies.

Conclusion
Increasing the regulatory burden on private market financing will not change this dynamic but could create a number of other serious unintended consequences. There is no silver bullet that will fix all the challenges to going public as a smaller company. But it is our hope that policymakers can come together on a bipartisan basis in order to find solutions that once again make the public capital markets welcoming to innovative small companies and avoid the unintended consequences of imposing roadblocks on private capital formation.

Thank you for your consideration of our views.

Sincerely,

Bobby Franklin
President and CEO
National Venture Capital Association