Proskauer

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July 17, 2026

By Email

Department of Financial Protection and Innovation
Commissioner Khalil "KC" Mohseni
651 Bannon Street
Suite 300
Sacramento, CA 95811

Re: PRO 01-26 – Fair Investment Practices by Venture Capital Companies

Dear Commissioner Mohseni:

We respectfully submit the comments below in response to the Invitation for Comments on Proposed Rulemaking Under the Fair Investment Practices by Venture Capital Companies Law, File No. PRO 01-26 (the "Invitation"), issued by the California Department of Financial Protection and Innovation ("DFPI") regarding the implementing regulations for the Fair Investment Practices by Venture Capital Companies Law, Corp. Code, § 27500 et seq. (the "FIPVCC").

Proskauer Rose LLP is a global law firm with more than 900 lawyers in key financial centers in the United States, Europe, South America and Asia. Our Band 1-ranked Labor and Employment routinely advises companies on challenging employment law topics, including matters relating to the collection of sensitive demographic information such as the information required by the FIPVCC. Our firm also has one of the largest private funds practices in the legal industry, with more than 250 lawyers representing more than 550 investment fund sponsors. Our practice is not concentrated in any one fund strategy, asset class or market segment, but instead spans all major private fund strategies and asset classes. Among our client base are several of the most prominent venture capital sponsors in the industry, as well as numerous other sponsors of funds that would be "covered entities" under the FIPVCC even though they do not hold themselves out as pursuing a venture strategy. Our comments are informed by our experience working with these clients, including issues we observed as firms prepared for the first FIPVCC reporting deadline before DFPI suspended implementation and enforcement pending this rulemaking. Though our comments draw from our experience and we have discussed them with certain clients, the comments and opinions expressed herein are ours alone, and do not represent the views of any client.

We recognize the Legislature's interest in greater transparency about the demographic makeup of founding teams that receive venture capital investment, and we support efforts to expand access to entrepreneurship and innovation. A reporting regime can advance those goals, however, only if the data it produces is reasonably reliable and if collection, retention and publication do not create unnecessary legal, privacy and operational risks. As currently structured, the FIPVCC is likely to produce duplicative, non-comparable and potentially misleading data. We therefore respectfully urge DFPI to use its rulemaking authority to adopt a simpler architecture centered on direct collection by DFPI, deemed compliance for good-faith survey distribution, appropriately limited public reporting and bright-line definitions.[1]

I. Executive Summary

In our view, DFPI should adopt final regulations that do the following:

A. Reconsider the reporting regime in its entirety to the maximum extent permitted by statute. The FIPVCC is likely to produce inaccurate and potentially misleading data that invites misuse by third parties.

B. Create and operate a centralized, state-run reporting portal. A DFPI-operated system would reduce costs, reduce legal and cyber risk and better respect the FIPVCC's prohibition on influencing participation.

C. Relieve covered entities of any obligation to obtain founder contact information they do not already possess, in recognition of the fact that many later-stage investments involve limited contact with founders, and portfolio companies may reasonably decline to participate in survey distribution.

D. Adopt bright-line definitions for key terms. "Primarily engages" should be defined using an objective test based on the entity's actual investment program. "Startup, early-stage, or emerging growth company" should be defined by reference to objective criteria, and should not reference the definition in federal law. "Significant presence" and "significant operations" in California should be defined using a 25% employee threshold. "Solicits" should mean delivering an offering memorandum and executable subscription agreement to a person known to be a California resident.

E. Fully implement consolidated reporting at the adviser level. A venture capital adviser managing multiple funds should be able to send a single set of surveys and submit one consolidated report, subject to one fee.

F. Make certain other minor clarifications and cleanups, as further described herein.

II. DFPI Should Reconsider the FIPVCC's Demographic-Reporting Regime in Its Entirety

We understand the importance of assessing whether founders receiving venture capital funding reflect the diversity of the broader community. We do not believe, however, that the reporting architecture the FIPVCC prescribes will produce data that reliably answers that question. We

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[1] Corp. Code, § 27506, subd. (a) (authorizing the Commissioner to make, amend and rescind rules, forms and orders as necessary to carry out the chapter, including rules and forms governing applications and reports and defining terms, whether or not used in the chapter, if not inconsistent with the chapter).

respectfully urge DFPI to treat this rulemaking as an opportunity to reconsider the basic architecture of the reporting system rather than only its edges.

The core problem is structural. The FIPVCC requires covered entities to report aggregated demographic information for founding teams and to report the number and amount of venture capital investments in businesses "primarily founded by diverse founding team members." The FIPVCC defines a business as "primarily founded by diverse founding team members" only where more than one-half of the founding team members respond to the survey and at least one-half of the founding team members are diverse founding team members. Because a founding team member's response is voluntary, and because a covered entity often cannot be certain it has reached every founding team member, response rates will vary across portfolio companies, across covered entities and from year to year.

The Invitation identifies the issue directly when it asks: "Since a founding team member's decision to disclose demographic information is voluntary, how can a covered entity ensure that the information reported to DFPI accurately reflects the demographic information of the founding teams that the covered entity invested in?"[2] We do not see a mechanism by which a covered entity can ensure that result within the current framework.

Consider a hypothetical covered entity that made numerous venture capital investments in the prior calendar year. If response rates across those portfolio companies range from 5% to 60% of each founding team,[3] the resulting aggregate percentages will reflect the composition of whichever founders happened to respond, not the composition of the covered entity's actual investments. A single portfolio company with an unusually high or low response rate can swing the covered entity's reported aggregate by a wide margin, and the same covered entity's reported percentages could shift substantially from one year to the next based on nothing more than which founders happened to complete a voluntary survey in a given year. Compounding this, covered entities will need to make judgment calls about who counts as a founding team member, whether a company has significant operations in California, how to treat follow-on investments and how to handle incomplete responses. Each judgment call adds another assumption between the reported number and any underlying reality.

We do not think this is a data quality problem that further rulemaking can fully solve, because the voluntary nature of the survey is precisely what makes the resulting aggregate unreliable. The non-response bias is likely to differ across covered entities and across portfolio companies, and it will be unknown and unmeasured (and in fact, unknowable and unmeasurable). A dataset built this way will not tell DFPI or the public how diverse California's venture-backed founding teams actually are. It will tell them how diverse the subset of founders who chose, in a given year, to answer a voluntary survey happened to be.[4] The fact that many companies will have accepted

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2 Invitation at Question 24.

3 Based on our experience before compliance was suspended, the high end of this range would be a very optimistic estimate.

4 A letter previously submitted by an industry trade group suggests that the most likely outcome would be an overcount of diverse founders. *See* National Venture Capital Association, Letter re SB 54 (Aug. 28, 2023), at 3

investment from more than one covered entity, the reporting system would exacerbate this issue; if one large company has accepted investment from ten covered entities and its founding team members respond to surveys from each of such team members, these would be given the same weight as ten other companies that have each only accepted investment from one covered entity.

The risk is heightened because the FIPVCC requires DFPI to make covered entity reports "readily accessible, easily searchable, and easily downloadable" on DFPI's website, and permits DFPI to use information collected under the FIPVCC in furtherance of its statutory duties, including civil actions.[5] Once published, the data will no longer be within DFPI's practical control. Other government actors (including other levels of government and other states), private litigants and similar parties may use (or misuse) the data for purposes DFPI does not intend and does not agree with, and such parties may treat it as more reliable than it is. One need only to open the newspaper to find numerous examples of demographic data being cited or used to promote causes that may be inconsistent with the aims of the DFPI or the State of California. We take no position here on any particular litigation or governmental inquiry involving demographic investment data. Our point is simply that unreliable but official-looking public data can cause harm precisely because readers may assume it is reliable, even when accompanied by very lengthy disclaimers.

The same public reporting structure creates risk that supposedly anonymous responses may be attributed to specific people.[6] Many venture capital portfolios include a small number of investments in a reporting year, the identities of companies that have been funded are frequently available on venture capital firms' websites, and early-stage companies often have small founding teams. Even if DFPI publishes only aggregate categories, a report that includes exact investment amounts, principal places of business and narrowly sliced categories may allow outside parties to infer sensitive information about specific founders. That is especially concerning for categories such as disability status, veteran or disabled-veteran status and LGBTQIA+ identification.

For these reasons, we respectfully recommend that DFPI use this rulemaking to reconsider, to the maximum extent permissible by statute, whether collecting and reporting this information is the right use of state and industry resources. If DFPI proceeds, the regulations should at least reduce duplicative effort and avoid publishing data in a form likely to be misunderstood or reverse-engineered.

III. <u>DFPI Should Create and Operate a Reporting System Directly</u>

If DFPI determines that some reporting regime should continue notwithstanding Section II above, we recommend that DFPI restructure the regime around a state-operated reporting system

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(noting that voluntary, self-reported diversity surveys can distort data because individuals from diverse backgrounds may be more inclined to participate, resulting in overrepresentation within the dataset), *available at* https://nvca.org/wp-content/uploads/2023/09/NVCA-Letter-re-SB-54-82823.pdf.

[5] Corp. Code, § 27502, subds. (a)(1), (b).

[6] Invitation at Question 18.

rather than one that relies on distribution, collection, storage and aggregation of voluntary survey responses by covered entities. Specifically, DFPI should build and operate the standardized survey on a centralized, DFPI-hosted website, and should deem a covered entity in compliance with its survey and reporting obligations once the covered entity (i) provides a list of each founder's company email address to the DFPI so that DFPI can identify legitimate responses, (ii) transmits the portal link to each founding team member whose contact information it possesses, and (iii) requests that the founding team member submit information directly to DFPI on a voluntary basis.

A state-operated portal would allow founding team members to submit one response even if they accepted investment from multiple covered entities. It also would reduce legal risk for covered entities and portfolio companies, reduce cyber risk from storing sensitive information across numerous private systems, and better respect the FIPVCC's prohibition on encouraging, incentivizing or attempting to influence a founding team member's decision to participate. A covered entity that never receives a founder's demographic response cannot, even inadvertently, use that response in future investment or portfolio-company interactions.

The practical benefits are significant. Consider a startup called Angeles, Inc. Angeles has five founding team members and accepted funding from funds run by Barbara Ventures, Clara Capital and Diego Partners. If each fund run by Barbara, Clara and Diego is a covered entity, each must separately determine who the founding team members are, distribute the same survey, collect responses, aggregate them and report to DFPI. That produces 15 survey requests and three separate data-retention and cybersecurity processes for the same five founders. If DFPI operates a portal, each firm can send the same DFPI link and each founder can decide whether to submit information once. In this example, direct DFPI collection reduces survey processing by two-thirds and eliminates three separate private repositories of sensitive demographic data.

A DFPI portal also would improve consistency. Different investors in the same portfolio company may have different information about historical founders or former CEOs and presidents. If Banner makes one good-faith assumption about Acme's founding team while Cardinal and Diego make different assumptions due to differences in personnel at the time of investment (which one would expect if the firms invested in different funding rounds), the same company may be reported in inconsistent ways. A centralized portal would not solve every definitional problem, but it would reduce the number of inconsistent data collection and storage processes built on the same underlying facts.

DFPI could implement this approach through adoption of a safe harbor along the following lines:

> A covered entity shall be deemed to have provided a founding team member with an opportunity to participate in the survey if the covered entity transmits the Department-specified survey or Department-operated portal link, together with the disclosures required by Corporations Code section 27501(c)(3), to what it believes in good faith to be a then-current email address

> for the founding team member in the covered entity's possession or makes a good-faith written request that the business receiving the venture capital investment transmit the survey or portal link to its founding team members.

We recognize that building and operating a public-facing portal requires resources, and DFPI may not be able to do so immediately. If DFPI is not in a position to adopt a state-operated portal in the first phase of rulemaking, we respectfully urge DFPI to adopt the same deemed compliance principle as an interim measure. A covered entity should be fully compliant with the distribution obligation once it makes a good-faith survey distribution effort.

IV. A Covered Entity Should Not Be Required to Obtain Contact Information it Does Not Already Possess

Later-stage venture capital and growth equity investments are frequently minority investments with limited information rights at the portfolio company level. They may involve limited or no contact with the founders of the business, particularly founders who left the company before the investment. As a result, many covered entities will lack direct contact information for the full founding team. Requiring a covered entity to obtain personal contact information it does not already possess would impose substantial burden, could generate inaccurate founder lists and could require portfolio companies to locate former personnel for a compliance obligation that is not their own.

DFPI also should recognize that portfolio companies may reasonably decline to distribute the survey themselves due to actual or perceived legal risk. Several categories required by the FIPVCC, including disability status, veteran or disabled-veteran status and LGBTQIA+ identification, may be illegal to distribute to employees under state or federal law. In addition to legal exposure a portfolio company may perceive other risks when it is asked to send the survey to current or former employees. The Invitation asks whether exceptions should apply where sending a survey to founding team members or collecting the data would be illegal or disfavored in another country.[7] Similar practical concerns can arise in the United States even if the precise legal source differs.

The regulations should therefore give covered entities an explicit choice with corresponding limits on liability:

- *Direct distribution*. A covered entity may distribute the DFPI survey or DFPI portal link directly to each founding team member whose contact information it already possesses.

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[7] Invitation at Question 12(a). The second sentence of Question 12(a) appears to contain a typographical error because it asks, "What if the collection is illegal but is disfavored in the country?" We read the intended question to ask "what if collection is not illegal but is disfavored?"

The covered entity should not be required to obtain contact information for any other person.

- *Portfolio company distribution*. A covered entity may request in writing that the portfolio company distribute the DFPI survey or DFPI portal link to founding team members. If the portfolio company declines, does not respond or states that distribution would be unlawful or otherwise inappropriate, the covered entity should have no further distribution obligation.

V. Terms Used in the Covered Entity Definition Should Be Defined Using Bright-Line Thresholds

A. "Primarily Engages"

The first prong of the covered entity definition applies only where a venture capital company "primarily engages" in the business of investing in, or providing financing to, startup, early-stage, or emerging growth companies. DFPI should define what it means to "primarily" engage in such activity. Without clarification, different firms will make different facts-and-circumstances determinations and, likely, reach different results. Such differences could undermine the usefulness of the data.

We recommend that DFPI adopt an objective test based on the entity's actual investment program. A venture capital company should be deemed to "primarily engage" in investing in, or providing financing to, startup, early-stage or emerging growth companies only if more than 50% of its aggregate invested capital, measured at cost, is invested in companies that meet DFPI's definition of startup, early-stage or emerging growth company at the time of the venture capital company's initial investment in the company. The measurement should be made annually, using information reasonably available to the covered entity, and should exclude cash instruments and other assets classified in good faith by the company as short-term or temporary in nature.

B. "Startup, Early-Stage, or Emerging Growth Companies"

The other language in the first prong of the covered entity definition is also unclear. The classification of a company as a startup or early-stage company is very subjective, and the term "emerging growth company" is defined in the federal securities laws to mean something very different from the definition that would make sense in the context of the purpose of the FIPVCC. As noted above when discussing "primarily," if these terms are not defined, firms are likely to take different interpretive positions, seriously undermining the usefulness of the data.

For this purpose, DFPI should define "startup, early-stage, or emerging growth company" to mean an operating company that, at the time of the covered entity's initial investment, (i) has not completed an initial public offering, de-SPAC transaction or other public listing, (ii) is not a reporting company under the federal securities laws, (iii) has been in existence for less than seven years and (iv) has fewer than 150 employees. Conditions (i)-(iv) should be evaluated by reference to the company itself and any company that controls or has a majority ownership stake in such company.

Importantly, the DFPI should not use the definition of "emerging growth company" in the federal securities laws. At the federal level, an emerging growth company ("JOBS Act EGC") could have been public for up to five full years, and could have revenues of $1.235 billion dollars while still remaining an JOBS Act EGC. It is implausible to believe that the Legislature intended such a broad reading; if they did so, they would not have needed to also use the words "startup" or "early-stage" because any such company would also be an emerging growth company. Bearing in mind the canon of construction *noscitur a sociis* (a word is known by the company it keeps), the DFPI should interpret "emerging growth company" in light of the neighboring terms "startup" and "early-stage," rather than as an incorporation of the federal securities law term.[8]

This approach would preserve coverage for traditional venture capital funds and other funds whose primary strategy is to invest in private startup, early-stage or venture-backed growth companies – the companies for which identifying and contacting current founding team members is practicable – while reducing uncertainty for funds whose strategy does not involve such investments. For example, Cloudflare, CrowdStrike, DoorDash, Datadog and Zoom were each JOBS Act EGCs when they went public, even though they each had thousands of employees and several hundred million dollars in revenue at the time they went public – hardly companies that would reasonably be in the same category as a "startup" or "early-stage" company.[9] If the Legislature wanted to capture information about funding provided to companies like these, they would have used different language.

C. "Significant Presence" and "Significant Operations" in California

One trigger to determine whether the FIPVCC applies to a venture capital company is whether it has a "significant presence" in California. Likewise, whether the venture capital company is a covered entity is based in part on whether it makes venture capital investments in businesses located in, or that have "significant operations" in California. Neither such term is defined. Without bright-line standards, covered entities will need to make facts-and-circumstances judgments for every fund and every portfolio company, and different investors in the same company may reach different conclusions.

We recommend that DFPI adopt objectively verifiable thresholds measured from ordinary business records. For a venture capital company, "significant presence" should exist only where at least 25% of its full-time employees (or the employees of the sponsor managing such venture

[8] We also note that incorporating a federal term by reference means the regulations may become outdated if the term is later amended. Recently, the SEC has undertaken several actions designed to encourage additional companies to go public. While, to our knowledge, no action has affected the definition of emerging growth company, which is set by statute, it is possible that future Congressional action could amend this definition in an unexpected manner.

[9] Statistics sourced from the companies' public filings at the time of IPO, available on EDGAR at https://www.sec.gov/edgar/search/.

capital company) are located in California. For a portfolio company, "significant operations" should exist only where the company has its headquarters or principal executive office in California or at least 25% of its full-time employees are located in California, in each case based on information reasonably available to the covered entity at the time of the investment. California law already uses 25% thresholds in a comparable context, including for certain "doing business" determinations under the Revenue and Taxation Code.[10]

DFPI also should specify the measurement date. We recommend measurement at the time the covered entity makes the reportable investment, with no obligation to revisit the determination based on later changes unless a separate reportable investment is made in a later year.

D. "Solicits" Investments from a Resident of California

Many venture capital advisers and fund sponsors have frequent interactions with investors and prospective investors. Those interactions range from general market updates to formal pitch meetings and delivery of subscription documents. Without clarification, firms may not know when a California meeting, contact-list entry or preliminary diligence exchange becomes a "solicitation" that triggers FIPVCC coverage.

We recommend that DFPI clarify that "solicits" means delivering to a person known by the venture capital company to be a California resident an offering memorandum and an executable subscription agreement. DFPI should further confirm that inclusion on a contact list, general brand marketing, a conference meeting, data room access, a preliminary diligence conversation, a general update meeting or a communication with an existing investor does not, standing alone, constitute solicitation.

DFPI also should clarify that residency is determined based on the covered entity's records at the time of the relevant subscription or capital commitment. Covered entities should not have a continuing obligation to monitor changes in investor residency after a commitment has been accepted unless a new commitment or subscription is requested.

VI. Consolidated Reporting

Compliance with the FIPVCC should occur at the level that minimizes duplication. Generally, management of a venture capital fund (which would be the "covered entity" under the FIPVCC) is conducted by a venture capital adviser. The fund typically does not have any employees or operations; it is simply a legal entity that is designed to take money in from investors to invest in portfolio companies, and then to receive proceeds when such portfolio companies are sold and distribute the proceeds to investors. Requiring compliance at the covered entity could require hundreds of nearly duplicate filings, which dramatically increases the risk that inadvertent mistakes in data entry corrupt the data that is reported.

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10 See Rev. & Tax. Code, § 23101.

DFPI should broadly interpret the provision of the FIPVCC deeming covered entities to be in compliance if a business that controls such covered entity (*i.e.*, the adviser) submits a report containing the required information. The final regulations should confirm that all obligations applicable to a covered entity can be deemed satisfied through compliance by a control person, including if the control person is acting on behalf of multiple covered entities. For example, a venture capital adviser managing multiple funds should be able to send out a single set of surveys to all founding team members, rather than individually on behalf of each fund. We also note that the reporting system initially released by DFPI did not permit registration or reporting at the adviser level; this should be addressed.[11] A consolidated report should be subject to one report fee, not a separate fee for each vehicle included in the consolidated filing.[12]

VII. Clarifications

DFPI should make several additional cleanups or clarifications:

- If a fund did not make any investments during a calendar year (including a fund outside its investment period or in liquidation), it should not be required to register or make a report for that year.

- A covered entity should be able to rely on any good-faith methodology it creates to determine who is a founding team member, and should not be required to ask detailed questions of a portfolio company. For the CEO or president prong, DFPI should specify that the relevant person is the CEO or president as of the date of the reportable investment.

- DFPI should clarify that a covered entity is not required to survey a former founding team member who is no longer associated with the business as of the date of the reportable venture capital investment. The Invitation specifically asks whether a covered entity should be required to send the survey to a founding team member who ceased providing services to the business during the calendar year.[13] DFPI should answer that question no and should extend the same principle to any person who ceased to be associated with the business before the covered entity's investment. If DFPI were to decide otherwise, this would be inconsistent with the purpose of the statute – to obtain

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11 For example, before compliance was suspended, the registration system asked about a covered entity's website, If a different entity had already entered the same URL, the registration system would not accept a subsequent registration using the same URL. This made consolidated reporting impossible in practice because websites are typically maintained at the adviser level and not established separately for each fund. It also did not take into account the possibility of a potential bad actor illegitimately submitting a registration that used such website address.

12 Depending on the governing documents of the applicable covered entity, certain venture capital advisers could charge the cost of registration and reporting to the covered entity, which would result in it being borne by the entity's underlying investors. Numerous investors affiliated with California state or local governments invest in such funds (as well as state and local pension plans from numerous other jurisdictions), meaning they would indirectly be bearing this cost if it were passed through.

13 Invitation at Question 15.

information about the founding team members who were actually involved in securing the funding – and would be impossible for many covered entities since they would never have met such former personnel and, in any event, their funding decision would not be based on the characteristics of the former personnel.

- If DFPI requires reporting about non-U.S. portfolio companies, the regulations should allow exclusion or modified reporting where survey distribution or data collection would be unlawful, materially inconsistent with local privacy or employment norms, or likely to create risk to founding team members (in each case, as determined in good faith by the covered entity, portfolio company or founding team member).

- DFPI should clarify that the location of an investee's principal place of business should be reported and disclosed at the state level for U.S. businesses. All other businesses should be reported as "rest of world" (or similar language), and should not be linked to a specific country. Although the FIPVCC does not appear to require public disclosure of portfolio company names, public disclosure of a city can effectively identify a portfolio company where the company is located outside a major venture market or where the covered entity made only a small number of investments in the reporting year. Limiting public location disclosure to state would preserve useful geographic information while reducing the risk that sensitive information, which is supposed to remain confidential, can be reverse-engineered.[14]

VIII. Conclusion

We commend DFPI for suspending enforcement of the FIPVCC pending this rulemaking and for the care reflected in the detailed questions the Invitation poses, many of which confirm the practical difficulties we raise above. We respectfully urge DFPI to (A) reconsider the FIPVCC's demographic-reporting regime to the maximum extent permitted by statute; (B) if DFPI nevertheless proceeds, create a state-run reporting portal; (C) relieve covered entities of any obligation to obtain founder contact information they do not already possess and acknowledge that portfolio companies may refuse to participate in survey distribution; (D) adopt bright-line definitions of terms used in the FIPVCC; (E) enable consolidated reporting and (F) adopt the additional clarifications noted above.

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[14] Invitation at Question 18.

Thank you for the opportunity to comment on this rulemaking. We appreciate your consideration of these comments and would welcome the opportunity to discuss these recommendations further or provide any additional information that may assist you. If you have further questions, please contact Nathan R. Schuur at (202) 416-5825.

Respectfully submitted,

Proskauer Rose LLP

Proskauer Rose LLP