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

Response to Inception Impact Assessment on Risk Finance Guidelines

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By clarifying the conditions set out in the General Block Exemption Regulation (GBER), the EU Risk Finance Guidelines (RFG) allow many start-ups and scale-ups to benefit from state aid support. As such, they are a crucial tool to foster innovation within the EU. As the association representing all types of private equity funds, including venture capital and growth ones, we broadly support the current Guidelines, which have been helpfully tailored to the specificities of businesses our members provide private support to.

Nonetheless, the current review still provides an opportunity to introduce additional flexibility within the GBER and RFG frameworks. This would ensure improved access to financing and support to innovation across the EU, also in the context of the economic consequences of a pandemic we have all faced in the past few months and will continue to face in the coming years.

Guidelines contain a crucial exemption from the undertakings in difficulty definition for "SMEs within 7 years from their first commercial sale". Several amendments could make it easier for innovative businesses to be eligible in all relevant cases:

(i) tailoring the **definition of an SME** for venture-backed firms

As recognised by the European Commission in the preparatory work on the review of SME definition (Recommendation 2003/361/EC of 6 May 2003), the current definition – and more specifically the concept of a "linked enterprises" - prevents businesses which receive majority ownership from a venture capital company (and any kind of ownership from a growth fund) to be eligible to this status.

Enterprises where a venture capital company owns a more than 50% share are not considered autonomous. These enterprises might therefore not be considered an SME, even if individually they meet the staff headcount and financial thresholds.

As we explained in our contribution to this consultation, we propose that the reference to venture capital companies include both legal forms of VC and PE AIFs and call for the removal of the thresholds and the application of a full exemption for both VC and PE investments to the criteria of SME's definition.

RFG should clarify that venture ownership has very distinct characteristics from trade group ownership (exit strategy, separated investments, absence of strategic interest, absence of central management). In the absence of a revision of the SME Recommendation, taking into account such characteristics in the RFG will ensure majority-owned VC and growth-backed companies remain eligible.

(ii) providing clearer exemptions to **the 7 year mark** in defined cases

It is explicitly recognised in the RFG that this period may be too short for innovative companies but more needs to be done. For example, an extension to 10 years could be granted based on a set of principles in combination with a "white list" of sectors/business activities.

As demonstrates BPI France's study, the initiative for encouraging investments in venture companies which are between 7 and 10 years is useful and necessary. This study showed the percentage of venture companies which are between 7 to 10 years is significant (52% of enterprises realised their first commercial sale) which confirm the failure of venture capital market for enterprises aged from 7 to 10 years (SA.55869).

This is a reason why we insist on this issue which is important for developing European Venture Capital Market.

(iii) First commercial sale

The terms of "first commercial sale" should be clarified. We propose to introduce a threshold of EUR 250,000 of turnover to justify when this "first commercial sale" is completed. This position is in line with the authorisation given by the European commission which considered the 10-year period to be counted from the following year the one with a turnover of more than EUR 250,000 (SA.41265/SA.40725).

On top of these changes, we suggest targeted amendments to existing concepts set in either the GBER or the RFG:

- **follow-on** investments

The condition for a **follow-on investment** to be "foreseen in the original business plan" is understandable but is difficult to apply in a Venture Capital context, where business plans are constantly revised and refined as the business and the markets in which it operates evolve. It would be better to recognise that follow-on investments should be allowed for those businesses where a further injection of capital (of an amount and for a purpose which is broadly identified) has been foreseen and expected from the start to achieve the stage of development for which the investment has initially been made.

The recent crisis of Covid-19 forced all SME to review their original business plan to adapt to the new situation. This means that none of them could receive follow-on investments. This approach is not relevant in practice for enterprises which suffer of this external context.

- **"first loss pieces"**

The terminology used in the GBER and FG for the most junior risk tranche that carries the highest risk of loss creates some uncertainty. The definition used in the RFG, which is more appropriate to the specificities of VC-backed firms, should also be applied in the GBER.

- **"replacement capital "**

Conditions for the use of "replacement capital" in the GBER (Article 21.7) are at odds with broader policy objectives of overcoming market failures in SME finance, and encouraging SME job creation. Restrictions on replacement capital can not only distort the natural activities of a company, but go even further, by potentially removing part of the financing chain.

In addition, this rule risks penalising minority shareholders who will not be able to transfer their shares of the company to another shareholder and will have to remain in the company's capital. In particular, this is the case of minority shareholders (i.e. Business angels) who will be obliged to remain in the capital of eligible companies longer than expected.

Finally, this measure leads to a dilution of the founding shareholders in the capital of the company. This rule is likely to be misunderstood by founding shareholders who will be obliged to be diluted in the capital.

In this context, we suggest that this measure be abolished or, failing that, that the percentage of new capital combination be limited to 10% of the capital of the company.

Contact

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About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

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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