

SEC Rulemaking Update Qualifying Venture Capital Funds Inflation Adjustment Final Rulemaking

On August 21, 2024, the Securities and Exchange Commission (SEC) adopted a rule that adjusts for inflation the dollar threshold used in defining a “qualifying venture capital fund” under the Investment Company Act of 1940 (“Investment Company Act”). The final rule also allows the SEC to adjust for inflation this threshold amount by order every five years and specifies how those adjustments will be determined.

Section 3(a) of the Investment Company Act defines the term “investment company” for purposes of the Act, and Section 3(c)(1) provides certain exclusions from that definition. Section 504 of the Economic Growth, Regulatory Relief, and Consumer Protection Act of 2018 (“EGRRCPA”) created a new exemption from registration under Section 3(c)(1) of the Company Act for “qualifying venture capital funds.” Section 3(c)(1)(C) defines a “qualifying venture capital fund” as “a venture capital fund that has not more than \$10,000,000 in aggregate capital contributions and uncalled committed capital.”

The exemption currently allows qualifying venture capital funds to have up to 250 “beneficial owners” or investors (rather than 100) who are accredited investors as long as the fund has no more than \$10 million in commitments. This allowed so-called micro venture capital funds the ability to raise money from a larger number of investors, which was expected to have a positive impact on start-up and emerging growth companies that receive funding from angel investors. The EGRRCPA directed the SEC to index the \$10 million limitation for inflation every five years beginning from a measurement date selected by the SEC.

Accordingly, in February 2024, the SEC proposed new rule 3c-7 under the Investment Company Act to implement these requirements. Substantially as proposed, final rule 3c-7(a) uses December 2023 as the current measurement date and adjusts the dollar threshold to \$12 million based on the Personal Consumption Expenditures Chain-Type Price Index (PCE Index), which is published by the Department of Commerce. Going forward, following November 1, 2029 (i.e., approximately five years after the effective date of this rule), the SEC will issue an order every five years adjusting the dollar threshold for inflation utilizing the PCE Index or any successor index, as the inflation benchmark.

The SEC noted that the PCE Index is often used as an indicator of inflation in the personal sector of the U.S. economy. The SEC considered other inflation adjustment benchmarks, including the Consumer Price Index for all Urban Consumers (CPIU), which has been required by certain statutes to conduct certain inflation adjustments. For the specific 5-year period considered, the two indexes yielded the same \$2,000,000 increase from \$10,000,000 to \$12,000,000 after rounding to the nearest \$1,000,000. However, the SEC proposed the PCE Index for future inflation adjustments because the methodology and scope of the PCE Index (which considers both urban and rural households and expenditures made on their behalf by third parties) reflects a broad sector of the U.S. economy.

Final rule 3c-7 was effective September 30, 2024. Reliance on section 3(c)(1) is voluntary and a fund that newly meets the definition of a qualifying venture capital fund under rule 3c-7 can choose whether to rely on the exclusion provided by section 3(c)(1) for such funds. Most Standish Compliance clients do not meet the qualifying venture capital fund definition and will not be impacted by this rulemaking. However, for micro venture capital funds, the current and future inflation adjustments will be meaningful. Following is a link to the adopting release.

See Adopting Release - <https://www.sec.gov/files/rules/final/2024/ic-35305.pdf>