

SUBMISSION

Date: 18 September 2019
To: Ministry of Business, Innovation and Employment
From: Bruno Bordignon, Avid.legal
Ref: **POLICY STATEMENT ON THE VENTURE CAPITAL FUND ACT**

OUR CONTEXT

1. Avid.legal is a specialist corporate law firm specialising in technology and assisting high-growth companies. In terms of relevant experience:
 - (a) Avid.legal regularly acts for high-growth companies raising capital (particularly from the Series A round onwards – this funding comes from number of sources including local Angel investors, local and international venture capital firms, international venture debt firms, local and international corporate venture funds and other strategic investors.
 - (b) On the capital side, Avid.legal also acts for Angel groups/clubs, venture capital firms (local), incubators and accelerator organisations.
 - (c) We also sponsor of the Angel Association and regularly contribute to promoting best practice on investment terms and practices.

INTRODUCTION

2. This memorandum is in response for submissions to the draft policy statement on the proposed Venture Capital Fund Act (the **Draft Policy Statement**).
3. We have only made submissions on points or topics where we hold a particular view or where we consider that the Draft Policy Statement has not applied sufficient attention in our view.
4. Our submissions do not purport to represent the views of our clients.

SUBMISSIONS

5. Our submissions are set out in the table in Schedule 1. We have not sought to prioritise the points we have made, but rather have raised them in the order that they broadly arise in the Draft Policy Statement.

Yours faithfully

AVID.LEGAL



Bruno Bordignon

Director

E-Mail: s9(2)(a)

SCHEDULE 1 – SUBMISSIONS

OBJECTIVES	
Purpose – increasing private investment	<p>While the purpose has been pulled from s24 of the proposed Venture Capital Fund Act, it doesn't place sufficient emphasis in our view, on increasing the amount of private investment in venture capital as an asset class at a local level in New Zealand. Without it, the matching capital will not be available to deploy the Venture Capital Fund, and without it, the long-term venture capital market is likely to be anaemic.</p> <p>New Zealander's are historically known for their love of investing in property as an asset class, however until and unless this mind-set is broadened, the existence of the Venture Capital Fund will only be a temporary solution.</p> <p>Adjusting the scope of the purpose in our view, would also then require the Guardians and NZVIF to consider how decisions that they make help or hinder this purpose to draw private investment into the venture capital market. Outside of mandated legislative intervention, this could manifest itself in differing fee structures for managers, different fund structures for institutional investors, etc.</p>
Purpose – increasing company capability	<p>The Objectives focus on the increased capability of the venture fund managers, however we consider it should extend and also apply (with almost as much equal weight) to increasing strategic and operational capability of the companies obtaining funding.</p> <p>A critical element of capital strategy in our view is having the right team to deploy that capital in the most efficient and sensible way. While the start-up ecosystem has made significant progress in sharing its learning, in our view it is still extremely difficult to find experienced executive team members with capabilities of growing companies beyond \$5M annual revenue and onwards. While this capability is growing (and will continue to do so over time), we think capability building should also be accelerated as part of the wider Venture Capital fund framework.</p>
DEFINITIONS	
Follow-on Investment	<p>The definition doesn't specifically provide that the existing portfolio Entity must be one that has previously been made by the Underlying Fund from funds that were co-mingled with VCF interests. Given the breadth of the scope of how Underlying Funds may be structured (particular in respect of offshore side-car funds) the definition shouldn't be wide enough to capture other investments made by an Underlying Fund, in which the VCF has not invested in.</p>

Foreign Fund Investment	Add to the first sentence words to the effect: <i>alongside on a matching basis with the other committed capital of the Foreign Fund (in such a way to meet the private capital requirements of Policy 5)</i> . At present the definition only obliges the Foreign Fund to deploy the VCF committed capital into New Zealand Entities.
New Zealand Connection	<p>Depending ultimately on how this definition is used in the context of matching capital, we consider the threshold is too low. The second limb requiring a senior investment professional does not add sufficient capability, participation and ultimately benefit into developing the venture capital market in New Zealand.</p> <p>We consider a more appropriate test should link to the benefit that the Fund brings to New Zealand. This could then be assessed by Guardians/NZVIF at the relevant time, and those conditions can also form undertakings as part of the contractual framework for the Funds and Guardians/NZVIF.</p>
New Zealand Entity	<p>We would like to consider this definition in greater depth over time, however in the limited time provided for submissions, we suggest that in addition to the existing bullet points, that a new one is added as follows:</p> <ul style="list-style-type: none"> • <i>the Entity qualifies for the venture capital exemption under the Foreign Investment Fund rules.</i> <p>This has the benefit of enabling an Underlying Fund to invest in a New Zealand entity that has previously undertaken a “flip” into another jurisdiction.</p>
Series A and B Capital	While we support the broad definition adopted, we do believe that either in this definition or elsewhere in the Draft Policy Statement there should be an obligation on Guardians to assess the mix of investments as against Series A and Series B to ensure that the purpose of the VCF is being met. The primary premise of the initiative is to fill a Series A funding gap, and this should not be lost through the aggregating of references to Series A and B Capital rounds.
Series C and C+ Capital	<p>This definition leaves an very broad discretion on the placement of up to 25% of the overall allocation, however we don't think is intended to cover emergency/rescue style funding, private-equity investments or takeovers. Consider including clearer parameters on what funding rounds are sought to be covered in this definition.</p> <p>Similarly from a policy perspective, we think you should consider in what instances these investments may be into listed entities.</p>
POLICIES	

Policy 2: NZ Fund Investments	<p>While we understand the rationale of Policy 2(iii), it is the one potentially at odds with the purpose of the VCF. With this in mind, we would prefer to see a statement in the policy that any exercise of the right is subject to Guardians being satisfied it satisfies the wider purpose of the VCF. This should be a non-delegable position in respect of Guardians.</p> <p>For clarity, we are not envisaging Guardians have oversight directly for this in application, however should any Underlying Fund propose to structure itself in a way that enables Policy 2(iii) to apply, that such Underlying Fund be approved by Guardians.</p>
Policy 3: Foreign Fund Investments	<p>It should be made clear that the 75% of the aggregate investable capital of the NZ Foreign Fund must be allocated for investment in Series A and B Capital for New Entities. This ties back into the definition a Foreign Fund Investment which requires the VCF interests to be invested only in New Zealand Entities.</p> <p>Separately, to the extent our previous comments on the Foreign Investment Fund definition are not adopted, it should be made clear that the corresponding matching capital to the NZ Foreign Fund Capital must also be deployed alongside.</p>
Policy 4: Co-investment with Underlying Funds	<p>This should be made clear that any such co-investment is at the invitation of the Underlying Fund and should not form some separate mandated requirement as part of the contractual framework between the Fund and Guardians/NZVIF. The motives for Co-investment should be around return on investment and should not be at the expense of the Underlying Fund fully exercising the opportunity to maximise its return.</p>
Policy 5: Private capital requirements	<p>We would prefer to see Option #2 as we see this more aligned to creating a sustainable venture capital market in New Zealand.</p>
Policy 6: Government expectations	<p>The opening statement confuses the issue of capital committed as against capital deployed and should be clarified. We would favour the view that in the Initial Investment Period, VCF must have simply committed capital to Underlying Funds and Foreign Funds. Placing arbitrary deployment timelines could result in sub-standard investment decisions being made. There are other levers in the structure of the contractual framework for the Underlying Funds and Foreign Funds to incentivise deployment in the desired ways (principally through their fee structures).</p> <p>Separately, we think it should be noted that Guardians may elect to commit VCF capital that may have previously been earmarked for Co-investment outside of the "Initial Investment Period". Ultimately this should be a decision of Guardians at the relevant time. However should Guardians determine that committing capital into an Underlying Fund outside of the "Initial Investment Period" is more desirable than available Co-investment opportunities, it should have the ability to commit accordingly. This becomes even more relevant should you expressly state that Co-investment may only occur at the invitation of the Underlying Fund.</p>



Policy 8: Return of funds	While a minimum period is only expressed the policy contains no statement around the VCF being potentially evergreen. We consider that a statement to this effect would be a better starting place rather than stating an expectation of return of funds but not within 15 years. This also caters for the opportunity of non-traditional venture capital models to be introduced over time.
IMPLEMENTATION	
We would prefer to see an express statement that the purpose of the VCF must be considered by the Guardians in applying the policies, and also that the application of the policies at a principal level cannot be delegated by Guardians. In both instances it is clear that parliament see an active role of Guardians in solving the Series A and B gap, and in bring confidence to the market that an asset manager of its capabilities is applying its thinking to the issue.	

Released under the Official Information Act 1982