April 1, 2022

RE: File Ref. No. S7-20-21

The National Venture Capital Association ("NVCA") is pleased to comment on the proposed amendments to Rule 10b5-1 under the Securities Exchange Act of 1934 ("Proposed Amendments").[1]

NVCA represents the U.S. venture capital (VC) and startup community. In 2021, VCs invested $332 billion in U.S. companies.[2] 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 (VC) 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 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

[1] *Rule 10b5-1 and Insider Trading*, File No. S7,20-21 (December 15, 2021), *available at* https://www.sec.gov/rules/proposed/2022/33-11013.pdf.
[2] 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/.

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.[3]

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.[4] 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),[5] around half of new FDA-approved cures, and are causally responsible for the rise of one-fifth of the current largest 300 U.S. public companies.[6]

BACKGROUND ON PROPOSED CHANGES TO RULE 10B5-1

NVCA appreciates the SEC's policy goals of limiting potential marketing abuses by insiders in using rule 10b5-1 plans but seeks to highlight certain unintended consequences associated with the broad nature of the proposed rule.

The SEC's Proposed Amendments focus on trading arrangements by natural persons. We note in this regard that all the data underlying the SEC's rulemaking is related to sales and purchase plans and focuses on trading by officers and directors of shares that they beneficially own. We believe it is appropriate to limit the application of the Proposed Amendments to such sales or purchase plans. Our comments serve to (a) distinguish natural persons (i.e., officers and directors) from private adviser-managed funds like venture capital funds (collectively referred to herein as "VCFs"); and (b) highlight the critical importance of 10b5-1 disposition plans for VCFs and their limited partners ("LPs") (i.e., public and private pension funds, university endowments, foundations, insurance companies, and other financial institutions).

Through its adoption of Rule 10b5-1(c)(2), the SEC appropriately recognized the fundamental difference between trading arrangements by natural person insiders and disposition

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

[4] *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

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

plans adopted by VCFs.[7] Most importantly, unlike other market participants, including officers and directors, VCFs have effective safeguards in place to protect against the misuse of material nonpublic information ("MNPI"). All private fund advisers, both registered investment advisers (RIAs) and exempt reporting advisers (ERAs), are required under Section 204A of the Investment Advisers Act of 1940 (the "Advisers Act") to establish, maintain, and enforce written policies and procedures designed to prevent the misuse of MNPI by the investment adviser or any of its associated persons. Furthermore, under Section 206 of the Advisers Act, all private fund advisers are fiduciaries to their clients, owing a duty of care and loyalty, consistent with protection of these investors.[8] A central tenet in carrying out this fiduciary duty involves seeking best execution, both quantitative and qualitative, of client securities transactions.

The adoption of 10b5-1 plans by VCFs serve as an essential component in fulfilling their fiduciary duties by providing a structured and legally permissible method of transfering VCF assets to VCF limited partners. The proposed rules, if applied to VCFs, would deliver punitive measures that limit, at best, or eliminate, at worst, best execution for VCF LPs in the name of a solution to an MNPI problem that does not exist for VCFs. At their core, Rule 10b5-1 disposition plans adopted by VCFs invoke Section 204A of the Advisers Act as the underpinning of such VCF's reliance on the affirmative defense.

We request, therefore, that any final Release regarding these Proposed Amendments to Rule 10b5-1 will affirmatively avoid adding new, detrimental restrictions on the availability of the affirmative defense under Rule 10b5-1(c)(1) for VCF disposition plans that currently satisfy insider trading rules and the Adviser Act. Our comments are limited to explaining why we believe that VCF LPs and newly public companies would benefit from this clarity and would be harmed were the Proposed Amendments applied to VCFs.

HOW VCFs USE 10b5-1 PLANS

VCFs are often "insiders" based on holding more than 10% of the shares of a newly public company. Separately, VCF investment professionals, who serve as VCF general partners (individually a "GP" and collectively, "GPs") may also serve on the boards of investee companies, are "affiliates" of VCFs.

To fulfill their fiduciary obligations to VCF LPs in a manner consistent with their insider status and compliance with insider trading rules, VCF's that have GP board members generally use two types of Rule 10b5-1-compliant disposition plans: a stock distribution plan[9] (a plan that

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[7] Release, footnote 11, ["*See* Rule 10b5–1(c)(2) ….This affirmative defense is available to entities that demonstrate that the individual making the investment decision on behalf of the entity was not aware of material nonpublic information; and the entity had implemented reasonable policies and procedures to prevent insider trading."]
See also, Adopting Release for Rule 10b5-1 (August 2000) at Section III.A.2. "Provisions of Rule 10b5-1." ["The proposal included an additional affirmative defense available only to trading parties that are entities."] https://www.sec.gov/rules/final/33-7881.htm.

[8] See Commission Interpretation Regarding Standard of Conduct of Investment Advisers, SEC Release No. IA-5248 (June 5, 2019), 84 FR 33669 (www.sec.gov/rules/interp/2019/ia-5248.pdf). The Interpretation became effective on July 12, 2019.

[9] Under Rule 10b5-1 stock distribution plans the VCF distributes the issuer's securities held by the VCF to its VCF LPs, pro rata in accordance with such VCF LP's ownership interest in the underlying venture capital investment

allows the VCF via a broker that is administering such plan to distribute shares of an issuer to the VCF LPs) and sale plans (a plan that directs the broker to sell the issuer's shares held by the VCF and provide the cash proceeds to the VCF, which then allows the VCF to distribute such cash proceeds to its LPs). VCFs adhere to their insider trading policies and procedures when adopting either type of Rule 10b5-1 disposition plan, which includes, without limitation, (a) confirming with (i) the GP serving on the board of the issuer that the GP does not possess MNPI and (ii) the issuer that its trading window is open; and (b) consummating a disposition plan agreement with a third-party broker (e.g., Merrill Lynch, J.P. Morgan, etc.) that contains a cooling off period before such plan will become active. We believe that neither of these disposition plans, given the process and procedures they entail in connection with their adoption by VCFs, raise the concerns that underly these Proposed Amendments.

Our comments arise from the fact that VCFs, which hold a substantial long-term investment in IPO companies, could arguably be subject to these new limitations on the use of Rule 10b5-1 plans based on exposure to MNPI at the time the VCF seeks to sell, purchase, or distribute stock of the issuer on behalf of its VCF LPs. If so, several of the proposed new conditions would inhibit the ability of the VCFs to fulfill their fiduciary obligations to its VCF LPs. These inhibitions would create a conflict between the VCF GPs' ability to continue to serve on the boards of public companies, discussed below, and VCFs' duty to maximize VCF LP returns when a VCF seeks to exit its investment through distribution and/or sale of the issuer's securities. Therefore, these proposed limitations would be harmful if applied to VCFs, as well as their VCF LPs and public investee companies.

Any final Release regarding these Proposed Amendments to Rule 10b5-1 should clarify that the provisions applicable only to officers or directors do not apply to plans adopted and maintained by VCFs irrespective of any relationships that may exist between the VCF and the issuer, including any commercial arrangements, registration rights, governance rights (including director/observer positions), and the like.

However, if the Commission is proposing to apply these new limitations on Rule 10b5-1 disposition plans of VCFs whose GPs sit on the boards of public investee companies, we offer these further comments as to why it should not.

BOTH VCF LIMITED PARTNERS AND NEWLY PUBLIC COMPANIES WOULD BE NEGATIVELY IMPACTED IF THE PROPOSED AMENDMENTS RESTRICT VCF ACCESS TO THE RULE 10B5-1(C)(1) AFFIRMATIVE DEFENSE

As noted, the proposed conditions on the availability of the Rule 10b5-1 safe harbor would impact the ability of a VCF to conduct an orderly plan of sales and distributions, risking the ability of the VCF LPs to maximize the return on their long-term investments. In the alternative, faced with this impediment to fulfilling its fiduciary duty to its VCF LPs, the VCF

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fund, who then decide for themselves whether to sell or hold such issuer's securities. Therefore, the VCF does not sell or purchase the securities of the issuer. As the SEC's Proposed Amendments focus on trading by natural persons, they address only sales plans. It is not clear whether the intent is specifically to exclude stock distribution plans from the ambit of the Proposed Amendments, and there are certainly reasons why stock distributions to underlying VCF LPs (who then may themselves sell or hold) should be treated differently.

could relinquish its right to a board seat by having its GP or other representative resign prior to the IPO, which would leave a newly public company without a trusted advisor to help guide it to the next phase of the company's lifecycle, as well as harm VCF LPs because the VCF's GP or other representatives are not in a position to provide strategic advice and help the company maximize its value.

All Shareholders Benefit from Venture Capital Fund Representatives Remaining on a Company Board Once It Has Gone Public

One of the fundamental hallmarks of venture capital is active, not passive, engagement and oversight of their fund investments—most typically by way of taking a board seat in their portfolio companies.[10] In addition, many issuers have a strong desire to have VCF GPs continue to serve as board members post-IPO considering the knowledge, experience, and continuity that VCF GP directors provide. The same is true for VCF personnel who are asked to serve as directors in connection with post-IPO M&A and investment transactions, such as PIPEs. Having early investors remain on the board and therefore active in the company gives credibility to the company as it becomes public because it demonstrates that early investors believe in the long-term trajectory of the company. The public markets are incredibly challenging for many newly public companies and the continuity of maintaining venture investors on the company board is helpful as the company grows into and navigates the public markets.

VCF GPs are often needed by a company to remain on its board after the company goes public to continue to provide the oversight and guidance and to maximize value for all shareholders, including the VCFs and their VCF LPs. This is especially true of life science and biotechnology companies that tend to go public earlier in their life cycle. In addition to the unique support that these board members offer the issuer, they also help the issuer meet exchange-mandates for board independence and financial expertise. As these newly public companies mature, VCF board members usually are replaced as part of thoughtful board development and company maturation.

Rushing VCF board tenure or disincentivizing VCFs from holding board seats through severe limitations on liquidity planning would hurt issuers and management teams, denying them financial and operational expertise. If every VCF board member had to step down pre-IPO—as could be the consequence if the SEC's Proposed Amendments are implemented—the company would need to scramble to replace them, adding to the many challenges of the IPO process.

Venture Capital Funds Need to Use Rule 10b5-1-Compliant Disposition Plans to Exit Their Positions

The responsibilities of VCF board members are numerous and varied and include their crucial duties as investment advisers under Sections 204 and 206 of the Advisers Act. In order to provide their funds' limited partners liquidity in an organized, appropriate and legally compliant manner while the VCF GP remains on the board, VCFs use sales and distribution plans adopted

[10] The first time that "venture capital" as an asset class was characterized and codified was in 1986 when the DOL adopted the Plan Asset Regulation, in which it developed the concept of the "Venture Capital Operating Company" to ensure that fund sponsors lived up to their claims of active engagement with their portfolio companies.

under Rule 10b5-1. VCFs routinely adopt both stock sale and stock distribution plans under Rule 10b5-1 to provide liquidity to their VCF LPs. Section 204 of the Advisers Act provides the compliance roadmap for VCFs to adopt these plans when its supervised persons do not possess MNPI. Coupled with Section 206, the fiduciary duty to maximize returns for their limited partners makes such plans an indispensable tool for many VCFs and their supervised persons, who often find themselves caught between the dueling imperatives to remain on a public company's board of directors and the need to provide liquidity for their VCF LPs. VCFs manage this tension by careful compliance with several SEC rules.

By remaining on the board, venture capital firms methodically balance their fiduciary duties and securities law compliance obligations (both MNPI and Rule 144 volume limitations) when approaching the ability of their affiliated funds to exit the position in an orderly fashion over a reasonable time horizon. All VCFs, both RIAs and ERAs, pay special attention to Rule 204 and their firm's insider trading compliance programs. Such policies are designed to avoid not only violations of applicable law but even the appearance of inappropriate trading activity. Accordingly, even where VCFs affiliated with board directors are not explicitly covered by an issuer's insider trading policy, industry practice is that the VCF will take into account the issuer's trading windows and black-out periods when seeking liquidity.

The typical trading window begins 1 to 2 trading days after the previous quarter's earnings release and ends approximately 1 to 10 days prior to the end of the next fiscal quarter, resulting in a total annual period of only about six weeks when trades might be permitted—absent any other MNPI during such periods. Adding the volume limitations imposed by Rule 144, the actual opportunities to meaningfully exit a position are exceedingly rare for a VCF with a VCF representative serving as a director on the board. Thus, it has become a common practice for VCFs with a representative on a company's Board to adopt Rule 10b5-1 disposition plans to structure an orderly exit. This is typically done through laddered price targets (representing anticipated future fair value, as well as more conservative price targets below that and "stretch goals").

<u>REQUESTED RELIEF SHOULD NEW RESTRICTIONS APPLY TO INVESTMENT FUNDS AFFILIATED WITH A BOARD MEMBER</u>

Mandatory Cooling-off Period

The SEC has proposed a mandatory 120-day "cooling-off" period following adoption or amendment of a Rule 10b5-1 sales plan before trading under such plan may begin or recommence. In the Release, this mandatory cooling off period appears applicable only to directors, officers, and issuers. If the SEC intends to exclude VCFs affiliated with board members from this provision, we request that be made explicit. If it is not, we request that VCFs be subject to a cooling off period that is the shorter of 60 days or the commencement of the issuer's next open trading window. This is fair because other market participants who implement Rule 10b5-1 sales plans are not under a fiduciary obligation to exit the position and imposing a long cooling off period merely serves to limit liquidity options for VCFs and VCF limited partners. As described above, VCFs have established policies and procedures, implemented under Section 204A of the Advisers Act, that require the VCF personnel to confirm they do not possess MNPI (and this would be in addition to the Proposed Amendments requiring certification regarding MNPI). VCFs are already subject to required policies and procedures, and furthermore, must weigh both the dimensions of time and price to obtain the best returns for their limited partners.

Once a company has gone public, investors generally expect the fund sponsor to begin exiting the position as expeditiously as possible, consistent with obtaining good value for the position. As VCFs are already subject to at least a six-month lock-up period following the IPO, the Proposed Amendments would, in a best case, push any opportunity to meet LPs' liquidity expectations to nearly a year after the issuer's IPO. Furthermore, once they have satisfied the initial cooling off period, VCFs should be permitted to establish a "rolling" plan with no new cooling off period to adopt a successor (as opposed to overlapping) plan to meet the liquidity needs of the LPs.

Overlapping Plans

The SEC proposes to make the Rule 10b5-1 affirmative defense unavailable for trades by a person who has established multiple, overlapping plans for securities of the same class. Here, too, this should be limited to directors, officers and issuers and should not cover VCFs affiliated with such individuals. The SEC provided in its request for comment scenarios where plans are appropriate (see paragraphs 13 and 14 on page 23). VCFs adopt multiple disposition plans so they can capitalize on multiple value opportunities consistent with performance expectations while moderating volume accordingly. They do not do this for hedging. As noted above, Rule 144 can severely limit the number of shares that can be sold by a VCF, either pursuant to a Rule 10b5-1 sales plan or in the open market. Therefore, VCFs may rely on both Rule 10b5-1 sales and stock distribution plans to satisfy the liquidity needs of VCF limited partners, who are often not subject to the same volume limitations applicable to VCFs.

A limitation on the number and structure of disposition plans also would make Rule 10b5-1 disposition plans simply unavailable for many VCFs, who often have multiple affiliated venture capital funds invested in the same issuer or have established Rule 10b5-1 disposition plans with different objectives and liquidity targets or needs that may favor different approaches to both sales or distributions-in-kind of the public shares. If each VCF that manages multiple venture capital funds were to be treated as a single "person," the VCF would effectively be unable to utilize the Rule 10b5-1 disposition plan, as its own fiduciary and contractual obligations to its funds would render it able to establish a plan on behalf of only one of its venture capital funds and not its other funds that hold the same security. We do not believe this is the SEC's intent, and respectfully request that this be clarified in the final rule.

Single-trade Plans

The SEC seeks to make Rule 10b5-1 trading plans available only for one single-trade plan during any 12-month period. The Proposed Amendments introduce significant ambiguity regarding the way that VCFs execute Rule 10b5-1 disposition plans, causing confusion for both plan adopters and administrators (i.e., brokers who facilitate the transactions under a Rule 10b5-1 plan). For example, VCFs may implement a Rule 10b5-1 trading plan that contains instructions for the broker to execute a block trade at a single price. Depending on the plan attributes (e.g., minimum block size) and how the block trade is ultimately executed by the broker (without any involvement, influence or oversight from the VCF), it is possible that this Rule 10b5-1 trading plan to execute a block trade could be deemed either a single trade or a multi-trade plan. For example, if the entire block of shares is sold at one price (either in a single transaction or multiple trades to more than one buyer) and the VCF reports the sales on a single line on its required Form 4 filing, does that count against the single trade plan? Does the VCF now need to bifurcate a block trade plan or will a construction of a plan with one price trigger even if it includes a single share (and executes more than one block trade) be constructively deemed to be a single trade plan? A clear interpretation of any such amendment will be critical to institutional investment funds' understanding of how plans can be constructed.

Public Disclosure

Under the proposed rulemaking, issuers would be required to make quarterly disclosure of all plan adoptions, amendments and terminations by directors and officers, including those that are non-Rule 10b5-1 trading arrangements. While we agree on the importance of disclosure that is fundamental to the integrity of the market, there are potentially negative ramifications if this requirement were extended to VCFs. The current rulemaking does not expressly exclude trading plans adopted by VCFs under the increased disclosure requirements. If issuers are required to disclose VCF Rule 10b5-1 disposition plans, even adoption of a plan by a VCF could arm predatory traders with market-sensitive information that they could use to drive down the price of the issuer's stock or front-run the disposition by other investors. Furthermore, this information already becomes publicly available through Form 4 filings which indicate that any such disposition was made pursuant to a Rule 10b5-1 disposition plan.

We appreciate the Commission's consideration of our comments on this proposal and would be pleased to provide any additional information that would be helpful.