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California's Broad Venture Capital Diversity Reporting Law Amended to Now Take Effect in 2026

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As we previously reported, in October 2023, California enacted SB 54, a law requiring venture capital (VC) firms with a nexus to California to report data regarding the diversity of the founding members of the portfolio companies in which they invest.

The law aims to increase transparency surrounding diversity in the VC industry and promote more equitable investment practices. Given the intentionally broad scope of the law, it will impact a wide variety of funds – including those not physically located in California.

While the initial reporting deadline was March 1, 2025, there were early indications that this timeline may be delayed. California Gov. Gavin Newsom's office stated that "cleanup language" would be proposed in a subsequent bill.

Those updates came in the form of SB 164, which was signed by Newsom in June 2024. Most notably, the first compliance deadline is now pushed back a year, to March 1, 2026, and the state agency administering the law will now be the Department of Financial Protection and Innovation (DFPI), rather than the Civil Rights Department.

Set forth below are the key requirements of the law as recently modified.

Covered entities

An entity is a "covered entity" subject to this law if it meets **all** of the following three criteria:

1. It is a "venture capital company" as defined in Section 260.204.9 of Title 10 of the California Code of Regulations, which means that the entity satisfies one or more of the conditions below:
    - On at least one occasion during the annual period commencing with the date of its initial capitalization, and on at least one occasion during each annual period thereafter, at least 50% of its assets (other than short-term investments pending long-term commitment or distribution to investors), valued at cost, are VC investments, as defined in subsection (a)(5) of Section 260.204.9 of Title 10 of the California Code of Regulations, or derivative investments, as defined in subsection (a)(6) of the same regulations.
    - The entity is a "venture capital fund" as defined in rule 203(l)-1 adopted by the Securities and Exchange Commission (SEC) under the Investment Advisers Act of 1940, as amended (17 CFR 275.203 (l)-(1)).
    - The entity is a "venture capital operating company" as defined in rule 2510.3-101(d) adopted by the US Department of Labor under the Employee Retirement Income Security Act of 1974 (29 CFR § 2510.3-101(d)).
2. It primarily engages in the business of investing in, or providing financing to, startup, early-stage or emerging growth companies.
3. It meets **any** of the following criteria:
    - It is headquartered in California.
    - It has a significant presence or operational office in California.
    - It makes VC investments in business(es) that are located, or have significant operations, in California.
    - It solicits or receives investments from a person who is a resident of California.

The statute does not specify what level of activity will be deemed a "significant presence" or "significant operations" in California, and it also does not clarify whether the last prong applies to only investments received

from individual California residents or also includes investments from entity investors with offices in California. We will wait to see if the DFPI issues guidance on these and other interpretive questions.

This is an expansive definition that may capture entities that do not view themselves as VC firms, as well as entities that have a very limited nexus to California. Given that California is a significant hub of VC activity, this law will impact a significant portion of the VC industry. VC firms that rely on the venture capital adviser exemption to be exempt from registration with the SEC pursuant to section 203(l) of the Investment Advisers Act of 1940 and rule 203(l)-1 thereunder should expect some or all of their funds to be covered entities.

Data collection and reporting

Covered entities must collect and maintain diversity data about the founding teams of the businesses in which they invest each calendar year, starting with investments made in calendar year 2025. This data must be aggregated and reported to the DFPI on an annual basis, with initial agency registrations due by March 1, 2026, and the first data reports due April 1, 2026.

Demographic surveys

Covered entities will be required to present the founding team members of all businesses in which they invest (no matter where located) with a standardized demographic survey in a form that will be provided by the DFPI. The survey must be delivered to founding team members after the covered entity has made the investment (i.e., executed an investment agreement with the business and made the first transfer of funds). The survey cannot, for example, be included as part of the covered entity's pre-investment diligence.

The law defines the "founding team member" of a business as either the person designated as CEO or president of that business, or any other person who satisfies **all** of the following conditions:

1. The person owned initial shares or similar ownership interests of the business.
2. The person contributed to the concept of, research of, development of or work performed by the business before initial shares were issued.
3. The person was not a passive investor in the business.

Founding team members can decline to participate in the survey. Covered entities must give written notice in connection with the survey that such founding team member's decision to disclose their demographic information is voluntary, no adverse action will be taken against the founding team member if they decline to participate in the survey, and aggregate data collected for each demographic category will be reported to the DFPI. Covered entities may not – in any way – encourage, incentivize or attempt to influence the decision of a founding team member to participate in the survey.

Survey results must be collected and reported in a manner that does not associate the survey response data with individual founding team members, and the covered entity must preserve data for at least five years after the report is delivered.

Reporting

Starting March 1, 2026, covered entities must "register" with the DFPI by submitting their name, designated point of contact and other contact information to the agency. Such information must be regularly updated in all subsequent annual reports.

Starting April 1, 2026, and annually thereafter, covered entities must report to the DFPI the following information:

- **Founding team demographic data.** Using the information gathered from the surveys described above, the covered entity must report, at an aggregated and anonymized level, the following demographic information for the founding team members of all businesses in which the covered entity invested during the prior year: gender identity, race, ethnicity, disability, LGBTQ+, veteran or disabled veteran, California residency and whether the person declined to provide any of the information described above.
- **Investments in diverse-founded businesses.** Covered entities also must report the number of investments and total amount of investments in businesses primarily founded by diverse founding team members, as an aggregate percentage of

the investments the covered entity made, and broken down according to the demographic categories listed above.
    - The law defines a business as primarily founded by diverse founding team members if more than half of the founding team responded to the survey and at least half are people with diverse backgrounds and perspectives (defined in the law as those who self-identify as female, nonbinary, Black, African American, Hispanic, Latino/Latina, Asian, Pacific Islander, Native American, Native Hawaiian, Alaskan Native, disabled, veteran or disabled veteran, lesbian, gay, bisexual, transgender or queer).
- **Total amount invested and principal place of business.** The covered entity also must report the total amount of money it invested in each business during the prior calendar year and the principal place of business of each company in which it invested in the prior calendar year.

How will these reports be used?

The law specifically mandates that the DFPI publish each covered entity's report on its website in a readily accessible, easily searchable and easily downloadable format. Covered entities thus must prepare certain information that is not otherwise currently publicly available – such as their aggregate invested amount (i.e., aggregate cost bases of all investments) and number of investments per year – to now be readily accessible to the public.

The DFPI also may publish aggregate results or information and use any of the information collected in furtherance of its statutory duties, including but not limited to bringing a civil action. This leaves open the possibility that the DFPI, another state agency, or a private individual or entity with adequate standing may use the information disclosed in these reports as the basis for a discrimination claim against a covered entity.

Fees, enforcement

To cover its administrative expenses, the DFPI will charge covered entities at least $175 per report. This fee will be adjusted as necessary to meet the reasonable costs of administering the law.

If an entity fails to timely file a report, it will receive notice from the DFPI that it has 60 calendar days to do so without penalty. If the entity doesn't submit within that time frame, the DFPI may pursue all available remedies – including injunctive relief, attorney's fees and monetary penalties. Such penalties could be as high as $5,000 for each day the violation continues and could be increased further for reckless or knowing violations.

Next steps

The DFPI is actively working to prepare for implementation of this law, and it will issue guidance in 2025. It remains to be seen whether the law will be subject to any legal challenges that may delay or alter its implementation.

At the same time that many VC firms are preparing to comply with this new California law, they also are grappling with the recent *Fearless Fund* ruling and its implications for race-conscious investment initiatives. As a reminder, applicable federal or state law often prohibits entering into contracts or making other grant or investment decisions on the basis of race (and potentially other protected characteristics). Many firms thus find themselves walking a tightrope: While a stark underinvestment in certain groups or communities may be seen as evidence of biased decision-making, any investment decisions that are explicitly based on a protected characteristic also may be subject to legal challenge.

Furthermore, the collection of protected characteristics and other sensitive personal information may be subject to significant privacy and security requirements and restrictions under applicable state and foreign data protection laws.

Until the DFPI's form survey is published, covered entities are not expected to proactively gather any of the demographic information from their portfolio companies. As we await further information, investment firms can, however, take the following proactive steps to prepare to comply with this new diversity data reporting law:

- Determine whether any entity in their organization meets the definition of a "covered entity" under the law.

- Assess how various data protection laws may impact their data gathering and reporting efforts.
    - Which, if any, data protection laws is the firm subject to, and what are its obligations under those laws?
    - How would the firm gather and store the information it must report to the DFPI in a manner that complies with these laws?
    - What policies and procedures are already in place, and do they need to be revisited as the entity prepares to comply with the diversity data reporting law?
- Coordinate internally on compliance-related logistics.
    - What is the least intrusive way to present the survey to founding team members and streamline collection efforts across the firm's investment portfolio?
    - How will the firm store the information it gathers from founding team members?
    - Who will be the firm's designated contact with the DFPI?
    - Who will prepare the report for submission to the DFPI?
    - Which internal or external stakeholders (including legal counsel) will review such report before it is submitted?
- Understand what the firm's current diversity footprint looks like.
    - If the firm were to submit a report for its investments in calendar year 2024, what might that report look like? Is the firm prepared for the implications of such a report being made publicly available?
    - What assumptions might one make about the firm's investment decision-making process upon viewing the report?
    - Is it worth revisiting the firm's investment criteria and/or how that criteria is publicly disclosed?

Cooley's multidisciplinary DEI strategic counseling and litigation team is closely following this area and will issue updates on any developments – including agency guidance and any legal challenges. Contact a member of the team if you have any questions about this law and its interaction with other relevant legal obligations.

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