



California Corporate & Securities Law

Defining “Venture Capital Fund” Is “No Small Task”

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Today, the Securities and Exchange Commission proposed a definition of “venture capital fund” for purposes of the new exemption from investment adviser registration under the Investment Advisers Act of 1940. This new exemption was created by Section 407 of the Dodd–Frank Wall Street Reform and Consumer Protection Act.

Congress gave the SEC one year to issue final rules defining “venture capital fund”. It is important that the SEC adopt final rules as soon as possible because this will help California and other states conform to the new federal registration regime. I addressed some of the issues for California in these posts on [July 29](#), [August 2](#), and [August 11](#).

Chairman Schapiro explained the focus of the SEC’s proposed definition in her [opening remarks](#) and noted that defining “venture capital fund” is “no small task”:

Importantly, our proposed definition distinguishes venture capital funds from hedge funds and private equity funds by focusing on the lack of leverage of venture capital funds and the non–public, start–up nature of the companies in which they invest. The rule therefore focuses on the provision of capital for the operating and expansion of start–up businesses, rather than buying out prior investors. This is, however, a challenging line–drawing exercise and I look forward to commenters’ views on whether we can refine our efforts.

Although the text of the proposed definition is not available at the time of this post, the SEC in its [press release](#) noted that a venture capital fund is a private fund that:

- *Represents itself to investors as being a venture capital fund.*
- *Only invests in equity securities of private operating companies to provide primarily operating or business expansion capital (not to buy out other investors), U.S. Treasury securities with a remaining maturity of 60 days or less, or cash.*
- *Is not leveraged and its portfolio companies may not borrow in connection with the fund’s investment.*
- *Offers to provide a significant degree of managerial assistance, or controls its portfolio companies.*

Please contact [Keith Paul Bishop](#) at Allen Matkins for more information kbishop@allenmatkins.com

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- *Does not offer redemption rights to its investors*

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