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January 24, 2011

John V. Jaggers
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13455 Noel Rd, Ste 1670
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VIA E-MAIL

Elizabeth M. Murphy, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-1900

rule-comments@sec.gov

Re: Release No. IA-3111, File No. S7-37-10, Exemptions for Advisers to Venture Capital Funds (the Release)

Dear Ms. Murphy:

As Managing General Partner of Sevin Rosen Funds, I would like to thank you for the opportunity to submit comments to the proposed rule implementing the Venture Capital Fund Exemption (VCF Exemption) from the registration requirements of the Investment Advisers Act of 1940, as enacted by the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Headquartered in Dallas with offices in Austin and Palo Alto, Sevin Rosen Funds is one of the nation's most successful and experienced early-stage venture capital firms. Founded in 1981, it currently manages funds with aggregate capital commitments of $1.5 billion and is well known for its role as an early financer of COMPAQ, Lotus, Electronic Arts, Cypress Semiconductor, Cyrix, Citrix Systems, CIENA, Capstone Turbine, and XenSource. As Texas' oldest and largest firm focused on early-stage venture investing, Sevin Rosen Funds has managed nine funds and backed 250 start-up companies across the United States. The firm's investments have grown to account for an estimated $45 billion in annual revenues and 110,000 jobs.

Sevin Rosen Funds is a long standing member of the National Venture Capital Association (NVCA), and until last year, I served on its Board of Directors. Sevin Rosen Funds supports the NVCA's recommendations to the Securities and Exchange Commission (the Commission) regarding the Exemptions for Advisers to Venture Capital Funds, as laid out in its letter addressed to you and dated January 13, 2011. Attached to this letter, you will find comments and recommendations from our firm that reinforce and, in some places, extend those of the NVCA. When possible, we have included real-world examples that support our point of view. Sevin Rosen Funds, its portfolio companies, and the structure of its financial transactions are all prototypical of the traditional "early-stage" venture capital model. Therefore, we believe our experiences and perspectives on this matter are very typical of the type of investment advisers Congress sought to protect by exempting "venture capital funds" from registration.

I believe it is worth noting that, based on the Commission's proposed definition of Venture Capital Fund (VCF), neither Sevin Rosen Funds, nor, we believe, virtually any other classic early-stage venture capital fund, would

qualify for the VCF Exemption. Even if managers to VCFs were to significantly alter current, standard investment practices in an attempt to comply with the many requirements and restrictions of the proposed VCF Exemption, use of the exemption would still be difficult and uncertain given the extreme rigidness and inflexibility of the proposed rules. Such a result seems entirely inconsistent with Congress' intent in creating the VCF Exemption for advisers to VCFs and would certainly have a negative impact on the venture capital industry.

I must emphasize that my partners and I wholeheartedly believe that it is *critical* that the NVCA's recommendations and our attached modifications and clarifications, or changes that accomplish the same objectives, be included in the final VCF Exemption rules, so that we and our venture capital colleagues have the certainty and security needed to continue running operations and making investments in an efficient and effective manner. When Congress enacted the VCF Exemption, it did so because it did not want to in any way hinder what venture firms do best—namely, fund entrepreneurs who build innovative, world-class companies that create jobs for Americans and give our country its competitive edge in an increasingly competitive global economy. Unfortunately, in its current form, the VCF Exemption will not accomplish this goal.

We appreciate your consideration of these important issues.

Sincerely,

John V. Jaggers
Managing General Partner
Sevin Rosen Funds

Comments on Exemptions for Advisers to Venture Capital Funds

Based on our thirty years of experience in the venture capital industry, Sevin Rosen Funds would like to reinforce and, in some places, extend the recommendations made by the NVCA in the following ways:

1. Basket of Permissible Non-Qualifying Investments or Activity

Based on the Commission's proposed definition of VCF, neither Sevin Rosen Funds, nor, we believe, virtually any other classic early-stage venture capital fund, would qualify for the VCF Exemption. Even if managers to VCFs were to significantly alter current, standard investment practices in an attempt to comply with the many requirements and restrictions of the proposed VCF Exemption, use of the exemption would still be difficult and uncertain given the extreme rigidness and inflexibility of the proposed rules. Such a result seems entirely inconsistent with Congress' intent in creating the VCF Exemption for advisers to VCFs and would certainly have a negative impact on the venture capital industry.

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We believe it is critical that the VCF Exemption allow for an aggregate level of non-qualifying investments or activities (*i.e.*, a "Basket"). A Basket would allow sufficient flexibility for VCFs to continue to fund start-up technology companies from inception through maturity in accordance with customary VCF practices and operate their funds in an efficient manner while maximizing investor returns. A Basket would also permit VCF managers to nimbly adapt investment strategies to changing circumstances—a characteristic that has contributed to the success of the venture capital industry through the years.

Essentially, we believe that a Basket is the only solution that would allow the definition of a VCF to simultaneously:

1. **Be flexible** enough not to severely impair the operations of bona fide VCFs, a critically important resource for American innovation and job creation, and

2. **Avoid the risk** that other financial vehicles, such as private equity funds and hedge funds, would somehow qualify as VCFs.

While the majority of our investments comply with the requirements of the VCF Exemption as currently proposed, there are many historical examples of non-qualifying investments.

Here are two common examples:

- **Bridge Loans**
  We often provide bridge loans to our portfolio companies to satisfy immediate cash needs while the company strives to achieve certain milestones or while the terms of the next equity financing or sale transaction are being determined. The note instruments we receive do not always meet the definition of "equity security" under the proposed rule.

- **Exchange Financing Structures**
  Some of our most promising portfolio companies have obtained financing through "pull through" or "exchange" financing structures. In such cases, participating VCFs exchange their original preferred securities for new preferred securities and make an additional investment to purchase a new series of preferred securities, while the preferred securities of the non-participating VCF investors are converted into common stock. Because these transactions involve an exchange of original securities with a change in the existing beneficial owners' rights, priority, and economic terms, a qualifying portfolio company (QPC) could become a non-qualifying portfolio company.

These are only examples. Because the practice of fostering young companies is constantly changing, and every situation is different, we do not believe it is practical or advisable to attempt to define every such non-qualifying practice explicitly. We believe the only way to allow for these critical, but often non-qualifying investments, is to use a Basket.

Such non-qualifying investments, while technically falling outside of the VCF Exemption, are still well within the bounds of traditional venture capital activity and do not present systemic risk to the financial markets or our investors. To the contrary, such investment activity allows for efficient risk management and capital formation, which in turn, enables portfolio companies to transition through critical periods, create new jobs, build innovative products, and deliver value for VCF investors. It would be a significant detriment to our

industry and the companies we support if VCFs are not permitted to use their business judgment to fund companies in the most effective manner under the particular circumstances.

In order for the proposed Basket to serve its intended purpose, (1) adequate Basket size and (2) certainty around how the Basket is measured and operates are crucial:

1. **We believe an appropriately-sized Basket would allow for up to 20% of a VCF's total capital commitments at any point in time.** In the Release, the Commission acknowledged the use of total capital commitments as the primary metric for managing a fund's assets and for determining compliance with investment guidelines. As stated by the NVCA in its January 13, 2011 letter, the 20% level is consistent with rule 35d-1 under the Investment Company Act of 1940, which requires a mutual fund to invest at least 80% of its assets in the type of investment suggested by its name. A 20% maximum threshold is low enough to ensure that only true VCFs are able to qualify for the VCF Exemption.

2. **VCFs must be able to calculate non-qualifying investments in the Basket with certainty at any point in time to ensure compliance with the VCF Exemption and govern their activities accordingly.** Therefore, we ask the Commission to provide sufficient detail regarding Basket measurement**.** In particular, **we recommend that the Commission provide clear guidelines regarding measurement basis and timing that are consistent with the following principles**:

    a. **Non-qualifying investments should be measured on a cost basis at the time of investment.**

    b. **Qualifying or non-qualifying status of investments should be determined at the time of each investment.** Qualifying investments should maintain such qualifying status over the life of the investment, regardless of future non-qualifying activity by a QPC. For example, if a VCF were to invest an aggregate of $10 million in qualifying investments in the Series A, Series B, and Series C financings of a QPC, and then later the VCF invests $2 million in a non-qualifying investment in a Series D financing of the same QPC, only the $2 million non-qualifying Series D investment would go into the Basket and count toward the 20% limit on non-qualifying investments. We believe this approach is consistent with the Commission's position on qualifying and non-qualifying investment measurement based on its use of the phrase "at the time of each investment by the venture capital fund" in the Release and we suggest that it should be expressly stated in the final rule for avoidance of doubt.

    c. **The 20% Basket allowance should be measurable at any particular point in time to include only those non-qualifying investments currently held by the VCF at the time of measurement.** For example, if a VCF made a $2 million non-qualifying bridge loan to a QPC, such non-qualifying investment would count toward the 20% Basket during the time such bridge loan was outstanding, but would no longer count toward the Basket allowance once such bridge loan was converted into a qualifying equity security, repaid or otherwise no longer held by the VCF.

2. Short-Term Investments

We agree with the position of the NVCA, as articulated in its letter, that the definition of Permissible Short-Term Investments should be expanded to include a broader range of safe cash or money fund equivalent short-term investments.

Managers of VCF's generally seek to avoid holding large cash positions by (1) calling committed capital from their limited partners only for anticipated venture investments or payment of VCF expenses, and (2) by distributing cash received from the sale or liquidation of its venture investments in a timely manner.

When cash balances are held at the VCF in anticipation of an investment or distribution, the VCF will seek to make safe investments in cash equivalent or money fund instruments that provide an appropriate level of return to the VCF's investors. The NVCA's letter highlighted other types of investments in which VCF's typically invest, including federal agency securities, repurchase agreements, money market mutual funds, deposit accounts, and U.S. Treasuries.

In addition to those already listed by the NVCA, based on our experience and current mode of operations, we recommend the following instruments also be considered Permissible Short-Term Investments:

- **Treasuries with maturities of 180 days or less** (rather than 60 days maturity suggested by the NVCA)
- **Highly-rated Corporate Commercial Paper (Moody's P1, S&P A-1, Fitch F1) with a maturity of 90 days or less**

3. Secondary Positions

We agree with the Commission's assumption that VCFs generally do not acquire portfolio company securities directly from existing stockholders. Sevin Rosen Funds has traditionally invested in securities issued directly by a portfolio company with the proceeds of such investment being used to fund company operations and expansion. However, from time to time, Sevin Rosen Funds has engaged in secondary investments to provide personal liquidity and wealth diversification to founders. Such secondary transactions serve to align the goals of VCFs and founders to continue to grow the company—rather than selling the company early to achieve founder liquidity. Secondary transactions are also a tool for VCFs to replace tired syndicate members.

We agree with the NVCA's recommendations, and would expand upon them, to:

1. **Apply the 20% secondary acquisition limitation to the VCF as a whole on the basis of total capital commitments (rather than on a company-by company basis), and**
2. **Increase the 20% company-by-company secondary acquisition limitation to 50%, including the purchase of any capital stock previously issued by the company.**

4. Offer of Managerial Assistance

While Sevin Rosen Funds and other typical VCFs are generally very actively involved with the management of portfolio companies as they seek to maximize growth and value of each company, **we believe the condition of a VCF's offer to provide managerial assistance to a portfolio company is unnecessary and should be removed from the final rule.**

As the Commission acknowledged in the Release, the fact that the assistance need only be "offered" may render the condition so readily met that the condition is not meaningful. The condition would simply be another administrative "hoop" for VCFs to jump through and would not add protection to VCF investors or the public. Additionally, in certain situations, such as with a later stage company or a company with a large syndicate of investors, a VCF may determine that an offer of managerial assistance is not the best course of action. VCF investors would be best served if advisers to VCFs retain discretion as to how best to use their resources and manage their portfolio companies.

In the event that the Commission chooses to include the offer of managerial assistance condition in the final rule, we agree with the NVCA's position that a "management rights" letter typically received by a VCF from a portfolio company in connection with the "venture capital operating company" rules under ERISA should expressly satisfy this condition.

We do not believe a VCF should be required to actually provide managerial assistance; nor do we believe numerical investment or ownership tests should be used. Additionally, a VCF should not be required to have a board seat or even board observation rights to satisfy the managerial assistance requirement—as this could lead to large, unwieldy boards. In our experience, smaller, more nimble boards are most effective for start-up companies.

5. QPC Borrowing Limits

Sevin Rosen Funds fully supports the NVCA's recommendation that the Commission use the "use of proceeds" criterion, as the Commission's proposed "in connection with" test is too vague and often beyond the VCF's control.

However, we would like to add a clarification:

> **In the rare event that a QPC engages in borrowing that the Commission deems not to be "in the ordinary course of business" and therefore loses its "qualifying" status, it is imperative that only *future* VCF investments are considered "non-qualifying"—leaving all past investments in that portfolio company as "qualified".**

This distinction will be vital when calculating a VCF's aggregate level of non-qualifying activity relative to a permissible Basket (as described in #1 above).

6. Bridge Loans

As described in #1 above, we often provide bridge loans to our portfolio companies to satisfy immediate cash needs while the company strives to achieve certain milestones or while the terms of the next equity financing or sale transaction are being determined. The note instruments we receive do not always meet the definition of "equity security" under the proposed rule. These types of non-convertible bridge loans are generally short term and do not present systemic risk to the financial markets or VCF investors.

Like the NVCA, we believe that non-convertible bridge loans to portfolio companies that have a maturity date of 180 days or less, with up to one 180-day extension period, should qualify as permissible investments for a VCF.

7. Investments in "Seed" VCFs

It is not uncommon for an early-stage VCF to invest in "seed" funds (aka "feeder", "incubator", "accelerator", or "micro-VC" funds). These smaller VCFs usually invest at the very earliest stages of a company's life (usually "seed" round) and then rely on larger early-stage VCFs to make investments in future rounds (usually "A-rounds"). The "seed" fund model has made resurgence in the last few years—specifically in the areas of Web and Mobile. Such funds are a great asset to entrepreneurs and larger VCFs alike—as they allow for a significantly larger pool of companies to build an initial product and garner early market traction—from which larger VCFs can then choose to back the most promising.

Sevin Rosen Funds has invested and benefited from such "seed" funds in the past (*i.e.,* StarTech) and will likely do so in the future. Therefore, **we recommend that the Commission allow VCFs to invest in smaller "seed" VCFs, as long as the latter also meet the VCF Exemption criteria.**

In the event that a "seed" VCF loses its exemption, it is imperative that other VCFs that have invested in that fund prior to the disqualification do not also lose their exemption. At the very least, they should have a reasonable period (at least one year) to pursue a divestiture and during that period the investment should not count against the VCF's Basket allowance.