April 11, 2022

Ms. Vanessa A. Countryman
Secretary
U.S. Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

RE: File Ref. No. S7-06-22: Modernization of Beneficial Ownership Reporting

The National Venture Capital Association (NVCA) is pleased to comment on the proposed amendments to the filing deadlines for initial and amended beneficial ownership reports filed on Schedules 13D and 13G.

NVCA represents the U.S. venture capital (VC) and startup community. In 2021, VCs invested $332 billion in U.S. companies.[1] Our members provide the capital empowering the next generation of American companies that will fuel the economy of tomorrow. As the voice of the U.S. venture capital and startup community, NVCA advocates for public policy that supports the American entrepreneurial ecosystem.

Background on Venture Capital and its Economic Impact

Venture capital has enabled the United States to support its entrepreneurial talent by turning ideas and basic research into products and services that have transformed the world. Examples of venture-backed companies include Moderna, Genentech, Zoom, SpaceX, Ebay, and Amazon. Venture capitalists create partnerships with institutional investors to combine the capital held by pension funds, endowments, foundations, and others. VCs combine patient capital with their talent and expertise to make high-risk, long-term equity investments into innovative young companies.

Venture funds are generally partnerships that last ten to fifteen years, building investments far longer than any other asset class. VCs do not simply pick winners; they actively work with entrepreneurs to develop startups into successful companies. VCs work alongside the entrepreneurs, often taking board seats, providing strategic advice and counsel, opening their

[1] NVCA 2022 Yearbook, data provided by PitchBook; a*vailable at* https://nvca.org/pressreleases/startups-in-400-congressional-districts-received-vc-funding-last-year-globally-u-s-accounted-for-less-than-50-of-vc-dollars-and-40-of-deal-count/.

contact networks, and generally doing whatever they can to help their portfolio companies succeed.

A recent survey of companies backed by venture capital showed that four out of five respondents spent at least 70 percent of their total expenses on two activities: wages and compensation and research and development. This statistic highlights the extent to which venture capital finances job creation and innovation despite the risks inherent in funding companies expected to operate in revenue loss positions for years.[2]

Despite the long odds, venture capital is a major economic engine of job growth, spurs innovation, and creates new business models that change the world. New research found that employment at VC-backed companies between 1990 and 2020 grew 960 percent, whereas total private sector employment during that same period grew only 40 percent. VC-backed jobs are distributed broadly across the entire U.S. with 62.5 percent of VC-backed jobs outside the states of California, Massachusetts, and New York.[3] This illustrates a fundamental trend in the modern economy: the path to greater economic opportunity for American workers runs through technological progress and long-term investment.

Companies backed by venture capital are responsible for over half of companies that undergo initial public offerings (IPOs) each year (including 40 percent of climate technology companies),[4] around half of new FDA-approved cures,[5] and are causally responsible for the rise of one-fifth of the current largest 300 U.S. public companies.[6]

NVCA Comments on Proposed Amendments on Reporting Deadlines for Schedules 13D and 13G

Venture capital funds (VCFs) are a vehicle through which long-term investors like pension funds, university endowments and foundations seek returns to support their financial commitments. VCFs are advised by a venture capital professional that functions as the general partner (GP) of the limited partnership fund. Investment returns are realized by the fund and its LPs when an investee company goes public or is acquired. Therefore, VCFs could be—for a limited time—significant shareholders in publicly traded companies. While VCFs often only reduce their positions in newly public companies and are not involved in contests for control, they still become subject to Regulation 13D-G reporting requirements.

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[2] *Venture Capital Investment at Work*, American Startups and Job Growth Coalition (April 2021), *available at* https://nvca.org/venture-capital-investment-at-work/.

[3] *An Analysis of Employment Dynamics at Venture-Backed Companies Between 1990 and 2020*, NVCA, Venture Forward, and the University of North Carolina Kenan Institute of Private Enterprise (February 2022), *available at* https://nvca.org/wp-content/uploads/2022/02/Employment-Dynamics-at-Venture-Backed-Companies_FINAL.pdf

[4] *Initial Public Offerings: Updated Statistics*; Professor Jay Ritter, University of Florida; *available at* https://site.warrington.ufl.edu/ritter/files/IPO-Statistics.pdf.

[5] Silicon Valley Bank, *Trends in Healthcare Investments and Exits 2019* available at https://www.svb.com/globalassets/library/managedassets/pdfs/healthcare-report-2019-midyear.pdf.

[6] *The Economic Impact of Venture Capital: Evidence from Public Companies;* Illya A. Strebulaev, Stanford University Graduate School of Business and Will Gornall, University of British Columbia Sauder School of Business (July 2021); *available at* https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2681841.

Shortening of the Filing Deadlines Would Create an Excessive Administrative Burden on Venture Capital Funds While Adding No Useful Information to Shareholders, Target Companies, or the Market

While we question the need to reduce Regulation 13D-F filing deadlines for venture capital funds at all, our comments highlight the significant unnecessary costs and risks that would result from reduction of the deadline for filing Schedule 13D amendments to one business day.

As the Proposing Release notes, "change of control transactions" are the focus of Section 13(d) requirements.[7] The purpose of the statute is "to alert shareholders of a large accumulation of stock by a party that might potentially affect the company's control."[8] Section 13(d) reporting provides information for both target companies and shareholders regarding risk and potential rewards when a party is <u>increasing</u> its ownership stake in the company. As noted, VCFs are long-term investors in private companies, some of which become publicly traded. When an investee company goes public via an IPO, VCFs which often hold more than 5% of the voting shares of a newly public company are appropriately "exempt shareholders" under Section 13 because they have acquired those shares over the many preceding years.

However, VCFs' liquidity events can occur in many investee companies when they are acquired by or merge with a public company. In these cases, VCFs are required to file a Schedule 13D. While shortening this filing deadline from ten days to five will present compliance challenges, <u>the proposed requirement to file amendments to Schedule 13D filings in one business day could make filing accurate amendments nearly impossible</u>. This burden and the associated risks are far greater than any benefit to be gained from the information that a VCF is <u>reducing</u> its share ownership in the ordinary course of exiting investments and providing returns to LP investors.

Both the newly public company and sophisticated secondary market investors are fully aware that VCFs will comply with their LP investors' expectations and expeditiously reduce their positions in post-IPO companies. Furthermore, such information becomes public outside of Section 13(d) filings as many VCFs are required to file ownership disclosures under Section 16 two days after any transactions. Therefore, since these reductions in ownership are baked into market expectations, the information provided in Schedule 13D amendments filed by VCFs within a "one business day" deadline would be no more meaningful than Schedule 13D amendments filed under the current "promptly" standard. However, the risk of errors in such filings would be far greater. Furthermore, the risk that retail investors will misinterpret this information as bearing on the fundamentals of the newly public company would increase substantially.

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[7] <u>Release Nos. 33-11030; 34-94211; File No. S7-06-22: Modernization of Beneficial Ownership Reporting.</u> Pp. 15-16.

[8] Brief of The Securities Exchange Commission, *Amicus Curiae*, in support of the Plaintiff - Appellant, United States Court of Appeals for the Seventh Circuit, Case No. 04-1299, <u>Edelson v Ch'ien, etal</u>. at p.2; *see also*, pages 3-4. Available at https://www.sec.gov/litigation/briefs/edelson121504.pdf

The Proposed One-Business Day Deadline Would Impose a Substantial Compliance Burden on VCFs

The Regulation 13D-G filing regime is so complex[9] that most VCFs rely on outside law firms to complete the filings. In addition to this legal complexity, venture capital advisers face the factual complexity inherent in VC fund advisers acting as GPs to multiple affiliate funds, which may hold stock in the same newly public company. Advisers must compile the necessary data and report it to their outside law firm, which must then determine the filing requirements resulting from transactions in a company's stock by multiple funds. Additional complexity arises when companies go public with multiple classes of voting shares and/or with a thin public float.

Many venture-backed IPOs are structured in dual-class voting securities, *e.g.* a Class A common stock and convertible Class B shares with ten votes. This further complicates the reporting requirements of 13D in assessing filing requirements when other shareholders' high-vote Class B shares convert to 1-vote Class A shares, *i.e.*, the same class that the VCF holds. In these instances, when VCFs obtain information regarding these conversions,[10] Schedule 13D filers must recalculate their percentages, based on a larger denominator. This often triggers amendments even if a VCF has made no addition or subtraction to their position. This is one example of the practical requirements that would need to be met under the proposed one-day deadline by 13D filers.

The burden of providing the critical information for Regulation 13D-G Schedules amid a fast-changing post-IPO phase falls on the small administrative staff of venture firms. These teams have adapted over the years so that the current "promptly" standard—generally interpreted as two business days—provides just enough time for VC firms to accurately compile the necessary information and provide it to the outside firm that prepares the actual filings. A requirement to provide this information in time to meet a one-day deadline would be exceedingly burdensome and, given the number of data inputs from multiple funds, the issuer and public filings would jeopardize a fund's ability to ensure that its filings were accurate. Correcting amendments could often be required.

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[9] See *e.g.*, this SEC Staff guidance. "If the security holder acquires additional equity securities after the effective date of the Form 10, the security holder must report its entire holdings on Schedule 13D or evaluate whether it is eligible to rely on Rules 13d-1(b) or 13d-1(c) to continue to report on Schedule 13G if the most recent acquisition, when added to all other acquisitions of securities of the same class during the 12 months immediately preceding the date of the most recent acquisition, aggregates to more than two percent of the class of such securities. See Section 13(d)(6)(B) of the Exchange Act. This 12 month period will run back from the date of the acquisition to the time when the issuer was privately held if the acquisition occurs within 12 months after the effective date of the Form 10. If the security holder has acquired two percent or less during this period, the security holder simply may continue to rely on Rule 13d-1(d) and reflect the present acquisition in its Schedule 13G pursuant to Rule 13d-2(b). [Sep. 14, 2009]." Exchange Act Sections 13(d) and 13(g) and Regulation 13D-G Beneficial Ownership Reporting. Last Updated: July 14, 2016. **https://www.sec.gov/divisions/corpfin/guidance/reg13d-interp.htm**

[10] VCFs often do not receive information on these conversions until it is reported in the public company's 10Q or 10k filings.

The Proposed One-Business Day Deadline Could Result in Giving the Market Information That is Misleading, Especially to Retail Investors

Shortened Section 13D reporting deadlines would exacerbate market structure problems for investors in companies that go public with a "thin" public float, and consequent low liquidity. Under Regulation 13D-G, a simple VCF distribution to limited partners—a mere change in ownership, not a sale—can require the VCF to file an amendment reflecting a substantial decline in its ownership percentage. With the current deadline for filing amendments, VCFs can manage distribution of shares to LP investors in ways that generally avoid erroneously signaling a sell-off to the market. As noted, sophisticated investors understand the needs of VCFs to reduce their positions. However, the liquidity pools of thinly traded companies—sometimes dominated by retail investors—are especially sensitive to such inherently large changes. These amendments can be, and sometimes are misinterpreted by the market as a major investor sell-off. When this occurs, liquidity in the company's stock can dry up quickly and the stock price can plummet for no economic reason or fundamental of the company. This harms both the issuer and misinformed investors. Only short sellers can benefit.

The "promptly" standard provides just enough time for VCFs to manage these distributions and filings in ways that mitigate the risk of falsely signaling a sell-off. Application of the proposed one-day deadline to VCF Schedule 13D amendments would create a heightened risk of significant retail investor confusion and possible losses, as well as unwarranted losses of liquidity for newly public companies.

Conclusion

To summarize, the proposed shortening of the time to file amendments should not apply when a private fund is reporting a reduction in its share position because of:

- the routine nature of information that a venture capital fund is reducing its position,
- the risk of misinterpretation by retail investors,
- the risk of loss of liquidity for newly public companies,
- challenges for venture capital fund's ability to return value to their LP investors, and
- the administrative burden on venture capital funds.

NVCA would be pleased to work with the Commission on ways to amend the Proposal that could avoid the unnecessary consequences we have detailed.

Sincerely,

Bobby Franklin

Bobby Franklin
President & CEO