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On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

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Response to the European Commission Consultation Document on the Review of the European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) Regulations

About Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately-held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

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Table of Contents

Opening Remarks.....	3
Introduction.....	4
Consultation response	9
Annex I: Overview of Fees Charged by National Regulators for use of the EuVECA passport.....	31

Opening Remarks

The Public Affairs Executive (“PAE”) of the European private equity and venture capital industry welcomes the European Commission’s efforts and appreciates the opportunity to respond to the European Commission consultation document on the review of the EuVECA Regulation (the “Consultation”). We write on behalf of the representative national and supranational European private equity and venture capital bodies.

For many years, Invest Europe has been an engaged interlocutor with the European Commission following closely the different discussions and initiatives affecting the European private equity and venture capital industry. In particular, Invest Europe has been a consistent and firm supporter of the EuVECA Regulation, believing it to be a valuable mechanism to facilitate cross-border fundraising and thereby to allow smaller fund managers to raise capital from experienced investors freely throughout the EU without having to meet the disproportionate costs of authorisation and administrative burdens under the Alternative Investment Fund Managers Directive (AIFMD).

In this consultation response, we have focused solely on those aspects of the Consultation which are of particular importance to the venture capital and private equity industry. As such, we have limited our answers to those questions relating to the EuVECA Regulation and have not responded to those dealing with the EuSEF Regulation.

We stand ready to provide whatever further contribution to this work the European Commission might find helpful, including attending meetings and contributing additional materials in writing, and look forward to the opportunity to play a constructive role in the development of a proportionate and workable framework for EuVECA funds and their managers.

Introduction

Limited Experience with the EuVECA Regime

- Before addressing the details of the EuVECA Regulation, we would note that information on the application of the Regulation remains limited at this stage. Only a few venture capital fund managers have obtained the authorisation and permission to start marketing their funds using the EuVECA label to date. A number of reasons can be found for this.
- Firstly, the EuVECA Regulation is an opt-in regime and provides a voluntary marketing passport, i.e. if a fund manager does not wish to use the EuVECA designation (for example, because it does not find the current provisions attractive), then it does not have to comply with the Regulation. A venture capital fund manager, whether eligible for EuVECA or not, may, in any event, elect to continue to market under the national private placement regimes or voluntarily apply the AIFMD and acquire an EU marketing passport via that route.
- Secondly, as indicated above, the EuVECA Regulation aims to provide a voluntary EU-wide marketing passport for qualifying venture capital funds and their managers with assets under management below the €500 million AIFMD threshold. It is intended as an alternative regime to that set out in the AIFMD, which aims to create and establish a comprehensive and harmonised regulatory and supervisory framework for the management and marketing of private equity and other alternative investment funds (“AIFs”) in the EU. The focus of EuVECA being on marketing, a venture capital fund manager does not need to comply with the EuVECA Regulation for the (continued) management of its funds.
- Thirdly, interest in the EuVECA regime also depends on where venture capital fund managers are in the life cycle of their fundraising(s). A fund manager’s fundraising life cycle could be five years or more. Fund managers who are currently not raising a new fund, or are not planning to do so in the short term (as they are still in the investment stage of their current fund), will not immediately look into or consider applying for the EuVECA Regulation. They might only do this when they are approaching their next fundraising.
- Finally, while there are many venture capital fund managers that both raise funds and invest across Europe, there are equally still many that have a national focus and operate mainly on a national basis. They raise funds from national investors and invest these funds in portfolio companies based/established in their home country. As such, these fund managers do not immediately need the EuVECA Regulation to be able to continue to do their business. While the EuVECA Regulation is itself designed to encourage funds to operate on a cross-border basis, this national focus is an ongoing feature of the industry that needs to be recognised.

Importance of maintaining flexibility and freedom of choice

- One of the main sources of equity financing for EU SMEs in their early stages of development is venture capital and private equity.

- Venture capital and private equity managers connect providers of capital from across the EU and beyond with businesses that are looking not only for equity investment but also for the operational guidance and assistance that such managers can bring. Indeed, one of the distinguishing features of venture capital and private equity is that its managers provide the active ownership which these young companies need in order to professionalise their business (e.g. advice regarding governance, management, operations and processes) and thus grow, expand and develop. It is this combination of patient capital and active management that characterises the venture capital and private equity model and differentiates it from other asset classes.
- In order to be able to make such investments, these managers raise funds from investors like insurance companies, pension funds, family offices and foundations across Europe, and in some cases also globally, and channel such funds into SMEs. Against this background, it is important that smaller fund managers are left with options for how best to market their funds and to raise capital from investors. They must not be forced to adopt one route or the other but given the freedom to choose that which best suits their specific needs. More concretely, they should be allowed the option to market in other Member States, whether through the voluntary EuVECA regime, an extended or similar voluntary EU regime (see next bullet point), or through (national) private placement regimes, all in the context of TFEU (Treaty on the Functioning of the European Union) freedoms.
- A voluntary EuVECA regime that provides an optional passport must therefore continue to exist alongside a functioning and open private placement regime. In addition, an extended or similar voluntary regime should be introduced for small managers employing private equity strategies which support SMEs at the next stage of their development. Such a new regime should have more relaxed eligible assets rules compared to EuVECA.

Increasing the accessibility of the EuVECA regime for venture capital and smaller private equity managers

- Private equity and venture capital funds do not generate systemic risk, a fact that was recognised by the co-legislators who agreed that it would be disproportionate to apply the full AIFMD regime to managers of either private equity or venture capital funds/AIFs with total assets below €500 million. The rationale behind establishing a tailored and proportionate regime for managers of smaller AIFs was (and is) clear, and also proved instrumental in the decision to adopt the EuVECA Regulation in 2013.
- However, while such smaller managers are - appropriately - excluded from having to comply with many of the AIFMD's requirements, countless managers are also effectively excluded from the opportunity to raise funds from investors located in other Member States, because of (i) the tightening of many national private placement regimes ("NPPRs"), or in some cases even their abolition; (ii) the AIFMD opt-in being too costly and burdensome; and (iii) the EuVECA Regulation (and its qualifying requirements) being too restrictive.

- Cross-border marketing by sub-threshold funds/AIFs has, post-AIFMD, become increasingly difficult due to the tightening and in certain EU Member States¹ even abolition of the NPPRs. (In this regard, it must be understood that the NPPRs applicable to EU sub-threshold managers are in many cases different from the NPPRs applicable to non-EU managers of non-EU funds seeking to access investors in the same Member States, also impacting competitiveness.) With the exception of a few Member States where rules are accommodating, sub-threshold managers are encountering obstacles in many jurisdictions where they want to register for marketing. Some Member States do not even allow smaller managers to make use of the national private placement regime to access investors. This has the effect of denying these managers any means to operate across borders, a state of affairs that arguably contravenes the free movement of capital in the EU and is in breach of Article 63 of the TFEU. Where Member States' rules allow smaller *domestic* funds to be marketed to institutional investors in their jurisdiction but not those from *other* EU Member States (e.g. as is the case with the Dutch regime), the negative consequences are particularly acute and quite contrary to the philosophy of the EU internal market.
- In addition, opting in to the full AIFMD regime is unlikely to be attractive to very many smaller managers, given the costs that this will entail.
- For many managers of sub-threshold funds, the EuVECA label is (or is becoming) the only way they can market across EU Member States. However, only a small group of these smaller funds will qualify for the voluntary EuVECA passporting regime given its operating requirements. Indeed, many EU-based venture capital funds are excluded from the EuVECA Regulation as it imposes a number of restrictions on, for example, what constitutes a qualifying investment (types of financial instrument that can be used and participation acquired) and what constitutes a qualifying portfolio company into which such a qualifying investment is to be made (e.g. only SMEs as per the EU state aid definition). Additional flexibility on the use of loan finance alongside equity finance would allow more managers to make use of the EuVECA regime, particularly for growth stage investment into SMEs and in turnaround situations where downside protection is of importance. The 250 employee limit under the SME definition is also a constraint, for example for companies in the services sector.
- We would therefore argue that the EuVECA regime should be optimised for managers of venture capital AIFs, including both smaller and bigger venture players, to ensure that (i) the EuVECA label becomes more workable and flexible for those venture capital managers already subject to it; and (ii) the label becomes more attractive and open to those venture capital managers whose AIFs currently do not qualify for the Regulation, thus allowing a much wider range of venture capital AIFs and their managers to qualify and benefit from the marketing passport.
- In addition, a similar regime for all other small (i.e. sub-AIFMD threshold) fund managers should be introduced. Smaller managers pursuing a 'growth' or similar strategy are also providing essential funding for developing European businesses and are helping to fill the funding and development gap

¹ For example, Germany. Within this context, it is important to keep in mind that the fact that a national private placement regime is abolished means, in the absence of a passport, that the market is completely closed.

for more established SMEs. They should not have to meet the full and, for them, highly disproportionate AIFMD requirements to be able to market to EU investors (which, given the difficulties encountered in cross-border marketing in the EU without an AIFMD passport, is often the only option). Furthermore, such an additional regime would contribute to the objectives of the Capital Markets Union (“CMU”) Action Plan, which aims at a better channeling of funds from investors to companies², as it will encourage and increase cross-border capital flows by reducing the costs and barriers of marketing. This in turn will increase competition and investor choice.

Potential options for achieving this include: (1) the creation of a separate chapter within the EuVECA Regulation for such funds and managers with operating requirements and conditions appropriate to them; or (2) the adoption of a separate but parallel legal instrument with similar provisions to the EuVECA Regulation and with operating requirements and conditions that are appropriate to this group of funds and managers.

EuVECA Regime - Changes needed but no further restrictions

- The barriers and disincentives that many Member States have put in place whilst implementing the EuVECA Regulation represent good examples of how the intentions of EU legislation to *remove* barriers to cross-border flows of capital may not be realised in practice. If such practices, such as the imposition of host fees and charges, are not challenged the benefits that the co-legislators intended to grant to small venture capital fund managers will not be achieved. These benefits - allowing them to access fully the single market and to compete when fundraising with those larger funds (for whom the AIFMD authorisation is proportionate) - are also consistent with the CMU Action Plan.
- Changes should therefore be made to the EuVECA regime in order to increase its take-up. However, the current review of the EuVECA regime must not lead to a revised Regulation that is more burdensome or to the imposition of disproportionate requirements with which smaller managers will be unable to comply. Taken together with the difficulties many such managers face in accessing national private placement regimes, this would further limit access to financing for SMEs.

A true single market for venture capital

- If the intention is to develop a true single market for venture capital, changes to the policy framework will be needed. EU investors interested in committing capital to venture capital find that the current regulatory framework pushes fund managers to focus on their domestic market, especially given the barriers to cross-border marketing that they now face. This is contrary to the goals of the EU single market and limits the risk diversification sought by investors.
- Clarification is needed as to whether the EuVECA passport only grants a marketing passport, or also a

² See speech by Commissioner Jonathan Hill at the Euromoney Capital Markets Union Forum, 3 December 2015, Speech/15/6244.

cross-border management passport. Neither the existing Regulation nor the consultation document are clear on this point.³ We would welcome the confirmation that the EuVECA passport may constitute (potentially) both a marketing passport and a cross-border management passport. For a venture capital fund to be pan-European or truly global, the passport should be all encompassing and include fundraising and management.

Within this context, it is important to keep in mind that investors sometimes request funds to be structured and/or to be established in certain jurisdictions (for example, for the sake of proximity). An EuVECA fund manager should be allowed to manage EuVECA funds across borders; it would make no sense for an EuVECA fund manager to be forced to set up an EuVECA fund in another jurisdiction with the exact same structure.

³ The wording used on page 4 of the Commission's consultation paper (the paragraph starting "In order to achieve the above aims...") refers to a marketing passport only) and on page 7 (the first paragraph starting "In these circumstances" explicitly mentions marketing and management passports) requires clarification.

Consultation response

Question 1) Should managers authorised under the AIFMD be able to offer EuVECA to their clients?
Please explain

- Yes. Fund managers who are above the AIFMD threshold should be permitted to manage and offer EuVECA funds as long as they are pursuing an investment strategy that meets the Regulation’s definitions and requirements. The nature of the fund’s investments (i.e. the venture capital strategy of the fund) should determine whether it qualifies for the EuVECA designation. Currently, the AuM threshold precludes larger venture capital firms from offering EuVECA to their clients. If the objective is to increase venture capital financing and to promote investment in non-listed companies, then it would seem logical to allow larger venture capital firms to offer EuVECA.
- This would (i) be consistent with Recital (9) of the EuVECA Regulation, and (ii) allow the fund manager access to ‘semi-professional’ investors. The manager’s total assets under management should not determine whether or not the venture capital fund can approach semi-professional investors.
- ESMA has already explicitly recognised that Alternative Investment Fund Managers (AIFMs) above the threshold of Article 3(2)(b) of the AIFMD can manage and market EuVECA funds. In its [Questions and Answers on the Application of the EuVECA Regulation](#), ESMA states on page 4 that:

“While the Regulation limits the benefit of the ‘light touch’ passporting regime to sub-threshold managers, the use of the EuVECA and EuSEF designation is not exclusive to these managers. In accordance with Article 2(2) of the Regulations, EuSEF and EuVECA managers that subsequently exceed the threshold in Article 3(2)(b) of the AIFMD, and therefore have to seek authorisation in accordance with the AIFMD, are entitled to market and manage EuSEF and EuVECA in accordance with the Regulations. Therefore, Article 2(1) of the Regulations cannot be interpreted as excluding AIFMs authorised in accordance with the AIFMD from using the designation EuVECA or EuSEF in relation to qualifying funds, as long as they ensure compliance with Articles 3 and 5 and points (c) and (i) of Article 13(1) of the EuVECA and EuSEF Regulations.

It should be taken into account that, to the extent AIFMs above the threshold are required to be authorised under the AIFMD and comply with the rules of the AIFMD, there are no prudential concerns in allowing these AIFMs to set up and market EuVECA and EuSEF to professional investors. From a regulatory and supervisory perspective, an authorisation under the AIFMD is more stringent than a registration under the EuVECA and EuSEF Regulation. Therefore, being authorised under the AIFMD should not trigger the process in Article 21(1)(c) of the EuVECA Regulation and 22(1)(c) of the EuSEF Regulation. (...)” (emphasis added)

- Any manager with a fund that meets the definitions and eligibility criteria should be able to offer an EuVECA fund under the Regulation’s requirements (rather than under the AIFMD requirements that

are applicable to the Alternative Investment Fund Manager itself). Obviously, a manager should be required to comply with the EuVECA Regulation (as opposed to the AIFMD requirements) in respect of the fund (albeit that certain organisational rules under the AIFMD - such as minimum capital requirements - will apply to the manager irrespective of the types of funds it manages).

- Furthermore, we believe that such application would add further flexibility for AIFMD managers, would likely increase the use of and knowledge about EuVECA, and would further promote the development and financing of small and medium-sized enterprises.
- It should also be noted that in some Member States sub-threshold managers that would be eligible to offer EuVECA funds and to benefit from that regime's proportionate requirements are actually being required to apply the much more demanding (and for them *disproportionate*) AIFMD. In Italy, for example, *all* national AIFMs, including sub-threshold managers, are required to be authorised by the supervisor and to comply with the same organisational and supervisory requirements (except that sub-threshold managers can benefit from certain limited exemptions).
- Against this background, greater effort should be made at EU level to improve the situation for those fund managers who are eligible to benefit from the EuVECA passport. This would probably include reconsidering the interaction between the EuVECA Regulation and section 3, paragraph 3, of the AIFMD allowing Member States to adopt stricter rules in regulating sub-threshold managers. Allowing managers authorised under the AIFMD to set up and offer EuVECA funds and/or extending the "grandfathering" rule for the EuVECA passport will not solve these regulatory discrepancies.

Question 2) Should managers authorised under the AIFMD be able to offer EuSEF to their clients? Please explain.

N/A

Question 3) What would be the effect of EuVECA or EuSEF managers, managing EuVECA or EuSEF funds only, continuing to enjoy the relevant passports once the total EuVECA or EuSEF assets under management, subsequent to their registration as fund managers, exceed the threshold of €500 million?

- Continuity of access to the EuVECA passport would enable longer-term commitment to a venture strategy and would provide incentives for scaling up. Managers would be encouraged to grow the number and size of EuVECAs under their management and to establish new EuVECAs without having to fear that doing so would trigger the significant and costly new requirements that would come from their breaching the AIFMD threshold. Creating incentives for managers to hold back their development so that they remain below the threshold is contrary to the original objective of promoting the growth of the cross-border venture capital industry in Europe.

- The benefit of being able to continue to apply the EuVECA regime is justified by the type of investments made by an eligible fund. We believe that this is true for venture capital investments (due to their importance to the economy) but also for smaller private equity fund managers - see further below.
- ESMA already explicitly recognises that EuVECA managers which subsequently exceed the threshold of Article 3(2)(b) of the AIFMD may set up new EuVECA funds once the threshold is exceeded.

[ESMA's Questions and Answers on the Application of the EuVECA Regulation](#) expressly states (page 4):

“In accordance with Article 2(2) of the Regulations, EuSEF and EuVECA managers that subsequently exceed the threshold in Article 3(2)(b) of the AIFMD have to seek authorisation in accordance with the AIFMD and comply with the AIFMD requirements. These managers can continue using the EuSEF and EuVECA denomination in relation to the marketing of qualifying funds under the conditions set out in subparagraphs (a) and (b) of Article 2(2) of the Regulations. The Regulations, therefore, do not prohibit the managers in this situation from setting up and marketing new funds under the EuSEF and EuVECA denominations.” (emphasis added)

- We are very much in favour of this approach as permitting EuVECA fund managers to continue to enjoy the EuVECA label as their total assets under management grow above the €500 million threshold would allow managers to subsequently raise further or slightly larger funds enabling growth of the sector and the eco-system for taking SMEs from seed stage to scale. Indeed, (qualifying) venture capital funds should be able to “follow the money” and invest in later stage companies providing development and growth capital to promote scaling opportunities. As the European Commission’s Action Plan on Building a Capital Markets Union recognises (page 7): *“Entrepreneurs with promising business plans need to be able to secure financing to realise their ideas. Successful firms will need access to financing on attractive terms to fund their expansion. (...) A successful Capital Markets Union (CMU) should broaden the range of financing options for growing companies. These opportunities should exist and be available to entrepreneurs across all 28 EU Member States and across all stages of the ‘funding escalator’.”*⁴ (emphasis added) On page 8, the Action Plan then goes on to say: *“Rapidly expanding firms, with high growth potential but limited working capital, may encounter funding gaps at critical moments in their expansion.”* (emphasis added)
- The principles-based approach of the EuVECA Regulation is much better suited to venture capital managers undertaking investment activities in relation to illiquid assets. Many of the provisions of the AIFMD are disproportionately burdensome for the venture capital industry as these AIFs neither trade nor are themselves traded in on a regular basis.
- However, there is one important issue (which is also covered in the ESMA Q&A) that should be reconsidered and reviewed. While the Q&A expressly allows venture capital managers who exceed the AIFMD threshold to continue to market their (qualifying) funds under the EuVECA label, they do have to seek authorisation in accordance with the AIFMD and need to comply with the AIFMD requirements.

⁴ http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf

Ideally, such venture capital fund managers should not be required to opt in to the AIFMD (or at least not right away), given the significant additional costs and compliance burdens that they will face when reaching that threshold. It is important to bear in mind that such fund managers might not exceed the AIFMD threshold on a permanent basis; it may as well be that after a few months they fall below the threshold again. Furthermore, in certain Member States the national law implementing the EuVECA Regulation provides a regulatory framework for smaller fund managers, not just a marketing passport.

- It is important to mitigate the impacts of regulatory cliff edges. It would be a disincentive if venture capitalists were obliged to comply in full with the AIFMD as soon as they are being successful and achieve a certain growth in assets under management. To put the issue in stark terms: is it really necessary for EU financial stability for managers of EuVECA funds to immediately comply with the AIFMD once their assets under management tick over from €499 million to €500 million? Does this not create a significant regulatory disincentive for venture capitalists to achieve the scale that is generally recognised to be missing in Europe?
- Furthermore, we would recommend caution regarding the retroactive application of the rules. It should be clarified that EuVECA should only cover those funds which fulfil the EuVECA definition; if the threshold of €500 million is exceeded, no retroactive compliance should be required. It is already problematic under the AIFMD that once the AuM threshold is reached a fund manager is forced to comply retroactively with rules which it was not subject to when a particular fund was set up. Where these rules incur more costs to investors (e.g. the appointment of a depositary; additional reporting) the effects will be particularly pernicious.

Question 4) What would be the effect of EuVECA or EuSEF managers, managing EuVECA and/or EuSEF funds, continuing to enjoy the relevant passports once their total assets under management, subsequent to their registration as fund managers, exceed the threshold of €500 million?

- See Question 3. It would add flexibility to the EuVECA regime and support the growth of the venture capital industry, an objective of the CMU. If such managers were not permitted to continue to use the EuVECA passport they would face a regulatory ‘cliff edge’, in effect penalising them for their growth and success.
- Provided the fund (or funds) in question meet (and continue to meet) the EuVECA criteria they should continue to be able to use the Regulation.

Question 5) What has been the effect of setting the current threshold at €100,000?

- Investors in venture capital funds are typically institutional investors as well as family offices and certain types of individuals. Individual investors may include:

- o Entrepreneurs and other angel investors (many of which are entrepreneurs themselves), who have traditionally constituted an important source of “intelligent capital” to the small funds sector;
- o Members of management teams running companies in which the fund invests;
- o Industry sector experts (where the fund has a sector focus);
- o Venture capital experts which would include both venture capital executives and other professionals connected with the industry;
- o Finance sector experts; and
- o High net worth individuals.

Against this background, Invest Europe welcomed and has always been a supporter of the introduction of an additional category of eligible investors in the EuVECA Regulation. Indeed, the availability of a passport for semi-professional investors and the freedom to market to high net worth individuals has been a big attraction for those firms that have applied for the EuVECA Regulation.

- In that respect, Invest Europe also welcomed the additional flexibility introduced in Article 6, paragraph 2 of the EuVECA Regulation, which exempts executives, directors or employees involved in the management of a manager of a qualifying venture capital fund from the marketing requirements of Article 6, paragraph 1 and the €100,000 minimum investment.
- The semi-professional investor concept is very similar to the ‘well informed investor’ test in Luxembourg (€125,000) that is extremely effective. It is very easy to apply in conjunction with an investment warning and given the threshold amount is high enough, no retail investor would invest lightly.
- Furthermore, the €100,000 threshold is helpful in that it ties in with the Prospectus Directive public offer exemption.

Question 6) What effect would a reduction in the minimum €100,000 investment have on the take-up of EuVECA? If you favour a reduction, what would be an appropriate level?

- Although a lower threshold would add flexibility to the EuVECA regime and could increase take-up, on balance we would not favour a reduction of the entry ticket and would prefer to keep the minimum investment level at €100,000.
- A lower threshold would bring EuVECA funds into the retail arena, which would inevitably lead to the (in many ways understandable) pressure to introduce additional investor protection requirements that are necessary for retail investors but would simply raise the cost of undertaking venture capital activity. The associated burden on managers would probably not be mitigated by increased take-up by private individuals.
- In any case, investors in venture capital funds are typically investing well above such threshold.

- However, in the context of closed-ended funds, it is important to recognise that this €100,000 threshold may be satisfied by reference to an investor's (total) initial "commitment" to the EuVECA fund, which may be drawn down in tranches - on an as needed basis - gradually over the life of the fund (i.e. not in one go).

Question 7) What effect would a reduction in the minimum €100,000 investment have on the take-up of EuSEF? If you favour a reduction, what would be an appropriate level?

N/A

Question 8) How would any reduction of the minimum €100,000 investment be balanced against the need to ensure appropriate retail investor protection?

- See Question 6. We do not, on balance, favour reducing the investment threshold for EuVECA funds. The additional retail-style protections, which would rightly be required, would bring additional costs which would make the regime unattractive for many smaller managers.
- Indeed, if minimums were reduced, whilst the fund could become attractive to smaller investors, operational costs will be increased, to accommodate the servicing of an enlarged investor base, and this is likely to have a negative effect on net performance - and hence possibly drive away institutional investors who make up the vast majority of the fund's investment.

Question 9) Are the costs relating to fund registration proportionate to the potential benefits for funds from having the passport?

- Further detail on the costs of fund registration and additional requirements is set out in our response to Question 18. While it will ultimately be up to each manager to carry out a cost-benefit analysis in relation to the timing of compliance, we generally consider these costs to be obstacles to setting up an EuVECA fund and do not agree these costs are proportionate for smaller fund managers.

National examples

- From a German perspective, the additional organisational requirements imposed by the German competent authority (BaFin) are substantial and are only accepted because otherwise there is no alternative to market for small fund managers. However, not all managers can afford these costs and so venture capital funds simply refrain from cross-border marketing.
- Pursuant to the Italian laws and regulations implementing the AIFMD and the EuVECA Regulation, an Italian EuVECA fund manager is subject to almost the same organisational and structuring requirements and burdens imposed on an Italian AIFM. Accordingly, setting up an EuVECA fund in Italy is more expensive than in other European jurisdictions.

Local marketing fees

- Local marketing fees also discourage managers from marketing a fund in the whole EU. The benefit of marketing a fund in the EU is very limited compared to the costs, and especially smaller funds will not, under the current rules, market a fund in most EU countries. The costs are an obstacle to the success of the EuVECA regime. See response to Question 18 for more information.

Question 10) Are the registration requirements for EuVECA a hindrance to the setting up of such funds in your Member State and, if so, how could this be alleviated without reducing the current level of investor protection?

While in some Member States the registration requirements are moderate and manageable, in other countries the time, costs and administrative burden associated with registering a small venture capital fund are not only too onerous but also a heavy burden for most managers of EU venture capital AIFs.

Country overview

Based on experiences of venture capital managers that have been through the EuVECA process we have the following observations:

- In Denmark the fees are relatively limited.
- The registration requirements in Ireland are not a hindrance to setting up new EuVECA funds. Once the AIFM is registered, when a new fund is established, no further registration is required unless the registered AIFM details are changed significantly. The registration requirements are moderate and manageable.
- Also in the Netherlands, the registration requirements are not considered a hindrance for setting up an EuVECA fund.
- At the other end of the spectrum, Member States are imposing additional, onerous registration requirements that were not foreseen by the Regulation itself.
- For example, the process in Germany is more akin to a full authorisation. Full authorisation is also required in the UK but under a very similar licensing regime to the pre-existing domestic authorisation regime, and therefore one which is reasonably well understood and manageable.
- Certain countries (including France) require full-scope AIFMD authorisation, completely obviating any benefit of the EuVECA regime.
- A similar situation can be observed in Italy, where the legislative framework for implementation of the AIFMD has not provided a lighter regulatory regime for sub-threshold managers, which is different

from that imposed on fully AIFMD compliant and authorised managers. A venture capital fund manager wishing to use the EuVECA designation and passport must comply with a number of operational, organisational and transparency requirements, including those related to portfolio composition, and concerns regarding borrowing, delegation, conflicts of interest and valuation. These obligations and compliance requirements impose additional costs on the setting up of such funds.

Sub-threshold managers who also decide to obtain the EuVECA passport must comply with the full set of obligations and requirements under the AIFMD. This is a costly and onerous exercise for smaller AIFMs arising from the:

- authorisation process (including legal and advisory costs);
 - AIF depositary costs (including the arrangements needed for the appointment of a depositary);
 - initial marketing notification and documentation.
- In other countries like Finland, managers have been facing local “fit & proper” requirements which were not clear at all and took some time to resolve.
 - In Luxembourg, registration requirements are also perceived as a hindrance for small managers which sometimes do not even consider an application for registration. Inappropriate requirements include high minimum capital requirements, high registration and marketing fees, the requirement to set up a local IT infrastructure or to use local service providers as opposed to well-known international cloud offerings, the requirement to hire an external auditor for the manager, and finally the separation of roles for micro entities.

Moreover, the requirements are to a large extent aligned to the requirements of the AIFMD, especially in terms of human resources (segregation between portfolio and risk management), own funds (currently at €125,000 in Luxembourg), infrastructure (including IT) and audit requirement at manager level (with annual costs of around €20,000).

Question 11) Are the registration requirements for EuSEF a hindrance to the setting up of such funds in your Member State and, if so, how could these hindrances be alleviated without reducing the current level of investor protection?

N/A

Question 12) Are the requirements for minimum own funds imposed on the managers relating to fund registration proportionate to the potential benefits for funds from having the passport?

- Yes, the approach and minimum own funds requirements as set out in the EuVECA Regulation, i.e. a general obligation to have sufficient own funds - with no specific amounts or formulae required - and

an obligation for the *manager* to be “*able to justify the sufficiency of their own funds to maintain operational continuity*”, are reasonable and proportionate.

- However, although the EuVECA is set out in a Regulation - which is directly applicable - and does not require separate national legislation for its implementation, it seems that in practice national regulators interpret the requirements for minimum own funds differently and as a result, the level of own funds requirements differs from Member State to Member State (and as such, the appropriateness and proportionality of such requirements varies, creating an uneven competitive environment). A short overview is set out below.
- We understand that there are or have been discussions in certain Member States about imposing high capital requirements, along the lines of those required under the AIFMD, on venture capital fund managers using the EuVECA label. We understand for example that in Germany the manager is required to retain $\frac{1}{4}$ of the yearly overhead costs. A similar case can be observed in Luxembourg, where the own funds requirement amounts to €125,000. In Denmark the own funds requirement totals $\frac{1}{8}$ of the costs for the preceding year, which is considered to be reasonable. In Ireland, under certain circumstances the $\frac{1}{4}$ can be reduced to $\frac{1}{8}$ of the yearly overhead costs.
- Invest Europe would strongly encourage the European Commission to maintain the flexible approach established in the current Regulation and to undertake a comprehensive assessment of any additional obligations not foreseen in the text of the EuVECA Regulation that are being introduced by Member State competent authorities (or are under consideration by them) to ensure they are genuinely compatible with EU law.
- ‘Sufficient capital’ for a venture capital manager has to be understood in the context of a small management company, with small management teams, offering high expertise and only taking very few investment/divestment decisions per year related to a limited number of illiquid assets. This context was the very reason for introducing a differentiated regime for such managers. It is also worth noting that managers often take out PII policies to cover general investment risks.
- There is benefit in allowing Member States (a certain level of) flexibility to determine sufficiency of capital, in part based on local circumstances. The disadvantage of this is that we end up with different levels of capital requirements across Member States. This is an area where ESMA’s supervisory convergence function could be used, helping Member States to arrive at a common understanding of ‘sufficient capital’ and what it means in the specific circumstances and context of the venture capital industry in their jurisdiction.

Question 13) Should the use of the EuVECA Regulation be extended to third country managers and if so, under what conditions?

- Yes, extending the availability of the EuVECA regime to third country funds and third country managers would be a sensible step. Europe should take the initiative to develop a regime that is open and welcoming and gives EU investors access to a wider range of managers (some of whom may well also be investing into European start-ups).
- The fact that the regime is only available to EU-domiciled funds and fund managers limits its attractiveness. EU innovative companies and SMEs need capital to grow and investors which can commit for the long term. Access of and to non-EU funds is important for the continuous supply to European companies with capital from outside Europe and for European investors and their asset allocation strategy. Particularly in the case of companies at the earliest stages of their development, there is a tendency for entrepreneurs initially to seek capital from managers with a particular niche-sector expertise. In an increasingly global market place companies will seek this capital and expertise irrespective of its location.

The European economy cannot afford to deprive its managers and companies of resources coming from investors in cooperative third countries. Similarly, the freedom of European investors to invest in EuVECA funds and managers located outside the EU should also be ensured, not least to enable them to pursue the investment strategy that is best for them.

- The position of third country venture capital managers should therefore be considered as an integral part of the review of the EuVECA Regulation. In today's market even investments in very early stage businesses in Europe may be funded by small funds based outside the EU; SMEs will look to obtain the capital and expertise from the best source for their particular needs, wherever that source may be located. From the investors' perspective, it is important to be able to manage an appropriately diversified portfolio of small funds (and private equity funds in general). Consequently, also for EU investors it is important to be able to invest freely in small funds, whatever their location, as fettering investors' ability to do so makes investing in small funds generally far less attractive.
- The global nature of capital markets and the need for the CMU to fit within a global framework is recognised in the European Commission's Action Plan on Building a Capital Markets Union. A key objective of the CMU is also to continue to attract global capital into Europe. On page 27 the Action Plan says: *"For EU capital markets to thrive, they will need to be open and globally competitive, and able to attract additional equity and debt investment from international investors. CMU will help to make EU capital markets more attractive to international investors by eliminating legal and administrative cost to cross-border operations, and enhancing convergence of supervisory outcomes across Europe. Given the global nature of capital markets, Capital Markets Union must take account of the wider global context and ensure that European capital markets remain an integral part of the international financial system."* Europe's venture capital and private equity industry is much smaller in scale in comparison with the US. The EU should not close itself off from this external expertise.

- Against this background, the industry is in favour of a level playing field in terms of regulations that are applied to both EU and non-EU small fund managers. All of the same freedoms for EU qualifying fund managers should be available on the same terms, and without further material conditions to:
 - o EU managers of non-EU qualifying/eligible funds;
 - o non-EU managers of EU qualifying/eligible funds;
 - o non-EU managers of non-EU qualifying/eligible funds; and
 - o affiliates established in the EU of non-EU managers of qualifying/eligible funds wherever established.
- Such a third country passport would of course bring the need for quality assurance of the manager (as in other pieces of financial services legislation). As such, the industry acknowledges that it should for example be appropriate to require non-EU jurisdictions not to be listed as a non-cooperative country or territory by the Financial Action Task Force.
- In addition, access to an EU investor base should/would inevitably come with certain conditions attached and organisational requirements to be put in place. Careful thought should therefore be given to more technical and organisational aspects that would be linked to such a third country passport for EuVECA. Examples include the need to appoint a Member State of Reference and the determination of the national competent authority that would be in charge of regulating, supervising and checking compliance by those third country entities.
- Finally, venture capital funds (active) in developing countries might be of particular interest here for broader policy reasons. EU investors are currently able to invest in small funds established in, or with an investment focus on, the developing world, where the EU investor is based in a Member State with a private placement regime which supports this activity. The small fund model is increasingly being used in developing economies and any EuVECA regime for third countries should not impede EU investors from being able to support such funds.

Indeed, it is important that the design of the EuVECA regime does not prevent small, developing world funds from participating through voluntary registration. It is equally important that such funds and fund managers who choose not to opt in (perhaps for cost reasons) are not prohibited by this initiative from reaching those investors in the European Union who are currently able to invest through Member States' private placement regimes (and/or under Treaty freedoms).

Question 14) Should the use of the EuSEF Regulation be extended to third country managers and if so, under what conditions?

N/A

Question 15) Is the current profile of eligible portfolio assets conducive to setting up EuVECA funds? In particular, does the delineation of a ‘qualifying portfolio undertaking’ (unlisted, fewer than 250 employees, annual turnover of less than €50 million and balance sheet of less than €43 million) hinder the ability to invest in suitable companies?

- The current profile of eligible portfolio assets limits the EuVECA regime’s attractiveness. The qualifying investment requirements as currently included in the EuVECA Regulation should be re-considered and made more flexible.
- The way in which “qualifying investments” is defined is unnecessarily narrow and fails to provide sufficient flexibility for fund managers to find innovative ways of financing growing businesses. For example, in Finland there have been cases of venture capital firms not taking equity ownership in the portfolio company itself, but instead investing in specific projects (such as the development of a specific video/mobile game). In practice, they have in some cases formed an SPV with the target company, but in others a combination of loans and an arrangement where the target company pays royalty or profit-sharing interest based on the specific project has been used. Such arrangements would not fit within the current EuVECA requirements but are nonetheless valuable mechanisms to enable growing companies to secure financing.
- Moreover, the requirement to invest 70% of fund commitments in qualifying investments may deter managers who invest in SMEs. At the start of the fundraising process - when the manager is considering an application to become an EuVECA - the manager may not be confident that they can *guarantee* finding the number of attractive qualifying investments that are necessary to stay within this limit during the life of the fund. No manager would want to run the risk of marketing a fund as an ‘EuVECA’ only to fail to comply with its requirements for legitimate reasons of portfolio selection. The risk that investors in the fund could seek legal recourse or use that as a legitimate reason to cancel their agreement to commit capital can be sufficient to discourage managers from pursuing EuVECA authorisation. Furthermore, even fund managers that *are* functioning under the EuVECA Regulation find the 70%/30% requirement restrictive and impacting negatively on their investment decisions: a company they would otherwise have invested in has not been backed as doing so would fall foul of the requirements.
- In addition, 70% of an EuVECA fund’s investments must be made into portfolio companies which are based in jurisdictions that have entered into a Relevant Tax Agreement with each EU Member State in which the fund will be marketed.

More specifically, pursuant to Article 3, paragraph d (iv) of the EuVECA Regulation, qualifying portfolio undertakings must be established within the territory of a Member State, or in a third country provided that the *third country* (...) has signed an agreement with *the home Member State of the manager* of a qualifying venture capital fund and with *each other Member State in which the units or shares of the qualifying venture capital fund are intended to be marketed* to ensure that the third country fully complies with the standards laid down in Article 26 of the OECD Model Tax

Convention and ensures an effective exchange of information in tax matters, including any multilateral tax agreements.

In practice, it is difficult and complicated for a manager to confirm whether these requirements are met and to establish the existence of such OECD-compliant information exchange agreements.

Furthermore, some EU Member States have entered into few Relevant Tax Agreements (i.e. one that complies with the OECD Article 26 tax convention); or have agreements that do not meet the OECD standard.

- A fund seeking to make significant investments in Switzerland, for example, could struggle to comply as the agreement between the UK (a major source of institutional capital) and Switzerland does not meet the relevant standard. And any fund looking to market to investors in Austria, Bulgaria, Croatia, Latvia, Luxembourg, the Netherlands or Romania - a quarter of the Member States - could face difficulties given the relatively small number of agreements they have in place.
- Such issues deter managers from making an EuVECA application. The application must be made right at the beginning of the manager's marketing and fundraising activities, a point in the fund's life when managers will often not have the level of clarity on where the portfolio companies into which they might invest will be based, or where their target investors will be based. For many the inability to determine with enough certainty whether this 70% obligation is achievable throughout the full life of a fund (which could be 10 years) will be sufficient to discourage them from making an application.
- Venture capital funds invest across a wide range of stages from funding start-ups to providing development capital and later stage growth equity. The narrowness of the SME definition used in the EuVECA Regulation raises issues, excluding companies that would be considered 'small or medium' sized by fund managers and investors. Many innovative and rapidly growing SMEs can achieve the defined threshold very early on. Companies active in the services field, for example, may fairly rapidly reach 250 employees but from a financing and business development perspective are still 'early stage' and looking for funding from venture capital or other active fund investors.
- Large fund managers tend to execute transactions of a larger size, i.e. they look at and invest in companies that are larger than those defined by the EuVECA legislation (but are still considerably smaller than the size of companies typically involved in large buy-out financings elsewhere in the private equity market). As a consequence, this legislation is not currently attractive to managers with large amounts of capital to invest. However, there are an increasing number of managers that have funds in the €100-200 million bracket that do invest in early stage companies, although often those with more than 250 employees. It is this aspect that is proving to be most problematic, rather than the Turnover/Balance Sheet criteria.
- Furthermore, thought should be given to the effect on the fund in the event that a manager makes (i) a bolt-on acquisition or (ii) grows a company over the 250 employees or €50 million turnover

threshold. We believe that growth to this extent should be accommodated without a fund losing its EuVECA status.

- Against this background, the appropriateness of the current SME definition as it is used in the EuVECA Regulation should be reconsidered, in particular whether the 250 employee limit should be raised, or whether a “two out of three” test could be appropriate. Inspiration for this can be found in the Prospectus field and in particular the European Commission’s recently adopted legislative proposal for the Prospectus Regulation, which includes a “two out of three” test (Article 2.1(f)).

Question 16) Does a EuVECA’s inability to originate loans to a qualifying portfolio undertaking in which the EuVECA is not already invested hinder the attractiveness of the scheme for potential managers of such funds?

- Yes, the limited ability of an EuVECA fund to originate loans to qualifying portfolio undertakings is highly problematic in light of what is common market practice for early stage investing (i.e. where the volume of deals occurs). Even at later stages of financing the problem remains. See also our response to Question 17.
- An SME may during its growth cycle have demand for equity, mezzanine, loan and turnaround funding. For example, an SME experiencing high growth may not wish to cede a (further) share of ownership through equity investment, so mezzanine or debt investment would be more appropriate. The same SME when experiencing challenging trading conditions may find only investors prepared to invest through instruments such as secured loan notes with downside protection.
- Furthermore, venture capital funds may be interested in granting a loan to a qualifying portfolio undertaking in which other venture capitalists have already made an equity investment or as prelude to a future equity investment in such an undertaking.

Giving EuVECA funds the possibility to originate loans to qualifying portfolio undertakings in which the EuVECA is not already invested can represent a boost for the venture debt industry that is not particularly developed in the EU.

- In fact, for start-ups venture debt - being less dilutive for all current stakeholders - may represent an efficient source of capital when the only real alternative is equity. Venture debt provides working capital, allowing early stage companies to extend their financial runways in order to hit their next milestones and improve the company’s valuation for their next round of equity financing.

Question 17) In this context, does the rule that a EuVECA can only use 30% of the aggregate capital contributions and uncalled committed capital for loan origination reduce the attractiveness of the scheme?

- Yes. The requirement that secured or unsecured loans not exceed 30% of fund commitments will discourage those managers who are unwilling to deny themselves the flexibility to find the right mix of debt and equity as determined by market conditions and the circumstances of each portfolio company.
- Venture capitalists use commercial criteria and reasoning to decide whether they will invest equity or debt. They need flexibility and want to be able to adapt to changing circumstances. While equity is at the heart of venture capital, companies also need access to debt and their venture capital investors should be seen as potential debt providers as well. Every portfolio company needs tailored financing which will depend on the sector, the stage, the entrepreneur's preferences, the co-investors, etc.
- Concentrations of loan notes alongside equity are not uncommon for earlier stage investment. Quite the contrary, loans are in many cases used when the company needs funds quickly but the valuations that are essential for determining an equity investment may not be ready or may still be very uncertain given the profile and potential of such companies; or when co-investors have not yet been able to decide whether they can or want to inject additional equity but the company needs urgent financing. Loan notes, convertibles and warrants help to mitigate down-side risk and offer some protection for the fund should the portfolio company become insolvent or, as described above, where there is a need to urgently provide additional funding while accurate valuations necessary for an equity investment are being worked out.
- More generally, as the funding and financing needs of SMEs will vary over time and as the company grows there should be full flexibility allowed in the financing instruments to be used (i.e. no restriction as to the type of assets/instruments). Any limitation of finance would be contrary to the great need of flexibility of investments in SMEs and will worsen SMEs' access to finance. It is important that regulation should reflect the reality of how companies are financed, rather than prescribing how they should be financed. The 30% threshold should therefore ideally be removed, or at least increased.

Question 18) What are the key issues or obstacles when setting up and marketing EuVECA or other types of venture capital funds across Europe?

Host fees and charges

- One of the key benefits of the marketing passport offered by the EuVECA Regulation was that it would enhance efficiency at an EU level (avoiding multiple time-consuming registrations in each Member State) and have neutral to positive cost effects in comparison to having to obtain first time

or ongoing professional legal advice on a country-by-country basis of changes to the national private placement regimes in those Member States where one wants to market.

- However, although the EuVECA framework, being embedded in a Regulation, does not require national transposition (it is directly effective and therefore binding on the regulators in all Member States), some ‘host’ Member States are imposing additional (local registration and/or supervisory) fees and charges and/or other requirements on EU fund managers looking to use their EuVECA passport to market in that jurisdiction. See Annex I for more information.
- These costs, which are to be paid in addition to the *home* national registration costs and any legal and other professional advisory fees, constitute a substantial burden for venture capital managers, contribute to regulatory divergence and are an impediment to cross-border marketing. In fact, they are a disincentive to firms to operate in other Member States and are already causing some fund managers not to market in certain jurisdictions, thereby restricting the free flow of capital across EU borders and undermining the single market. Indeed, for many sub-threshold AIFMs seeking to market in only one or a few Member States, the cost of compliance may be higher than the benefit of the EuVECA passport.

Also the related requirement to define at registration the Member States in which the fund is considered to be marketed, simply diminishes the purpose of the passport.

- The imposition by *host* Member States of such passport fees which are not foreseen by the Regulation undermines its purpose and calls into question the co-legislators’ decision to develop a proportionate regime, tailored to the size and systemic risk characteristics of venture capital. The EuVECA passport will be seriously undermined if venture capital fund managers are obliged to pay up to 27 (or potentially 30 including EEA) host Member State regulators, navigating 27 (+3) registration and payment procedures in order to do so. The burden of completing the forms which many countries are also requiring (including the costs of discovering which forms need to be completed) is significant and should not be overlooked, especially if a fund manager needs to do this every year in 27 (+ potentially 3 EEA) countries using different forms in each.
- Where a venture capital fund manager has been authorised by its ‘home’ Member State to use the EuVECA label and to market this fund in other Member States, it cannot be obliged to pay any fee or charge to the authorities in any ‘host’ Member State as a condition of marketing in that jurisdiction. In a meaningful single market a fund manager that is fully compliant with the relevant EU law and that is in possession of a valid passport should be free to market across the EU.
- Moreover, there is no legal basis in the Regulation or other legitimate justification under EU law for Member States to impose such fees, or any other (additional administrative) requirements, on fund managers using the EuVECA label. The Regulation is very clear on the extent of the rights granted to a manager for a fund that has secured the EuVECA label:

Article 14(3)

“Registration under this Article shall be valid in the entire territory of the Union and shall allow managers of qualifying venture capital funds to market qualifying venture capital funds under the designation ‘EuVECA’ throughout the Union.” (emphasis added)

As such, there is also no legal basis in the EuVECA Regulation for such fees, rights or duties *in terms of registration*. On the contrary, it makes clear - in keeping with the whole philosophy of the Regulation - that it is the *home* Member State authority which is responsible for the registration process.

For cases of cross-border marketing, the Regulation makes clear that:

Article 16(2)

“The host Member States indicated in accordance with point (d) of Article 14(1) shall not impose, on the manager of a qualifying venture capital fund registered in accordance with Article 14, any requirements or administrative procedures in relation to the marketing of its qualifying venture capital funds, nor shall they require any approval of the marketing prior to its commencement.” (emphasis added)

- There is also no legal basis *from a supervisory perspective*. It is the *home* Member State authority that supervises the fund manager’s compliance with the Regulation, even where there are alleged breaches of the Regulation in the territory of a *host* Member State, and will take any subsequent enforcement action. The last resort procedure foreseen under Article 18 does not provide a legal basis or a justification to charge fees.
- This absence of any legal basis is also confirmed by case law of the European Court of Justice. According to case law, Member States may not add provisions to the legal framework laid out by a Regulation. Since Regulations are directly effective, Member States are not able, unless it is *specifically provided for* in the Regulation, to take any measures to modify the scope or add *any provisions* to these Regulations (see for instance Cases 74/69 and C-24/13).
- As the acquisition of units of an investment fund constitutes a movement of capital for the purposes of Article 63 TFEU, it is also our contention that restrictions on the free movement of capital are in principle prohibited. The fee requirement imposed by some national authorities creates a restrictive effect and discourages qualifying venture capital fund managers from marketing their funds across the European Union. It seems that no legitimate justification, such as those found under Article 65 TFEU, can be advanced for imposing such fees. Even if the objective of prudential supervision of financial institutions were invoked, it remains clear that imposing fees is disproportionate and that other, less restrictive, means (such as improved cooperation between national authorities) could be relied upon to ensure the fulfilment of that objective. Fees imposed by host Member States on EuVECA fund managers constitute therefore a hindrance to the free movement of capital, as protected within the European Union.

Inconsistencies in application - Varying national requirements

- In addition to the removal of the additional requirements set out above, which would bring immediate advantages, there are numerous inconsistencies with regard to the actual implementation of the EuVECA Regulation across the EU as explained in our response to Questions 10 and 12 that should be addressed and ideally ironed out.
- Ensuring that the EuVECA Regulation is applied consistently and appropriately across Member States could be an important step in encouraging take-up. Reducing incoherence and inconsistency will give smaller funds a better opportunity to make use of the EuVECA passport and to fundraise cross-border under this label by lowering the costs associated with it. The more requirements that are added by Member States, the greater the levels of complexity that are generated, which thus makes the regime less attractive for the small fund managers at which it is aimed. Goldplating of the Regulation by Member States should therefore be discouraged.

Incomplete implementation

- In countries like Norway, the national competent authority (Finanstilsynet) is arguing that “the distribution of units under the EuVECA Regulation is currently not possible in Norway as the EuVECA Regulation has not been transposed into the national law of Norway”.
- In Liechtenstein, the national regulator (FMA) does not accept notifications under the EuVECA Regulation pending implementation of the EuVECA Regulation into local law. During the interim period the FMA will accept cross-border marketing of EuVECAs only in compliance with the law on Investment Undertakings of May 19, 2005 (IUG) and the Ordinance on Investment Undertakings of August 23, 2005 requiring the EuVECA manager *inter alia* to appoint a representative and a paying agent in Liechtenstein.

Question 19) What are the key issues or obstacles when setting up and marketing EuSEF or other types of social investment funds across Europe?

N/A

Question 20) What other measures could be put in place to encourage both fund managers and investors to make greater use of the EuVECA or EuSEF fundraising frameworks?

Consistency and Proportionality

- Consistent application and notably the absence of any form of goldplating is a prerequisite to enhance the take-up of EuVECA funds.

- Furthermore, the concept of proportionality (i.e. the fact that policies must be appropriate to the size and organisation of the EuVECA manager and the nature, scale and complexity of its business) is a critical one, and any review of the EuVECA Regulation should be considered in light and on the basis of this overarching principle. Greater use of the concept of proportionality in particular in relation to smaller, start-up fund managers would also assist in reducing the year 1 regulatory burden (e.g. reporting).

Accommodating non-EuVECA qualifying, sub-threshold fund managers

- There is a strong case for reconsidering the narrow focus of the EuVECA regime and for extending this voluntary regime to other venture capital fund managers whose assets under management are also below the €500 million threshold but who currently do not qualify for EuVECA.

Limiting EuVECA only to venture capital AIFs that meet a specific set of fairly restrictive criteria automatically limits its potential take-up. It also implies a stark distinction between fund investment strategies that may not be helpful nor reflective of the needs and the experiences of neither the investors nor companies which they are typically looking to finance through different stages of growth.

- In addition, we believe a similar regime is needed for sub-threshold funds pursuing a growth/expansion strategy or even a small private equity/buy-out strategy. It is not just venture capital funds that provide finance to European SMEs; a major part of the financing provided to SMEs from our industry is provided by enterprise/growth capital funds, as explained further below.

This additional regime would only be attractive if the restrictions related to qualifying investments and portfolio undertakings were removed or reduced as explained further in our response to Question 15.

More concretely, such an extended regime should have broader eligible assets definitions and would need to allow for the greater use of loan investments and debt instruments. In addition, it should permit replacement capital (as well as the subscription for new shares) in companies, as well as the acquisition of shares in portfolio companies from existing shareholders (as opposed to treating as eligible only subscription for newly issued shares by portfolio companies). Furthermore, the SME definition should be reviewed as the employee test is proving to be problematic in practice.

- During their development smaller companies may be backed at different stages of their life by different types of funds. Funds with a ‘Growth’, ‘Development’ or buy-out strategy can play as important a role in the long-term success of a European SME as those with a ‘Venture Capital’ objective. A recent industry report showed that the probability of raising mid or late stage capital in Europe is three times lower than it is for early stage funding (compared to the US, where no such difference exists)⁵. This suggests that later stage fund investors into smaller companies may have an increasingly important contribution to make in Europe.

⁵ “Europe is your competitive advantage” - FranceDigitale, TechEU et al

- But such Growth, Development or small buy-out funds do not currently have access to an internal marketing passport unless they opt in to the full AIFMD (which is likely to be unduly burdensome for the type and size of fund they represent and not commensurate with their risk profile).
- These small funds should be provided with a means to market across EU borders, as failure to do so undermines the objective to establish a single market for capital. Fund managers who do not need to be authorised under the AIFMD are not likely to pose a higher degree of risk for investors than venture capital funds, and would still only enjoy a pan-EU passport to market to “professional” investors (and not to retail investors). Since development and growth finance, which is often also provided by a “buy-out” investor offering an exit to a founder, are just as important for the EU economy as start-up capital, an internal market passporting regime should be made available to these fund managers as well. There are several ways of achieving this: for example, by creating a second chapter in the EuVECA Regulation (while of course retaining a specific label for venture capital), or by developing a separate but parallel and very similar legal instrument to provide for such a passport for sub-threshold, non-venture capital managers.

Application Process

- The national application processes should be kept as short as possible. Time-to-market is key; otherwise managers will choose non-regulated vehicles which can be set up within a few days.

Other measures

- Other relatively straightforward measures could include:
 - increase the (awareness and) knowledge of EuVECA among investors, managers and regulators. Within this context, it is worth highlighting that ESMA’s EuVECA database/register is not updated on a regular basis. Keeping this up-to-date would help to make the label more visible and to compare the progress on registrations in other countries; and
 - financial incentives in order to support exit opportunities for venture investors and reduce the length of time to exit.

Question 21) What other barriers exist to the growth of EuVECA and EuSEF? Please specify. Are there other changes that could be made to the EuVECA and EuSEF regulations that would increase their up-take?

Please see our response to Questions 18 and 20.

Question 22) What changes to the regulatory framework that govern EuVECA or EuSEF investments (tax incentives, fiscal treatment of cross-border investments) would make EuVECA or EuSEF investments more attractive?

Prospectus Directive

- EuVECA funds should be exempted from the Prospectus Directive requirements where these funds are marketed only to professional and “semi-professional” investors, i.e. those who invest a minimum of €100,000 and understand the nature/risk of the investment, as defined in the EuVECA Regulation (Article 6.1). In Finland, for example, most offerings would be subject to an exemption in any event (small target group, minimum commitment, etc.) - although this may of course vary in different jurisdictions.

Investor Regulation

- Venture capital funds have great difficulty in raising capital from long-term institutional investors, in part because of the prudential requirements imposed on these institutions by European regulators.
- There is an extensive network of EU regulatory measures that apply to institutional investors, often designed to ensure the prudential soundness of the institution and to ensure financial stability. But legislation such as Solvency II, CRD IV/CRR or IORPD will also have a major impact on the investment decisions of those investors. They will, in effect, shape their willingness to act as suppliers of capital to particular asset types: prudential capital charges, for example, effectively change the anticipated net return to the investor from a particular investment.
- The experience of Solvency II highlighted serious difficulties in applying a ‘market-consistent’ approach to the determination of the risk associated with long-term asset classes, overstating in our view the risk that institutional investors face from such assets and thereby discouraging the commitment of capital to them. Where changes can be made easily (for example to the Solvency II Delegated Acts) or where further Level 1 legislation is necessary for other reasons (for example amendments to CRD/CRR to implement further recommendations from the Basel Committee) prudential capital requirements should be amended to promote rather than discourage the commitment of capital to private equity and venture capital funds, and through them to European businesses. Joined up thinking is essential. It is not possible to expect SMEs to grow and scale and yet to restrict access to the significant pool of capital managed by life insurance companies, pension funds and other institutional investors.

Tax Regime - Tax transparent fund structures

- A regulatory and tax regime that encourages capital to be committed to funds and that facilitates fund managers to invest in European businesses is vital for the growth of European venture capital. In its Annual Tax Report from 2015 the European Parliament stressed that “*cross-border investments, and in particular private investments, are imperative for the EU economy*” and highlighted that

“‘business friendly’ and ‘investment friendly’ tax initiatives are imperative in order to deliver a sustainable tax system which contributes to growth”.⁶

- If fund structures are unfairly penalised such cross-border investments will be impeded. Indeed, investors can face discriminatory and prejudicial treatment as soon as they are ‘pooled’ in a fund and denied the same treatment as those that invest directly into the underlying portfolio companies. In many circumstances, investors are faced with the risks of double taxation or unexpected taxes due to the use of a fund structure in a cross-border scenario. This tax disadvantage for investors could come from any of several sources such as national withholding tax, application of a potential EU FTT, or disallowance of tax treaty benefits via proposals from the OECD. This makes investment in private companies less attractive than investing in listed companies or even investing directly in private companies. The fiscal environment can therefore either reduce or reinforce the natural risk aversion of private investors.
- Put simply, institutional investors must not be left in a disadvantageous tax position from investing in an AIF (whatever the legal vehicle chosen) when compared to investing directly in assets. It is necessary to prevent double taxation: first, at the AIF level, when it receives income or realises an investment; and second, when an investor receives income or capital from the AIF. Tax transparency ensures investors are only subject to tax in their home jurisdiction, just as they would be when investing directly in company shares.

Fiscal benefit for individual investors

- One measure that could be introduced to encourage investors to invest in EuVECA funds is a tax incentive for investors that are not tax-exempt. Allowing EuVECA vehicles to benefit from a tax reduction for investors would help to maximise the amount of money that can be raised from individuals (although we recognise that this is largely an issue for Member States).

⁶ European Parliament, Annual Tax Report, March 2015 Eva Kaili Rapporteur

Annex I: Overview of Fees Charged by National Regulators for use of the EuVECA passport

Country	Amount of the fee	Details on the circumstances of payment and payment terms for the fees	Legal basis	Reference to the relevant national supervisory (and/or legislative) text	Additional information
Denmark	2,599 DKK (fee applicable for the calendar year 2014)		<p>Part 22 of the Financial Business Act</p> <p>The fixed fee amounts in section 361(1) of the Financial Business Act are stated at the 2004 level. These amounts are adjusted annually, corresponding to changes in the appropriation to the Danish FSA in the year's Finance Act. The fees in section 361(1) are in the year 2014 adjusted with an index of 206.25.</p> <p>According to section 368(2), an undertaking has to pay the full fee, even though it has only been under supervision for part of the year.</p>	<p>According to the Danish Financial Business Act No 182 of 2 February 2015, a foreign alternative investment fund marketing its shares or units towards Danish investors in Denmark has to pay a fee per alternative investment fund and sub-fund marketed in Denmark. The payable fee to the Danish FSA is not dependent on whether a fee has to be paid in the home Member State.</p>	<p>The Danish FSA says to be entitled to collect fees through statutory debt collection under the regulations laid down in Act no. 1333 of 19 December 2008 on collection of debt payable to the public sector.</p> <p>If the manager fails to pay the amount before the due date, the claim will be turned over to the Collection of the Central Customs and Tax Administration (SKAT).</p> <p>More information can be found on: www.dfsa.dk/afgifter</p>
Finland	1. €1,100 - for the processing of a notification concerning registration of a manager of a venture capital fund		1. Article 14		<p>The Finnish Financial Supervisory Authority published a schedule of processing fees, covering EEA AIFs (AIFs established in an EEA state other than Finland) and EEA AIFMs (AIFMs</p>

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	2. €400 - for the processing of a notification concerning marketing of units in an <u>EuVECA</u> fund in another <u>EEA state</u> by a manager of venture capital funds		2. Article 15		authorised in an EEA state other than Finland), as well as EuVECAs (345/2013) and EuSEFs (346/2013).
France	The amount of the total contribution due for an AIF is equal to the number of sub-funds multiplied by €2,000. An AIF without sub-funds is due to a fee of €2,000.		Articles L. 621-5-3 4° and D. 621-27 4° of the French Monetary and Financial Code	According to the French Monetary and Financial Code, foreign AIFs for which a marketing notification has been filed in France are subject to a fixed annual fee.	
Italy	Around €1,316 per qualifying venture capital (EuVECA) fund			Entities that need to provide information to enable the calculation of a fee seem to be defined as follows: “the entities held to provide the data and information required by the Procedure are all SGRs and SICAVs incorporated under the Italian law as well as all issuers of undertakings for collective investment instituted in a foreign country, both UCITS and not-harmonized undertakings, in accordance with the contribution criteria	The Italian supervisory authority has indicated that they want the venture capital fund manager to register first; based on that, they would compute the fees. According to the financial authority, the supervisory fees are due because of the notification for the marketing in Italy of the qualifying (EuVECA) venture capital funds.

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				effective from time to time”.	
Latvia	850 LVL for each fund marketed in Latvia annually	The payment shall be made annually until the Financial and Capital Market Commission receives a notification that the AIF marketing activities are going to be brought to an end.	<p>According to Article 82 of the Law for the supervision of AIF marketing in Latvia, the manager shall pay to the Latvian Financial and Capital Market Commission a fee of 850 LVL (or €1,209) for each fund marketed in Latvia annually.</p> <p>This fee is due for the supervision of the marketing of the investment units (shares) of each fund established in the member state or each third country fund managed by the fund manager.</p>		<p>The Law on Alternative Investment Funds and Their Managers transposing the AIFMD (Directive 2011/61/EU) and related legal acts is in force since 7 August 2013.</p> <p>The Law can be accessed here:</p> <p>http://www.fktk.lv/en/law/alternative_investment_fund_ma/laws/2013-09-24_law_on_alternative_investment_funds_and_their_managers/</p>
Luxembourg	The CSSF levies fees of €5,000 with respect to the processing of the initial registration of EuVECA managers / funds				
Malta	<p>For European AIFs:</p> <ul style="list-style-type: none"> • A notification fee of €2,500 • An annual supervisory fee of €3,000 	The MFSA is requesting payment of notification and supervisory fees.			European Venture Capital Funds are considered by the Authority as AIFs in accordance with Article 3(a) of Regulation (EU) No 345/2013.

Country	Amount of the fee	Details on the circumstances of payment and payment terms for the fees	Legal basis	Reference to the relevant national supervisory (and/or legislative) text	Additional information
	For sub-funds/compartments (fee is applicable per sub-fund): <ul style="list-style-type: none"> • A notification fee of €450 • An annual supervisory fee of €500 				In view of this, EuVECA funds are subject to <u>marketing notification fees</u> in accordance with L.N. 9 of 2014 - Investment Services Act (Fees) Regulations, 2014.
Spain	Initial registration fee of €2,500 (Tarifa 4.5.1).		The CNMV is requesting the payment of an initial registration fee according to Law 16/2014.		http://www.boe.es/boe/dias/2014/10/01/pdfs/BOE-A-2014-9895.pdf