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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-2018-0010
RIN 1557-AE27

Federal Reserve System
regs.comments@federalreserve.gov
12 CFR Part 248
Docket No. R-1608
RIN 7100-AF 06

Federal Deposit Insurance Corporation
comments@FDIC.gov
12 CFR Part 351
RIN 3064-AE67

Securities and Exchange Commission
rule-comments@sec.gov
17 CFR Part 255
Release no. BHCA-3; File no. S7-14-18
RIN 3235-AM10

Commodity Futures Trading Commission
https://comments.cftc.gov
17 CFR Part 75
RIN 3038-AE72

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, Chairman Powell, Chair McWilliams, Chairman Clayton, and Chairman Giancarlo,

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

Our comments specifically focus on the Agencies' request for responses to various questions regarding the definition of "covered fund," including congressional intent and the discretion afforded the Agencies to accomplish the objectives of the Volcker Rule without creating collateral damage. We appreciate the opportunity to discuss the ways in which we believe that defining "covered funds" to include venture capital funds is not what Congress intended; how this over inclusive definition has created significant adverse economic consequences which Congress was rightly concerned about during consideration of the legislation; and how existing authority allows the Agencies to tailor the regulations to correct this issue and more accurately reflect congressional intent.

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

Venture capital investors 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.

New Company Formation and Growth Fuels the American Economy

Young companies, many of which are supported by venture capital investment and mentorship, create an average of three million new jobs a year and have been responsible for almost all net new job creation in the U.S. in the last forty years.[1] From Google to Genentech, startup entrepreneurs have fueled economic growth and expanded opportunities for American workers. A recent study by Stanford University demonstrated that nearly half of all companies that went public from 1974 to 2015 have been backed by venture capital. These venture-backed companies have also been responsible for 85 percent of total R&D investment undertaken by all companies that have gone public during this time.[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.

Congress Provided Regulatory Agencies' Broad Authority to Define Covered Funds Appropriately

The Volcker Rule statute prohibits banks and their affiliates from investing in or sponsoring a "hedge fund or a private equity fund," with certain exceptions. Congress defined "hedge fund and private equity fund" to mean an issuer that would be an investment company

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[1] https://www.kauffman.org/what-we-do/resources/entrepreneurship-policy-digest/the-importance-of-young-firms-for-economic-growth

[2] https://www.gsb.stanford.edu/insights/how-much-does-venture-capital-drive-us-economy

but for sections 3(c)(1) or 3(c)(7) of the Investment Company Act of 1940, **or such similar funds as the Agencies may by rule determine.** The italicized language provides the Agencies with the regulatory authority to tailor the covered funds definition to fulfill the legislative intent and purpose of the Volcker Rule in the least intrusive manner. One of the primary policy objectives of the Volcker Rule—to protect against systemically risky trading—may be applicable to certain private funds which operate at significant scale or whose activities expose the fund's sponsors to excessive risk. It is not, however, applicable to all private funds as defined under the Investment Company Act and is certainly not applicable to venture funds for the reasons set forth below.

Congress also provided additional discretionary authority to the Agencies to effectively tailor the definition of covered funds under Section 619(d)(1)(J), which authorizes the Agencies to permit banking entities to engage in activity otherwise prohibited by the Volcker Rule if the activity "would promote and protect the safety and soundness of the banking entity and the financial stability of the United States." As discussed below, Congress viewed venture capital as a prime candidate to be a beneficiary of this exemptive authority.

Congress Was Clear in their Intent to Exempt Venture Capital

The congressional record includes a number of instances where congressional intent is explicitly stated regarding the desire of Congress to exempt investments by banking entities into venture capital funds from the covered funds rule. In the below colloquy, Senator Chris Dodd (D-CT), one of the authors and namesakes of the Act which codified the Volcker Rule, could not have been more clear in his expectation that the authority provided by Congress be used to protect investment by banking entities into venture capital funds:

> Mrs. BOXER… I know the chairman recognizes, as we all do, the crucial and unique role that venture capital plays in spurring innovation, creating jobs and growing companies. I also know the authors of this bill do not intend the Volcker rule to cut off sources of capital for America's technology startups, particularly in this difficult economy. Section 619 explicitly exempts small business investment companies from the rule, and because these companies often provide venture capital investment, I believe the intent of the rule is not to harm venture capital investment.
>
> Is my understanding correct?
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> Mr. DODD. Mr. President, I thank my friend, the Senator from California, for her support and for all the work we have done together on this important issue. Her understanding is correct.
>
> The purpose of the Volcker rule is to eliminate excessive risk taking activities by banks and their affiliates while at the same time preserving safe, sound investment activities that serve the public interest. It prohibits proprietary trading and limits bank investment

> in hedge funds and private equity for that reason. But properly conducted venture capital investment will not cause the harms at which the Volcker rule is directed. In the event that properly conducted venture capital investment is excessively restricted by the provisions of section 619, I would expect the appropriate Federal regulators to exempt it using their authority under section 619(J). [3]

Another example that the Volcker Rule's prohibition on bank investment into venture capital funds goes against congressional intent is the explicit exemption for Small Business Investment Companies (SBICs) from the rule. These investment firms bear similarities to the venture capital model in that both invest in small and emerging companies. SBICs can borrow from the government and tend to use more debt, but neither factor makes them less systemically risky than venture capital funds. Yet SBICs can continue to raise capital from financial institutions while venture capital funds cannot.

Harmful Economic Consequences from Prohibition of Bank Investment into Venture Capital

The Volcker Rule's prohibition on investment by banking entities into venture capital funds is contrary to congressional intent, a clear representation of overreach, and has no measurable policy benefit. The general mechanics of the industry are quite straightforward: make long-term patient equity investments into startups and emerging growth companies and work alongside the portfolio companies to build them into successful firms. There is nothing exotic or complicated about these investments, nor is there much complexity in the structure of venture capital partnerships. The venture capital industry is also far smaller than many realize, with approximately $300 billion under management. In fact, the combined assets of the two largest hedge funds add up to the size of all assets under management in the entire venture capital industry.[4] Barring investment into venture capital funds does **nothing** to accomplish the underlying objectives of reducing systemic risk in the financial system, yet these funds—which would otherwise be using this capital to support entrepreneurs and build new companies—are victims nonetheless.

While providing no public policy benefit, the Volcker Rule prohibition of investment by banking entities into venture capital funds has harmful consequences for entrepreneurial capital formation and the U.S. economy. The loss of banking entities as limited partners in VC 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.[5] To put this in perspective, removing the three most significant states for venture capital activity (CA, NY, MA), the median size venture capital fund in the U.S. is roughly $28 million.[6] This size fund is often too small for the

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[3] 156 Cong. Rec. S5904-S5905 (July 15, 2010) (colloquy between Senator Dodd and Senator Boxer stating that the statute's prohibitions should not extend to venture capital funds).

[4] Source: NVCA 2017 Yearbook, Data Provided by PitchBook; hedge fund websites

[5] Limited partners are investors into venture funds and other alternative assets funds.

[6] Source: PitchBook

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 a number of small and regional venture capital funds. By limiting the pool of potential limited partner investors into venture capital funds, the Volcker Rule has unwittingly reduced the amount of capital available to American entrepreneurs. Perhaps most critical among these are entrepreneurs in emerging ecosystems, many of which 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 who 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've heard stories of 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. A 2012 letter to the Department of the Treasury from Silicon Valley Bank, one of the premier banks providing services to participants in the entrepreneurial ecosystem across the country, noted:

"Nationally, banks provide 7% of the dollars invested in venture capital funds. It is clear that banks contribute a higher percentage of venture capital investment in areas outside the traditional venture capital centers, such as Silicon Valley. However, even using the very conservative 7% figure, banks contributed approximately $133 million to venture funds in the industrial Midwest in 2011. If banks contribute 13% of venture funding in the upper Midwest, as described in the attached letters, the amount *of bank investment rises to $247 million in 2011."*

Conversations with NVCA members outside of the traditional venture capital centers lead us to believe Silicon Valley Bank's estimates paint an accurate, even conservative, view of the impact that the Volcker Rule has had on venture capital in the regions most in need of capital formation.

With these consequences in mind, and no discernable public policy benefit to keeping the prohibition in place, we implore the Agencies to use the authority provided to them in the statute and allow banking entities to once again invest in venture capital funds.

Proposals to Exempt Investment in Venture Capital Funds from the Volcker Rule

As noted above, the congressional record makes clear that the bill's sponsors had no intention of impacting venture capital and expected the Agencies to exclude venture capital investment during the rulemaking process using the discretionary authority provided them. It is unfortunate that despite no mandate to do so—indeed, despite explicit congressional support for excluding venture capital funds—the final rule included venture capital in the covered funds

prohibition. It is our hope that the intervening years have demonstrated that forcing venture capital into the covered funds prohibition was a significant regulatory overreach with no material public policy benefit. We are encouraged by the Agencies' efforts to review this issue and hope the decision this time will be more in line with the spirit and the letter of the law.

We recommend two ways the Agencies could fix this problem: first, a very narrow solution specific to venture capital; and second, a broader solution that would create parity between permissible direct investing by banking entities and indirect investing by banking entities through funds.

Exempt Venture Capital Investment from the Covered Funds Prohibition

Specific to the impact of the Volcker Rule on the entrepreneurial ecosystem, NVCA proposes that the Agencies use the authority granted by Congress to approve a clear permission for banking entities to invest in venture capital funds. As a starting point, the Agencies could look to the narrow definition of a venture capital fund that is included in rule 203(l)-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. This definition defines a venture capital fund as a private fund that meets the following:

A) Represents itself as pursuing a venture capital strategy to its investors and prospective investors;
B) Holds no more than 20 percent of its aggregate capital contributions and uncalled committed capital in assets (other than short-term holdings) that are not qualifying investments;
C) Does not borrow, issue debt obligations, provide guarantees or otherwise incur leverage, other than limited short-term borrowing;
D) Does not offer its investors redemption or other similar liquidity rights except in extraordinary circumstances; and
E) Is not registered under the Investment Company Act and has not elected to be treated as a business development company.

Use of this definition would be consistent with either discretionary authority noted above.

Create Regulatory Parity between Permissible Direct Investing and Indirect Investing Through Funds

The Agencies could also improve entrepreneurial capital formation by allowing banking entities to invest in private funds, including venture capital and other funds, that do not engage in prohibited proprietary trading activities, the core activity with which Congress was concerned in enacting the Volcker Rule. This approach would once again allow banking entities to invest in venture capital funds that make long-term investments in companies.

Currently, Financial Holding Companies and other banking entities can use their authority, which has existed for almost two decades, to make so-called "merchant banking

investments" to provide direct equity investments in startups and other companies. The authority to make such investments was not altered by Congress in enacting the Volcker Rule. Under the Agencies' implementing regulations, those same banks cannot, however, invest in funds whose sole purpose is to provide long-term equity investments in startups and other companies, a strange and indefensible policy anomaly.

There are a number of risk-control advantages for banks investing in VC funds that engage in long-term investment activities, including gaining a greater understanding of business formation and growth in the region, diversifying risk in startup investment, and tapping into the expertise of the VCs who run the fund to have a greater chance of success.

There are public policy advantages to investment by banking entities in VC funds as well. This type of investment encourages greater understanding, coordination, and efficiency across a regional economy, and does so while de-risking startup investment activities. As noted by Chairman Dodd, this is precisely the reason that Congress intentionally included discretionary authority in the statute.

Conclusion

For the reasons encompassed above, we believe that defining "covered funds" to include venture capital funds is not what Congress intended and existing authority allows the Agencies to tailor the regulations to correct this issue and more accurately reflect congressional intent. As is the case in too many policy debates, entrepreneurs and their investors have become the unintentional victims of the Volcker Rule. We applaud the willingness of the Agencies to review this important issue, and look forward to working with you to lift the prohibition of financial institution investment into venture capital funds. Please feel free to contact me at (202) 864-5925 or bfranklin@nvca.org or Charlotte Savercool, Director of Government Affairs at (202) 864-5928 or csavercool@nvca.org.

Sincerely,

Bobby Franklin
President and CEO