



April 1, 2020

VIA ELECTRONIC FILING

Department of the Treasury
Office of the Comptroller of the Currency
Regs.comments@occ.treas.gov
12 CFR Part 44
[Docket No. OCC-2020-0002]
RIN [1557-AE67]

Federal Reserve System
Regs.comments@federalreserve.gov
12 CFR Part 248
[Docket No. R—1694]
RIN 7100-AF70

Federal Deposit Insurance Corporation
comments@FDIC.gov
12 CFR Part 351
RIN 3064-AF17

Commodity Futures Trading Commission
<https://comments.cftc.gov>
17 CFR Part 75
RIN 3038-AE93

Securities and Exchange Commission
Rule-comments@sec.gov
17 CFR Part 255
Release no. BHCA-8; File no. [S7-02-20]
RIN 3235-AM70

Re: *Proposed Revisions to Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*

Dear Comptroller Otting, Chair Powell, Chair McWilliams, Chair Clayton, and Chair Tarbert,

On behalf of our nation's venture capital investors and the entrepreneurs they support, I write to express our view on how the Volcker Rule impacts venture capital and entrepreneurial capital formation, and to support your proposed solutions to these unintended challenges.

Our comments specifically focus on the Agencies' request for responses to various questions regarding revisions to the definition of "covered fund," and, in particular, the proposed revision to exclude qualifying venture capital funds from the covered fund definition. We are encouraged by the Agencies' proposal and appreciate the opportunity to discuss the ways in which we believe the proposed exclusion will have a meaningful impact on entrepreneurial capital formation and the U.S. economy.

Venture Capital Provides Long-Term Investment into the Next Generation of American Companies

Venture capital fund sponsors create partnerships with institutional investors to combine the capital held by pension funds, endowments, foundations, and others (previously including banks and their affiliates) with their talent and expertise to make long-term equity investments into innovative startups. Venture investors work with startups to help entrepreneurs turn ideas into successful companies and continue to support a company through multiple investment rounds, often spanning between five and ten years. While entrepreneurship is a risky endeavor, this is true whether its funded directly by a bank loan, as in the case of traditional small businesses, or by equity investment through venture capital funds, as in the case of growth companies. New company formation and growth is vital to society's progression and innovation, and perhaps determinative to economic competitiveness in the 21st century economy.

Over the last five years, approximately 34,000 companies in the United States have received venture capital investment and mentorship, and are currently responsible for 2.27 million jobs.¹ In addition, these venture-backed companies have been responsible for 85 percent of total R&D investment undertaken by all companies that have gone public between 1974 and 2015.² In short, while a small industry by relative standards, venture capital helps to fuel economic activity with the ultimate promise of creating growth and opportunity and is the pipeline to the public markets.

It was the Clear Intent of Congress to Exempt Venture Capital Funds from the Definition of Covered Funds

In the release, the Agencies cite the congressional record showing the clear intent of Congress to exempt investments by banking entities into venture capital funds from the covered funds rule. These statements include those made by Senator Chris Dodd (D-CT), one of the authors and namesakes of the Dodd-Frank Act which codified the Volcker Rule, Representative Anna Eshoo (D-CA), Senator Barbara Boxer (D-CA), and Senator Scott Brown (R-MA).³ It is clear through these statements that the Congressional intent is to protect investment by banking entities into venture capital funds. The proposed exclusion for qualifying venture capital funds is necessary both to implement that intent and to avoid the harmful economic consequences resulting from the prohibition on banking entities investing in venture capital funds.

¹ Pitchbook Platform, data as of March 26, 2020. <https://pitchbook.com>

² *How Much Does Venture Capital Drive the U.S. Economy?*, Stanford Graduate School of Business (October 2015), available at <https://www.gsb.stanford.edu/insights/how-much-does-venture-capital-drive-us-economy>

³ See 156 Cong. Rec. E1295 (daily ed. July 13, 2010) (statement of Rep. Eshoo); 156 Cong. Rec. S5904 (daily ed. July 15, 2010) (statement of Sen. Boxer); 156 Cong. Rec. S5905 (daily ed. July 15, 2010) (statement of Sen. Dodd); 156 Cong. Rec. S6242 (daily ed. July 26, 2010) (statement of Sen. Scott Brown)

Harmful Economic Consequences from Prohibition of Bank Investment into Venture Capital

The loss of banking entities as limited partners in venture capital funds has had a disproportionate impact on cities and regions with emerging entrepreneurial ecosystems – areas outside of Silicon Valley and other traditional technology centers. The more challenging reality of venture fundraising in these areas of the country tends to require investment from a more diverse set of limited partners.⁴ To put this in perspective, if one removes the three most significant states for venture capital activity (California, New York, and Massachusetts), the median size venture capital fund in the U.S. is roughly \$43 million.⁵ This size fund is often too small for the institutional investors that provide capital to much of the alternative assets industries. Prior to the Volcker Rule, banking entities were an important source of investment for many small and regional venture capital funds. By limiting the pool of potential limited partner investors into venture capital funds, the Volcker Rule has greatly reduced the amount of capital available to American entrepreneurs. Perhaps most critical among these are entrepreneurs in emerging ecosystems, many of whom are in economically distressed areas of the country for which there is bipartisan support to encourage capital formation and venture capital investment.

Take for example Renaissance Venture Capital Fund, a regionally focused fund of funds based in Michigan that estimates that every dollar they invest attracts \$16 dollars of additional capital into the state of Michigan. Renaissance believes that the Volcker Rule has cost them as much as \$50 million in investment, costing the state of Michigan as much as \$800 million of potential capital available to emerging companies that could drive growth, job creation, and new economic opportunity in the Midwest.

This narrative unfortunately repeats itself, as we have heard firsthand from investors about how the Volcker Rule has affected venture capital investment and entrepreneurial activity across the country. The majority of these concerns about the Volcker Rule have come from members located in regions with emerging ecosystems, including states like Ohio, Michigan, North Carolina, New Hampshire, Wisconsin, Georgia, and Virginia, to name a few.

As discussed above, the congressional record makes clear that there was no intention of impacting venture capital funds and that Congress expected the Agencies to exclude venture capital funds using the discretionary authority provided to them. NVCA is encouraged by the Agencies' efforts to review this issue and propose an exclusion for "qualifying venture capital funds" from the definition of a "covered fund."

The Agencies' Proposal to Provide an Exclusion for Qualifying Venture Capital Funds from the Volcker Rule

The proposed rule creates an exclusion for "qualifying venture capital funds" from the definition of a "covered fund" that would allow banking entities to acquire or retain an ownership interest in, or sponsor, certain venture capital funds to the extent the banking entity is

⁴ Limited partners are investors into venture funds and other alternative assets funds.

⁵ Source: NVCA 2020 Yearbook, Data Provided by PitchBook

permitted to engage in such activities under otherwise applicable law. To be eligible for the exclusion as a qualifying venture capital fund, the Agencies' propose meeting the definition of a venture capital fund that is included in rule 203(1)-1 under the Investment Advisers Act. The definition was crafted by the SEC at the direction of Congress, which called for venture capital funds to be exempted from the registered investment advisor requirements contained in Dodd-Frank.

NVCA supports the use of this definition for the proposed exclusion and believes it provides the narrowest possible approach to implement the Congressional intent described above. However, at a minimum, the Agencies should confirm that the guidance provided in SEC IM Guidance Update 2013-13 (December 2013) applies, as well as any future guidance provided by the SEC.

The use of the SEC definition of a venture capital fund is sufficient to distinguish a qualifying venture capital fund from a covered fund, and no additional standards or requirements are necessary. We note that the SEC studied this issue extensively when it adopted the exemption from the registration requirements of the Investment Advisers Act for advisers to venture capital funds. The SEC noted that:

“[T]he proposed rule was designed to: (i) implement the directive from Congress to define the term venture capital fund in a manner that reflects Congress' understanding of what venture capital funds are, and as distinguished from other private funds such as private equity funds and hedge funds; and (ii) facilitate the transition to the new exemption.... The final rule defines the term venture capital fund consistently with what we believe Congress understood venture capital funds to be, and in light of other concerns expressed by Congress with respect to the intended scope of the venture capital exemption” (footnotes omitted).⁶

The Agencies' inquire how a banking entity would ensure the activities of a qualifying venture capital fund are consistent with the safety and soundness standards the apply to a banking entity. The limitations imposed by the definition of a venture capital fund, together with the additional criteria proposed by the Agencies, are sufficient to ensure that the activities of a qualifying venture capital fund are consistent with the safety and soundness standards that apply to a banking entity. For example, (i) investments are made in private companies; (ii) leverage is extremely limited; and (iii) a qualifying venture capital fund cannot engage in any activities that are principally for the purpose of short-term resale, benefitting from short-term price movements, realizing short-term arbitrage profits, or hedging positions resulting from such activities.

We also note that many banking entities invest directly in venture capital companies. For example, financial holding companies may acquire 100% of a venture capital company under merchant banking authority, and bank holding companies that are not financial holding

⁶ *Exemptions for Advisers to Venture Capital Funds, Private Fund Advisers With Less Than \$150 Million in Assets Under Management, and Foreign Private Advisers*, Investment Advisers Act Rel. No. 3222 (June 22, 2011) (“SEC 2011 Final Release”) at p. 133

companies may acquire up to 4.9% of any class of voting shares and up to 33% of the total equity of a venture capital company under Section 4(c)(6) of the Bank Holding Company Act. Permitting banking entities to do indirectly through venture capital funds what they may already do directly promotes and protects the safety and soundness of banking entities by (i) providing diversification to a banking entity's venture capital investments, which is a critical component of successful venture capital investing; and (ii) providing a banking entity with access to professional venture capital managers with industry knowledge and connections, as well as access to the most promising venture capital companies.

NVCA Opposes Additional Considerations for Requirements to the Venture Capital Fund Exclusion

The Agencies' release includes several questions contemplating additional requirements to the venture capital fund exclusion from the definition of covered funds, including a revenue requirement for venture-backed companies and changing the SEC venture capital fund definition threshold of a fund's qualifying investments. For the reasons explained above, NVCA believes that the use of the SEC definition to determine a qualifying venture capital fund exclusion is sufficient to distinguish characteristics and activities of venture capital funds from covered funds. Moreover, the SEC contemplated and rejected each of the considerations in 2011 during the proceedings to define a venture capital fund. Perhaps most important, the activities which are of concern are already prohibited by explicit provisions, such as the prohibition on banks covering losses in sponsored funds and proprietary trading activities.

We firmly believe that adding additional requirements to the exclusion would result in a less than meaningful change for entrepreneurial capital formation, and therefore, NVCA opposes both additional requirements under consideration.

NVCA Opposes an Additional Proposed Revenue Requirement for Companies

Neither an additional revenue requirement nor any other metric should be added to the venture capital fund exclusion. The range between industry sectors of venture-backed companies vary significantly as it relates to a company's revenue. For instance, companies in the manufacturing and retail sectors generally see revenues significantly earlier than the biotechnology sector, which receive venture investment for many years pre-revenue to navigate clinical trials and the drug approval processes. Using a portfolio company's revenue as an additional requirement for the exclusion imposes an arbitrary data point between sectors and could put higher revenue sectors at a disadvantage for accessing venture capital.

In fact, the SEC expressly rejected this approach in 2011:

“As discussed in the Proposing Release, we considered defining a qualifying fund as a fund that invests in small companies, but noted the lack of consensus for defining such a term. We also expressed the concern in the Proposing Release that defining a “small” company in a manner that imposes a single standardized metric such as net income, the number of employees, or another single factor test could ignore the complexities of doing business in

different industries or regions. This could have the potential result that even a low (*sic*) threshold for a size metric could inadvertently restrict venture capital funds from funding otherwise promising young small companies. For these reasons, we are not persuaded that the tests for a “small” company suggested by commenters address these concerns” (footnotes omitted).⁷

NVCA Opposes Increasing the Qualifying Investment Threshold to 100 Percent to Qualify for Exclusion

The proposed venture capital fund exclusion should not require that 100 percent of the fund’s holdings, other than short-term holdings, be in qualifying investments (as opposed to the current requirement of 80 percent. This provision would likely render the entire proposal ineffective, for reasons as benign as acquiring a single secondary share of a portfolio company. As the SEC noted in 2011:

“In summary, the non-qualifying basket is designed to address commenters’ concerns regarding the occasional deviations from typical venture capital investing activity, inadvertent violations of the definitional criteria and flexibility to address evolving or future business practices. We considered these comments in light of our concerns that the exemption not be expanded beyond what we believe was the intent of Congress and that the definition not operate to foreclose investment funds from investment opportunities that would benefit investors but would not change the character of the fund. We concluded that a non-qualifying basket limit of 20 percent would provide the flexibility sought by many venture capital fund commenters while appropriately limiting the scope of the exemption” (footnotes omitted).⁸

Moreover, because of the extreme consequences of having even one inadvertent, non-qualifying investment, the allowance for unintended or insignificant deviations, or differences in interpretation, is absolutely necessary.

It is important to note that by far the most common nonqualifying investments for venture capital funds are secondary share acquisitions, or the purchase of portfolio company shares, from founders, angel investors, and others. Even though they are nonqualifying for purposes of the definition, secondary share acquisitions are in no way contrary to the goals of the Volcker Rule.

The activities which the Volcker Rule intends to prohibit are already covered by other aspects of the Volcker Rule, such as prohibitions on fund losses being covered by bank sponsors and proprietary trading activities.

⁷ Id. at 12-13

⁸ Id. at 135

As a practical matter, we believe that the exemption for qualifying venture capital funds would have very little utility without a non-qualifying basket. Neither the investing banking entity nor the venture capital fund would be willing to take the risk of non-compliance.

Clarification is Needed that Super 23A and Super 23B Do Not Apply to a Banking Entity That is Simply Investing in a Qualifying Venture Capital Fund

The proposed conditions for the proposed exclusion for qualifying venture capital funds are generally appropriate. However, it should be clarified that the conditions in paragraph (c)(16)(iv)(A) of the proposed regulations (relating to Super 23A and Super 23B and material conflicts of interest and material exposure) apply only to a banking entity that is acting as a sponsor, investment adviser, or commodity trading advisor to the qualifying venture capital fund, and not to a banking entity that is simply investing in the qualifying venture capital fund. This seems to be the intent. The notice of proposed rulemaking notes at page 67 that "... applying the requirements in section .14 would restrict a banking entity that sponsors or advises the fund from providing additional support or bailing out of the fund" (emphasis added). Question 48 also indicates that the conditions of paragraph (c)(16)(iv)(A) only apply to a "banking entity that sponsors or advises a qualifying venture capital fund" However, the proposed regulation could be read to apply to a banking entity that simply invests in the qualifying venture capital fund. This should be clarified.

Conclusion

We applaud the willingness of the Agencies to propose meaningful revisions that exclude qualifying venture capital funds from the covered fund definition. Thank you for the opportunity to provide input. We look forward to working with you to advance these impactful changes for the venture capital industry and entrepreneurial ecosystem. Please feel free to contact me at [REDACTED] or Charlotte Savercool, Director of Government Affairs at [REDACTED]

Sincerely,



Bobby Franklin
President and CEO