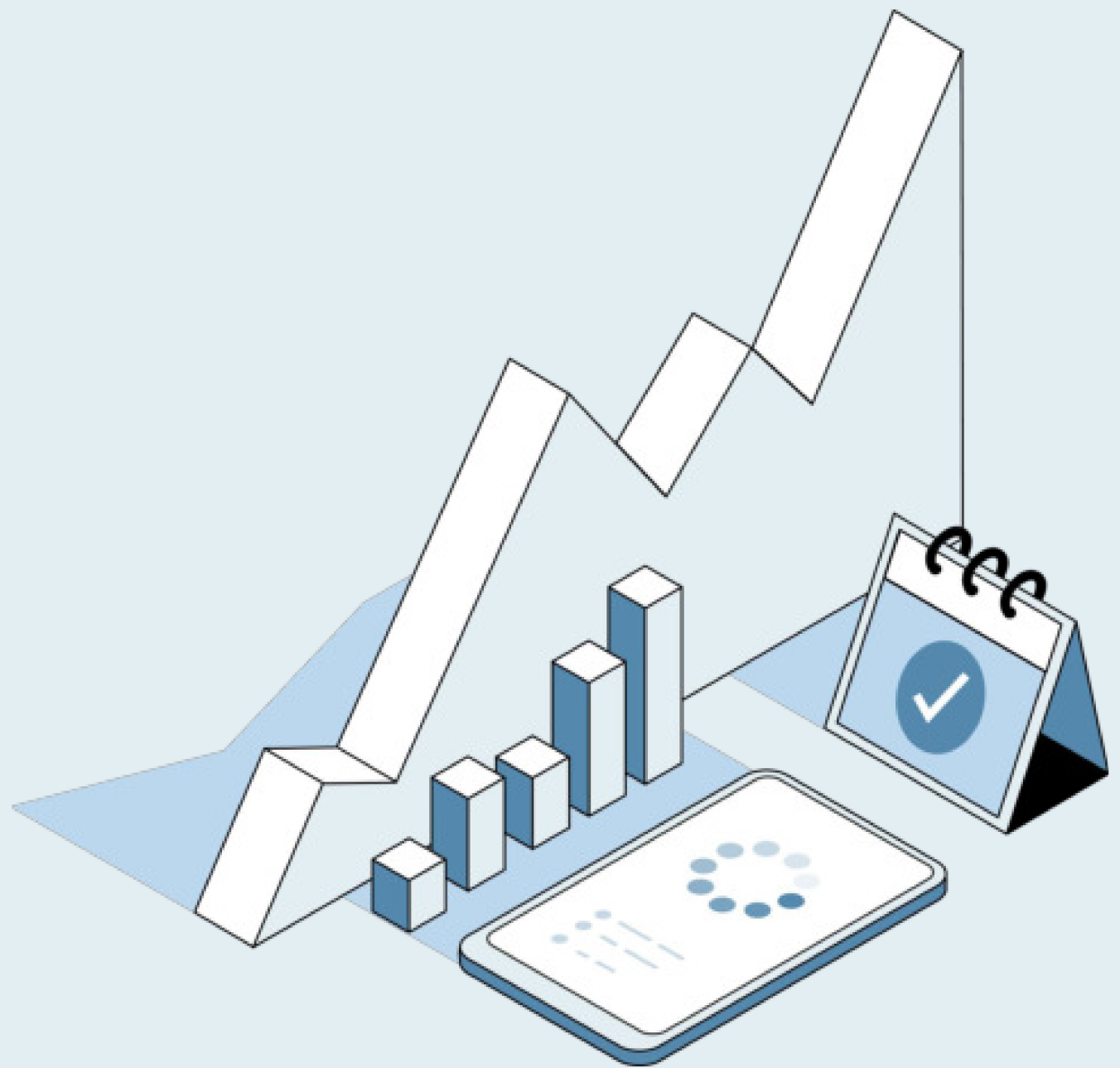


VC regulatory playbook

The VC regulatory landscape is changing.
Are you up to date?



VC regulatory playbook

As regulatory scrutiny increases on private funds—and private markets more generally—Carta has put together a playbook that lays out the regulatory landscape, compliance requirements, and additional considerations for fund managers to consider as they navigate the evolving private market regulatory landscape.

1

Regulation of the private fund

→

2

Regulation of the fundraising process

→

3

Regulation of the fund manager

→

4

ERA compliance checklist

→

5

Additional regulatory considerations

→

Private fund regulation: the basics

There are three categories of regulation all venture capital advisers should be aware of:

- Regulation of the fund (Investment Company Act)
- Regulation of the fund manager (Investment Advisers Act)
- Regulation of the fundraising process

We'll cover each of the three areas in depth, and provide answers to some of the frequently asked questions below.



Fund regulation

- Do I need to register my fund?
- What are Section 3(c)(1) and Section 3(c)(7)?
- What are the limits on registration exemptions?
- Who can invest in registration-exempt funds?

Fundraising regulation

- What is Regulation D?
- What are Rule 506(b) and Rule 506(c)?
- Can I advertise my fund offering?
- What is Form D and when do I file it?

Fund manager regulation

- Do I need to register as an investment adviser?
- What is Form ADV and when do I file it?
- What regulatory obligations do exempt reporting advisers (ERAs) have?

This guide is not meant to cover every legal obligation or be a substitute for legal advice, but rather serve as an informational guide to legal and regulatory compliance requirements. You should discuss with your own legal counsel other factors that may apply to your specific circumstances to ensure compliance.

Regulation of the private fund

A fund must register with the SEC as an investment company unless it meets the criteria for an exemption. Venture capital funds rely on two exemptions to avoid SEC registration:

Section 3(c)(1)

Section 3(c)(7)

Section 3(c)(1)

A 3(c)(1) fund involves a private placement by a fund that will have no more than 100 beneficial owners who are accredited investors.

Counting beneficial owners: As a default, one individual or entity will count as one LP. But in certain instances, the SEC will “look through” an investment vehicle or entity for purposes of counting its underlying beneficial owners. These include:

- LP entities created by their members for the specific purpose of investing in the fund
- LP entities investing 10% or more of the fund voting assets
- LP entities investing 40% or more of the LP’s assets into a single fund

Qualifying venture capital funds

Congress created a special category of 3(c)(1) funds known as a “qualifying venture capital fund” that can have up to 250 beneficial owners if the fund is under \$12 million and meets the definition of a venture capital fund.

A venture capital fund has its own special requirements:

- A venture capital fund must hold at least 80% of assets in “qualifying investments” — cash and equity securities acquired directly from portfolio companies. In other words, VC funds can invest in non-qualifying investments—fund-of-fund investments, digital assets, secondary transactions, etc.—but they are limited to no more than 20% of capital.
- A venture capital fund cannot be substantially leveraged: To maintain their exemption, VC funds can’t leverage more than 15% of their AUM and outstanding loans must be repaid in 120 days of borrowing.
- A venture capital fund cannot provide redemption rights except in limited, extraordinary circumstances.
- A venture capital fund must pursue a venture investment strategy.
- A venture capital fund cannot be registered under the Investment Company Act. In other words, it must be a private fund and cannot be a business development company (BDC).

Section 3(c)(7)

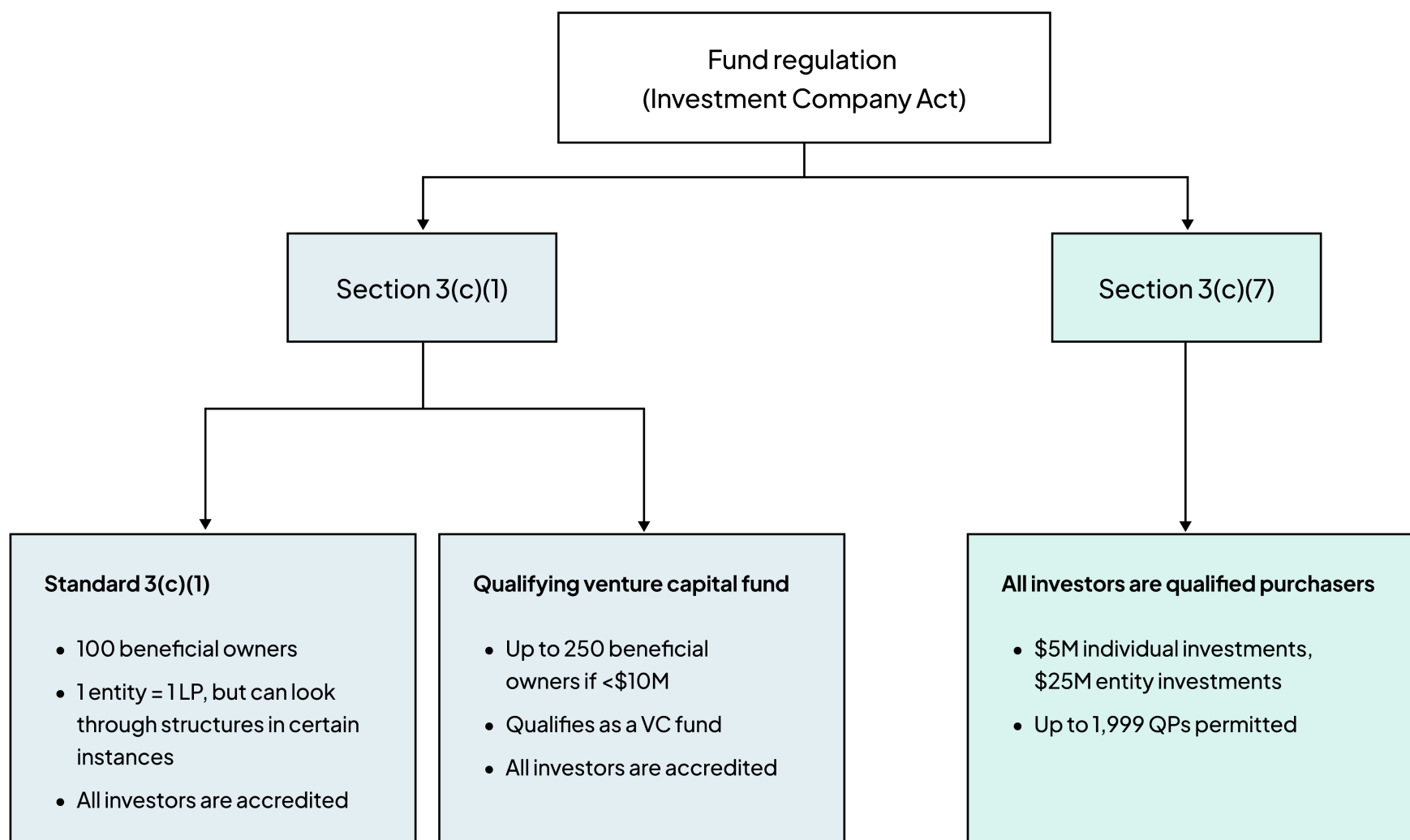
A 3(c)(7) fund involves a private placement to qualified purchasers. While there is no explicit investor limit, a 3(c)(7) fund cannot have more than 1,999 investors to avoid being considered a reporting company under Section 12(g) of the Securities Exchange Act.

Qualified purchasers must meet a higher bar than accredited investors. Qualified purchasers are individuals or family investment units with \$5 million or more in investments, or an entity with \$25 million or more in investments.

Some points to note:

- Knowledgeable employees of the fund are not counted as beneficial owners under 3(c)(1) and do not need to be qualified purchasers to invest in a 3(c)(7) fund.
- For purposes of the 100 beneficial ownership limit under 3(c)(1), the SEC can integrate—or view as a single fund—similar funds, unless a reasonable investor would consider their interests to be materially different. Section 3(c)(1) funds are not integrated with 3(c)(7) funds, which means this parallel fund structure can be used to maximize the number of investors.

Exemptions under the Investment Company Act



Regulation of the fundraising process

Generally, the federal securities laws require every offer and sale of a security, including interests in a fund, to be registered with the SEC unless an exemption applies.

Most venture capital in the United States is raised in private placements through an exemption created under Rule 506 of Regulation D. Rule 506 supplies two pathways to an exempt private placement:

Rule 506(b)

Under 506(b), fund managers can raise an unlimited amount of capital from an unlimited number of accredited investors (and up to 35 non-accredited, sophisticated investors with enhanced disclosure). Fund managers may not use general solicitation in this type of offering.

Note:

- While it's technically possible to include non-accredited investors in VC funds, fund managers almost universally avoid it due to the costs associated with additional disclosure requirements.

Rule 506(c)

With 506(c), fund managers can use general solicitation for offerings. Just like 506(b), fund managers can raise an unlimited amount of capital, but they can only raise from accredited investors. The fund must also take “reasonable steps” to verify that all fund investors are accredited—a more burdensome undertaking that requires more than self-certification.

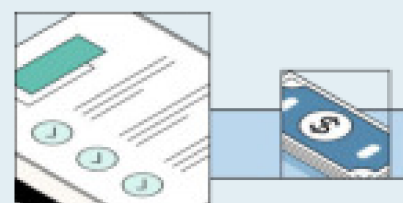
Rule 506(b) vs. 506(c)

Compare the different safe harbors set forth by Rule 506(b) and Rule 506(c) to determine which is right for your fund.



Rule 506(b)

- Can raise unlimited capital
- Can raise from accredited investors and up to 35 non-accredited, sophisticated investors with additional disclosures
- Accredited investors can self-certify
- Cannot advertise outside network; must have pre-existing, substantive relationship



Rule 506(c)

- Can raise unlimited capital
- Can raise from accredited investors only
- Must take steps to verify that all investors are accredited
- Can publicly market capital raise to prospective investors

Form D

Funds raising capital under 506(b) or 506(c) are required to file a Form D with the SEC no later than 15 days after the first close.

Note:

- The SEC is expected to consider changes to Regulation D that could impact timelines associated with Form D filings, as well as the information collected on the form. Follow Carta's Policy Desk and [subscribe to the weekly policy newsletter](#) to stay on top of any changes.

Blue sky filings

In addition to filing a Form D with the SEC, funds that raise capital under Regulation D will likely have state [blue sky](#) filing requirements. Securities offered and sold under Regulation D are exempt from state registration, but most states require notice filings.

Regulation S

Funds can use Regulation S to raise capital outside of the U.S. Offerings under Regulation S are generally limited to non-U.S. persons, and the fund and its affiliates are prohibited from undertaking directed selling efforts in the U.S.

Policy outlook:

- Congress and the SEC are expected to consider reforms to make it easier for funds to raise capital under Regulation D, including expanding accredited investor on-ramps. Follow Carta's Policy Desk and [subscribe to the weekly policy newsletter](#) to stay on top of any changes.

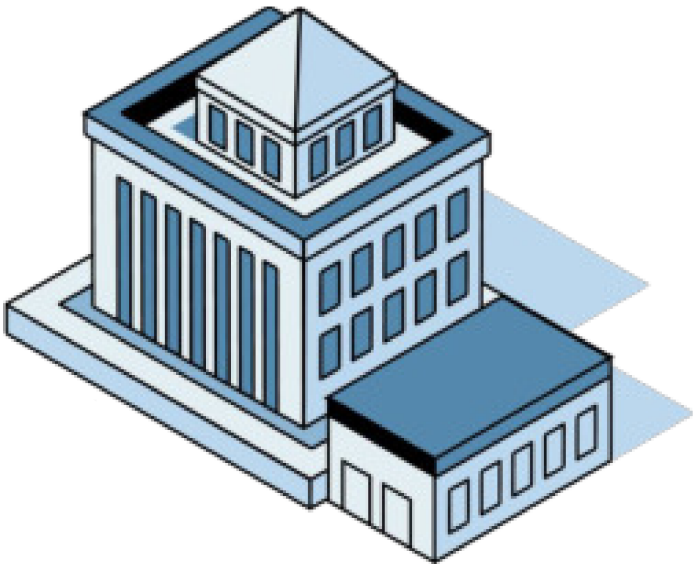
Regulation of the fund manager

Under the Investment Advisers Act, any person who provides advice to others regarding securities in exchange for compensation is an investment adviser. Most VC fund managers meet this definition.

Private fund advisers, including VC fund managers, must register with the SEC as an investment adviser unless they qualify as an exempt reporting adviser (ERA) or do not meet certain asset requirements.

The size of the adviser’s assets under management (AUM) will determine whether the adviser will register with the SEC or a state securities regulator.

Size of assets under management by the adviser	Regulated by
Small adviser (less than \$25M)	State
Mid-size adviser (\$25M-110M)	State or SEC
Large adviser (more than \$110M)	SEC



Registered investment advisers

Registered investment advisers (RIAs) have heavier compliance burdens than exempt reporting advisers. On top of the the ERA compliance requirements, RIAs are subject to additional Advisers Act requirements, which include:

- **Enhanced filing requirements:** RIAs are required to file additional information on Form ADV (Part 2A fund brochure) and Form PF.
- **Compliance:** RIAs are required to adopt written policies and procedures designed to prevent violations of the Advisers Act. These policies and procedures must be reviewed annually, and the annual review must be documented in writing. RIAs must also have a dedicated chief compliance officer and compliance program tailored to the business.
- **Recordkeeping rule:** RIAs are required to maintain extensive books and records of their business, including records of all written communications and documentation to support other Adviser Act compliance requirements.
- **Code of ethics:** RIAs must establish and enforce a written code of ethics that outlines responsibilities and standards of conduct, including with respect to personal trading by employees and disclosure of conflicts of interest.
- **Custody and annual audit requirements:** RIAs are subject to the Adviser Act's custody rule obligations and audit requirements.
- **Marketing rule:** RIAs must disclose net performance metrics alongside gross performance metrics, whether they're reporting on single investments or a group of investments.
- **Limitations around performance-based compensation:** For RIAs to receive performance-based compensation, fund investors must be qualified clients.

Policy outlook: Under the previous administration, the SEC proposed a number of changes that could have significantly increased RIA compliance obligations, including limiting the privately offered securities exemption under the custody rule, heightened cybersecurity and vendor due diligence, and new ESG disclosures, among others. We do not expect the Trump administration to take the same approach, and could see efforts to provide clarity or streamline compliance obligations for RIAs. [Subscribe to Carta's Policy Weekly newsletter](#) for updates.

Exempt reporting advisers

Fund managers can avoid costly regulatory and compliance requirements associated with being an RIA if they meet certain requirements to be an exempt reporting adviser (ERA):

- **Private fund adviser exemption:** The fund manager solely advises private funds and the total AUM overseen by the fund manager is less than \$150 million.
- **Venture capital adviser exemption:** This exemption is available to fund managers who solely advise venture capital funds. Unlike the private fund exemption, VC fund managers can raise an unlimited amount of capital without being required to register with the SEC.

A venture capital fund has its own special requirements:

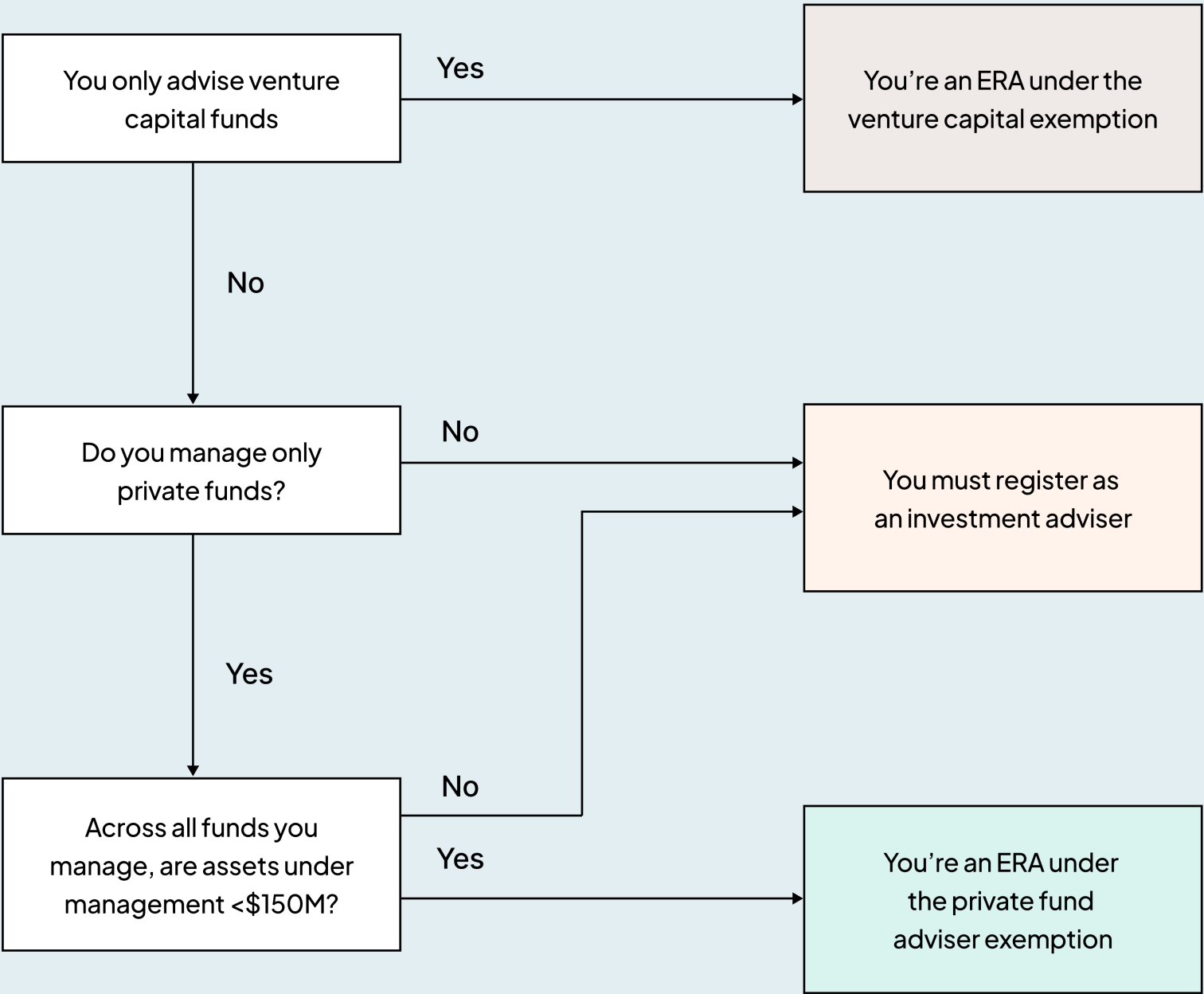
- A venture capital fund must hold at least 80% of assets in “qualifying investments” —cash and equity securities acquired directly from portfolio companies. In other words, VC funds can invest in non-qualifying investments (fund-of-fund investments, digital assets, secondary transactions, etc.) but they are limited to no more than 20% of capital.
- A venture capital fund cannot be substantially leveraged: To maintain their exemption, VC funds can’t leverage more than 15% of their AUM and outstanding loans must be repaid within 120 days of borrowing.
- A venture capital fund cannot provide redemption rights except in limited, extraordinary circumstances.
- A venture capital fund must pursue a venture investment strategy.
- A venture capital fund cannot be registered under the Investment Company Act. In other words, it must be a private fund and cannot be a business development company (BDC).

Per SEC guidance, a fund must be eligible to register with the SEC to be eligible to file with the SEC as an ERA. This means that private fund advisers who otherwise meet the venture capital or private fund adviser exemption will not be able to file with the SEC as an ERA unless they have over \$25 million in AUM, generally speaking. They would instead be subject to state law requirements, and many states have adopted exemptions that mirror the federal private fund adviser exemptions. But even if a fund manager does not file as an ERA with the SEC, fiduciary duties and Advisers Act obligations still apply.



Am I an ERA?

Use the flow chart below determine if you're an exempt reporting adviser (ERA).



ERA compliance checklist

While ERAs are not subject to SEC registration, “exempt” is somewhat of a misnomer. In addition to filing basic information with the SEC, ERAs must comply with certain provisions of the Advisers Act and can be examined by the SEC.



Reporting requirements

Form ADV

ERAs are not required to register with the SEC, but they are required to file certain information on [Form ADV](#). Form ADV is the uniform document used by investment advisers to register with both the SEC and state securities authorities. This is the same form that RIAs use to register, but ERAs are only required to complete certain items in Part 1A and not the entire brochure.

PART 1A INFORMATION INCLUDES:

- Basic identifying information, such as legal name, and principal office and place of business
- Fund size
- Other business interests
- Disciplinary history
- Control persons

PROCESS:

- Form ADV is electronically filed and publicly available on FINRA's IARD system.
- The initial Form ADV must be filed with the SEC within 60 days from when the advisory relationship with the first fund begins, which is typically the first close.
- Form ADV must be updated at least annually within 90 days after the end of the adviser's fiscal year. More frequent updates may be required in the event of material developments listed in form instructions.
- ERAs who claim the private fund exemption (AUM < \$150 million) must update their valuations annually to show the exemption is still valid.
If the AUM increases beyond \$150 million, the adviser must register and become an RIA within six months.
- ERAs claiming the venture capital exemption do not need to confirm AUM because the VC exemption has no threshold.

State registration and blue sky filings

States generally require advisers whose principal place of business is in that state to make notice filings and pay fees. This can generally be done by selecting the relevant states on Form ADV so that the state automatically receives a copy. Most states have adopted state law exemptions that mirror the federal exemptions for venture capital advisers, though state-specific rules vary. ERAs should check their state's laws to determine if any additional compliance requirements apply.

The compliance obligations that apply to federal ERAs will still apply to unregistered or state-registered private fund advisers (including small private fund advisers who may not have any filing requirements).

Checklist

REPORTING REQUIREMENTS

- ☐ Form ADV
- ☐ State registration

FIDUCIARY OBLIGATIONS AND THE ADVISERS ACT

- ☐ Anti-fraud requirements
- ☐ Pay-to-play
- ☐ MNPI policies

ADDITIONAL CONSIDERATIONS

- ☐ SEC examinations
- ☐ Registering as an RIA

OTHER COMPLIANCE OBLIGATIONS

- ☐ KYC/AML
- ☐ Privacy
- ☐ Corporate Transparency Act
- ☐ CA diversity disclosure

Fiduciary obligations and the Advisers Act

As investment advisers, fund managers owe fiduciary obligations to their clients, which means the fund manager is required to put client interests (i.e., those of the private fund and its investors) above their own. As a fiduciary, the adviser must make full disclosure of all material facts relating to the advisory relationship, including full disclosure of all material conflicts of interest. These fiduciary obligations cannot be waived through disclosure or investor consent. The SEC recently reaffirmed these fiduciary obligations as part of its [Private Fund Adviser rules](#).

While a number of the provisions of the Advisers Act do not apply to ERAs, there are certain requirements that do apply to venture capital fund managers, in addition to broader fiduciary responsibilities.

Anti-fraud requirements

All investment advisers—ERAs and RIAs—are subject to the Advisers Act’s anti-fraud prohibitions under Section 206 and Rule 206(4)–8. These rules prohibit advisers from making false or misleading statements, omitting material facts, or otherwise defrauding current or prospective investors in the funds they manage. Examples of conduct that have been found to violate the anti-fraud rules includes: providing misleading performance metrics, promising guaranteed returns, making inaccurate management fee disclosures, and failing to disclose conflicts of interest.

The SEC has increasingly focused on conflicts and fees, and has interpreted its anti-fraud enforcement broadly. To ensure compliance with the anti-fraud provisions, a fund manager should:

- Review whether current operating practices align with requirements in fund documents, particularly around calculation of fees and valuation practices
- Ensure all material conflicts of interest are disclosed
- Ensure provisions in fund offering documents and other fund documents are aligned and there is no confusion or conflict.

The bottom line for anti-fraud requirements: Do what you say you are going to do and disclose your conflicts.

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Pay-to-play

ERAs are subject to Advisers Act requirements that prohibit investment advisers from engaging in pay-to-play (P2P). In other words, an adviser can't be compensated for services provided to a government entity or official after making political contributions to the same. Fund managers should take note if federal, state, or local government entities—including pension plans and university endowments—are investors or are being solicited as potential investors in the fund.

Here is what you need to know:

- ERAs and their associates are subject to a two-year cooling off period after making a contribution to an official or government entity before the adviser can receive compensation for advisory services provided to that official or entity. In addition to direct contributions, ERAs cannot solicit or coordinate campaign contributions for government officials or entities to whom the adviser is providing or is seeking to provide services.
- P2P violations are strict liability, meaning no quid pro quo or other intent is necessary to be held liable for a violation.
- The SEC is pursuing P2P violations and has brought several cases recently.

MNPI policies

All investment advisers—RIAs and ERAs—are required to establish, maintain, and enforce written policies and procedures designed to prevent the misuse of material nonpublic information (MNPI) by the fund manager or associated persons.



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- ☐ CA diversity disclosure

Additional regulatory considerations

SEC examinations and enforcement

Even though they are not registered, ERAs are subject to regulatory review by the SEC's Division of Examinations. ERAs can be examined for cause or as part of the SEC's routine examination program. SEC examinations staff outline yearly exam priorities to highlight areas of focus and issue risk alerts to drive attention to specific matters.

SEC staff has historically not conducted ERA exams on a regular basis, though that posture has shifted as more scrutiny is applied to the growing private fund industry.

What Fund Managers need to know:

The SEC has been increasing its scrutiny of private fund managers, including venture capital fund managers, and this scrutiny will only increase as new regulatory requirements are implemented. Current and aspiring VC fund managers should understand their regulatory obligations, put policies and procedures in place to meet those compliance obligations, and ensure they are abiding by terms in LPAs and other fund agreements. This is particularly important in areas the SEC has flagged through a risk alert or exam priority, or where the Commission has focused recent rulemaking efforts.

The SEC's 2025 Exam Priorities, which were announced under former SEC Chair Gary Gensler, focus on a number of areas that will impact ERAs, including:

- Portfolio management risks in light of current market conditions, including the impact on valuation and how this may impact fee and expense calculation
- Due diligence practices around prospective portfolio companies
- Compliance with custody, audit, and reporting requirements under Form ADV and Form PF
- Fiduciary obligations

New SEC leadership will likely shift focus away from private fund managers as compared to the prior administration, but we expect the agency to continue to pursue fraud and rigorously enforce compliance and fiduciary obligations. The SEC will also be responsible for examining private funds—ERAs and RIAs—for compliance with new AML requirements.

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Registering as an RIA

With the additional regulatory requirements and added compliance costs and burdens, why would a VC fund manager consider registering as an investment adviser?

Additional flexibility

Venture capital funds are fairly limited in the types of investments they can make, and VC ERAs can only advise venture funds. Private fund ERAs are limited to \$150M AUM. SEC registration may make sense for venture firms looking to explore new business lines, different asset classes, or joint ventures.

Investor demand

Given the additional regulatory requirements, some investors may be more willing to invest in a fund that is advised by an RIA vs. an ERA.

VC funds will have to decide whether to register by balancing regulatory requirements and costs with what works best for their respective business models. The SEC has adopted or proposed a number of new compliance obligations for private fund advisers that will significantly impact RIAs more than ERAs. The cumulative burden of these expected regulatory changes, in addition to heightened scrutiny, could be prohibitive for funds that may have been considering registration to pursue new business opportunities.

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Other compliance obligations

Know your customer / Anti-money laundering considerations

Most funds incorporate know-your-customer/anti-money laundering protocols in their operations, but beginning in January 2026, fund managers will have to comply with a formal regulatory regime.

The Financial Crimes Enforcement Network (FinCEN) finalized new rules to apply its anti-money laundering/countering the financing of terrorism (AML/CFT) requirements to investment advisers, including private equity and venture capital fund advisers. This rule aims to address illicit financing threats involving investment advisers and raises concerns that VC funds, in particular, have been a haven for illicit proceeds and are used by foreign actors to access critical technologies.

New compliance obligations for private funds include:

- Develop and implement “risk-based” AML program, which includes internal controls and policies, designated AML officer, compliance staffing and training, routine independent audits, and ongoing customer due diligence
- File suspicious activity reports (SARs) with FinCEN to report suspicious transactions over \$5,000
- Recordkeeping with respect to transmittal of funds
- Comply with other Bank Secrecy Act (BSA) obligations that apply to financial institutions

The SEC will be responsible for examining private fund RIAs and ERAs for compliance with the new AML requirements.

While many advisers have some AML protocols in place, this formal regulatory regime will shift the standard, imposing significant compliance obligations particularly for smaller private fund managers. Exempt reporting advisers (ERAs), who are currently not subject to these types of regulatory obligations and exam scrutiny, will bear the same compliance burden of larger, well-resourced SEC-registered investment advisers (RIAs). This will create a disproportionate compliance cost and burden for smaller fund advisers.

These rules are set to become effective on January 1, 2026.

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Privacy

While RIAs are subject to privacy requirements specified under the Advisers Act (Regulation S-P), ERAs must comply with data privacy and security requirements implemented by the Federal Trade Commission under the Gramm-Leach-Bliley Act. The FTC requires ERAs to develop, implement, and maintain comprehensive information security programs that identify risks to security, confidentiality, and customer information and contain safeguards for protecting nonpublic personal information. ERAs must send initial privacy notices to investors along with standard fund documents describing their privacy and procedures. ERAs should routinely monitor and test privacy safeguards and appoint an individual responsible for monitoring.

Corporate Transparency Act reporting requirements

Beginning January 1, 2024, new reporting requirements took effect under the [Corporate Transparency Act](#). Unless an exemption applies, entities formed or registered after this date are required to disclose beneficial ownership information (BOI) to FinCEN within 90 days; existing entities have to file an initial report by January 1, 2025, though these deadlines have shifted due to court and administrative actions. As of this writing, CTA compliance is not being enforced against U.S. persons, though this issue remains fluid and could shift again.

CTA exemptions

- SEC-registered investment advisers
- Venture capital fund advisers
- Pooled investment vehicles operated or advised by RIAs or venture capital fund advisers
- Large U.S. operating companies with 20+ full-time employees and \$5 million in revenue
- Entities wholly owned or controlled by an exempt entity

Generally speaking, many private funds and private fund advisers who are registered with the SEC or meet the requirements of the venture capital adviser exemption will be exempt from CTA reporting. However, there remains uncertainty around the scope of these exemptions. Notably, ERAs that manage small private funds (<\$150M) but do not meet the venture capital exemption must comply with CTA reporting requirements. Consequently, entities like management companies, special purpose vehicles, and co-investment vehicles may still be subject to BOI reporting requirements. Early-stage portfolio companies may also be subject to CTA reporting requirements. Fund managers should consult with counsel to determine if any CTA filing obligations exist with respect to their funds.

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Policy update:

- On March 2, 2025, the Treasury Department [announced](#) it will not enforce the beneficial ownership filing requirements for U.S. persons and companies at this time. FinCEN plans to provide new guidance on compliance for foreign entities. This situation remains fluid, and additional legal challenges may arise. Keep up to date with the latest actions [here](#).

California VC diversity disclosure requirements

In 2023, California enacted legislation aimed at increasing transparency around diversity in the venture capital ecosystem and promoting more inclusive investments through disclosures. Under the new requirements, which are set to take effect March 2026, VC funds with a nexus to California will need to collect and report demographic information about the portfolio company founders in which they invest as well as investment information to the California Department of Financial Protection and Innovation (DFPI) on an annual basis.

Covered entities

The new law applies to VC investors, VC funds, or VC operating companies that are primarily engaged in the business of financing or investing in startup, early-stage, or emerging growth companies over which California has some jurisdiction, as determined by one of the following factors:

- The company is headquartered in CA.
- The company has a significant presence or operations in CA.
- The company invests in businesses that are located in or have significant operations in CA.
- The company solicits or receives investments from CA residents.

In other words, most VC funds will fall under this regime.

Reporting requirements

- **Demographic data:** VC funds must report demographic information for the founding teams of the portfolio companies in which the fund invested the prior calendar year. Such information includes race, gender identity, LGBTQ+ identity, and disability or veteran status, and must be reported on an aggregated and anonymized basis. Funds must collect this information through a standardized survey provided to founders post-investment, though founders can decline to participate.
- **Investment data:** VC funds must also report the total amount invested in primarily diverse founding teams over the past calendar year, including as a percentage of the total venture capital investments they made.
- **Public reporting:** The law requires DFPI to publish each report on its website, which means information related to investments that is not currently public will soon be made accessible.
- **Failure to report:** VC firms that fail to file timely reports will have 60 days after receiving notice from DFPI to file. After that time period, the state could pursue additional remedies, including stiff monetary penalties of up to \$5,000 per day, for noncompliance.

Implementation

Venture capital firms will have to comply with the new diversity reporting requirements beginning in March 2026, which means VC funds will need to collect this information for investments made beginning in 2025. This law may still face legal challenges or be delayed further to address implementation issues, but fund managers should start assessing their compliance functions in preparation for these upcoming reporting obligations.

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