EUROPEAN COMMISSION
Directorate-General for Financial Stability, Financial Services and Capital Markets Union

FINANCIAL MARKETS
**Asset management**

# CONSULTATION DOCUMENT

# REVIEW OF THE EUROPEAN VENTURE CAPITAL FUNDS (EUVECA) AND EUROPEAN SOCIAL ENTREPRENEURSHIP FUNDS (EUSEF) REGULATIONS

**Disclaimer**

This document is a working document of the Commission services for consultation and does not prejudge the final decision that the Commission may take.

The views reflected on this consultation paper provide an indication on the approach the Commission services may take but do not constitute a final policy position or a formal proposal by the European Commission.

The responses to this consultation paper will provide important guidance to the Commission when preparing, if considered appropriate, a formal Commission proposal**.**

You are invited to reply **by 6 January 2016** at the latest to the **online questionnaire** available on the following webpage:
http://ec.europa.eu/finance/consultations/2015/venture-capital-funds/index_en.htm

Please note that in order to ensure a fair and transparent consultation process **only responses received through the online questionnaire will be taken into account and included in the report summarising the responses**.

The responses to this consultation will provide important input for the Commission services future policy in the field of asset management.

In replying to these questions, please indicate the expected impact of potential changes described in each section of this consultation on your activities or on the activities of firms in your jurisdiction. Please also assess possible impacts on other stakeholders. For stakeholders other than firms or competent authorities, please indicate as far as you can the impact of different options on you.

In your response, you are also invited to give views on whether there are any other aspects of the current EuVECA/EuSEF framework that need to be addressed.

This consultation follows the normal rules of the European Commission for public consultations. Responses will be published unless respondents indicate otherwise in the online questionnaire.

Responses authorised for publication will be published on the following webpage:
http://ec.europa.eu/finance/consultations/2015/venture-capital-funds/index_en.htm#results

**Commission services consultation**

## Introduction

Creating a true Capital Markets Union which strengthens Europe's economy and creates jobs in all 28 Member States is a top priority of the Commission.

Venture capital has a key part to play in supporting growth and offering entrepreneurs an option to raise funding in Europe. Venture capital is typically long-term (equity) capital, channelled through funds which pool investor interest and diversify risk. However, EU venture capital funds remain relatively small. At around EUR 60 million, the average European venture capital fund is only half the size of that in the US, and around 90% of EU venture capital investment is concentrated in only 8 Member States.[1]

EU legislation has attempted to establish the regulatory conditions for a successful EU venture capital sector. The Regulation on European Venture Capital Funds (EuVECA)[2] and the Regulation on European Social Entrepreneurship Fund (EuSEF)[3] in particular define the conditions under which these funds can be marketed to institutional and high net worth individuals across the EU. However, the EuVECA and EuSEF passports are currently available only to smaller fund operators managing asset portfolios below EUR 500 million. Changes to these regulations could enhance the effectiveness of the passports by, for example, allowing larger fund managers to establish and market EuVECA and EuSEF funds, reducing the investment threshold in order to attract more investors and expediting cross-border marketing and investment.

The Capital Markets Union Action Plan confirms the Commission will take forward a comprehensive package to support venture capital and risk capital financing in the EU, including amending the EuVECA and EuSEF legislation. This consultation paper asks for detailed responses to a range of questions in order to take this work forward.

Venture capital investors provide finance to companies that are generally very small and new, often innovative start-ups, with strong growth potential. This type of investment, which often takes the form of temporary stakes in the capital of the companies, entails high risk since returns are linked to the success of newly created companies. For this reason some venture capital investors also provide important non-financial support to these companies, such as consultancy services, financial advice, marketing strategy and training.

Traditional investors in venture capital comprise entrepreneurs, family offices, angel investors, member of the management teams, industry sector experts, venture capital experts, finance sector experts and wealthy individuals.

Most Member States allow some private individuals, for example, high net worth individuals, to invest in venture capital provided certain conditions are met. These conditions may involve a minimum investment limit or some form of appropriateness

[1] Source: European Private Equity & Venture Capital Association.

[2] Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds, OJ L 115, 25.4.2013, p. 1.

[3] Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds, OJ L 115, 25.4.2013, p. 18.

test to ensure that such investors are aware of and accept the risks inherent in venture capital investing.

Social entrepreneurs often tackle challenges and fill gaps not addressed by mainstream business or via philanthropic work. But to do this they need access to a wider range of finance than is currently usually available. Venture capital funding which explicitly targets social entrepreneurs is one of those sources of funding.

Social enterprises are usually small business which target social, ethical or environmental goals as their primary and explicit corporate objective in what are often highly innovative ways. In common with other SMEs they often struggle to get funding. Indeed their challenges are often greater as their business models and emphasis on social rather than economic return is not always understood. Yet their role in focusing on areas that fall beyond the traditional boundaries of State responsibilities, complementing public policy rather than replacing it, is vital to Europe's economy. Improving the framework for venture capital aimed at social entrepreneurs is therefore part of this consultation paper.

The EuVECA[4] and EuSEF[5] Regulations were adopted in 2013 and sought to:

- **Bring together investors and unlisted SMEs and other mid-range, small or 'start-up' companies**. Unlisted start-up companies do not always have the size or structure to gain access to financing, such as issuing shares on a listed market or issuing bonds. EuVECA and EuSEF both aim to deepen the capital pool available for investments in such companies.

- **Increase non-bank finance for the economy**. EuVECA and EuSEF form part of Commission's initiative to increase non-bank finance for the economy in a well regulated way, and are aligned with the objectives of President Junker's Investment Plan for Europe, to increase competitiveness and to stimulate investments for the purpose of job creation.

In order to achieve the above aims, the EuVECA and EuSEF Regulations create a capital raising passport for managers authorised to use these labels. The passport constitutes the right to market funds under these labels across the European Union. The EuVECA and EuSEF passports currently apply only to smaller fund operators which are defined as those managing an overall portfolio of assets (comprising VCF and other types of alternative investment funds) below €500 million. According to European Venture Capital Association data (2011), 98% of European VCF managers manage a portfolio of venture capital funds that are beneath the €500 million threshold set out in the Alternative Investment Fund Managers Directive (AIFMD). There is no data on how many alternative investment fund managers (AIFM) manage VCF as part of a broader portfolio. The Regulations were initially limited to smaller operators because this group does not usually have access to the fund raising passport provided for in the Alternative Investment Fund Managers Directive (AIFMD)[6].

Whereas the AIFMD passport only covers marketing of funds to professional investors,

4 Regulation (EU) No 345/2013 of the European Parliament and of the Council of 17 April 2013 on European venture capital funds

5 Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds

6 Directive 2011/61/EU of the European Council and Parliament of 8 June 2011 on Alternative Investment Fund Managers.

the passports in the EuVECA and EuSEF Regulations extend the passport also to marketing to high net worth individuals defined as those investors able and willing to commit at least €100,000 of their investable funds to them.

Since entry into force of the EuVECA Regulation in April 2013, national authorities have registered 34 EuVECA funds that aim to raise approximately €1.3 billion in capital. For EuSEF, there are 6 registered funds with a capital target of €6 million. The Commission's Impact Assessment estimated that, over time, roughly €4 billion in additional venture capital funding could result from EuVECA. This means that take-up of the opportunities presented by EuVECA is satisfactory but could still be improved further. The take-up for EuSEF funds is clearly unsatisfactory.

As part of the Green Paper on CMU, the Commission received representations on a variety of issues relating to how the attractiveness of EuVECA and EuSEF could be improved.

The CMU consultation paper asked whether changes to the EuVECA and EuSEF Regulations would make it easier for larger EU fund managers to run these funds. Almost 60% of respondents proposed specific changes to the EuVECA and EuSEF Regulations, raising the following main issues:

- Most respondents advocated revising the calibration of the threshold before the AIFMD authorisation requirement applies.
- They also advocated clarifying that above-threshold and fully authorised AIFMs are equally entitled to set up and market EuSEF and EuVECA funds.
- Some respondents also indicated that additional requirements in different jurisdictions, in particular in the level of setting-up fees and costs for host registration, constitute an impediment to setting up EuVECA or EuSEF funds.
- Others indicated that the minimum investment commitment of €100.000 could dissuade potential investors.
- Some also expressed an interest in opening the Regulations to non-EU managers who would have the expertise to establish and operate EuVECA and EuSEF funds.
- The issues identified by respondents in relation to EuSEF focused on who can manage them and the minimum investment required from potential investors.

A limited number of respondents proposed more fundamental changes to both Regulations, including (i) extending the eligible investor base to encompass non-professionals and retail investors with no minimum investment commitment; (ii) removing the pure "venture" label; (iii) broadening the range of eligible assets, to include larger companies as investee companies in the portfolio of an EuVECA, and (iv) extending the eligibility for EuSEF to "all organizations which have a positive impact on the largest possible number of people".

In addition, further action on tax incentives, or lower capital requirements for EuVECA and EuSEF managers was proposed as well as considering EuVECA or EuSEF as collective investment undertakings within the meaning of Article 1(2)(a) and (b) of UCITS.

About 25% of the respondents, mostly public authorities argued that further assessment is still necessary before concluding that there may be a need for changes to the EuVECA and EuSEF Regulations. The EuVECA and EuSEF Regulations are not due for general reviews until July 2017 but, given the feedback and evidence received, and in light of the objective to work quickly to put in place the building blocks of the Capital Markets Union, the Commission has decided to bring the review forward.

### *The Consultation*

The objective of this consultation is to collect further information on the performance of the current legislation and identify measures the Commission could propose to increase take-up of the two new fundraising passports for venture capital and social entrepreneurship funds. This supports the objective of Capital Markets Union which is to facilitate a greater flow of capital from willing investors into the real economy. Interested parties are invited to report on their experiences with the new passports and on potential obstacles to their take-up that can be addressed further by legislative or other means. In particular, this consultation invites interested parties to provide more detailed responses to the issues raised in the CMU consultation paper, outlined above.

At this stage, the Commission's services have identified six potential issues limiting the broader take-up of EuVECA and EUSEF funds.

### *Who can manage and market EuVECA and EuSEF funds?*

EuVECA and EuSEF are currently designed for management and marketing by EU domiciled managers who manage a total portfolio of assets of less than €500 million. This threshold was chosen because managers below this threshold do not usually benefit from the passport under the AIFMD. To fill this gap, the Regulations introduce a separate marketing passport for EuVECA or EuSEF only. A recent European Securities and Markets Authority (ESMA) consultation on EuVECA and EuSEF revealed that managers authorised under AIFMD would also like to set up, manage and market EuVECA or EuSEF funds using their respective labels.

The text of the Regulations currently explicitly allows only those managers that were initially registered under the Regulations and subsequently came within the remit of the AIFMD due to an increase in their assets to continue using the EuVECA and EuSEF labels. One possible policy approach could be to amend the regulations to allow managers already regulated under AIFMD to set up and market EuVECA and EuSEF funds.

Targeted amendments to the Regulations could make the use of those labels available to authorised AIFM whilst still subject to the full AIFMD authorisation.

**Questions**

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

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

### *What happens when a EuVECA or EuSEF manager, post registration, exceeds the €500 million threshold?*

Currently, the manager of either a EuVECA or a EuSEF must obtain an authorisation under AIFMD as soon as its overall portfolio (irrespective of whether it comprises EUVECA/EUSEF only or other alternative investment funds as well) exceeds the AIFMD threshold of €500 million. In these circumstances, the EuVECA and EuSEF Regulations only provide for the continued use of the EuVECA or EuSEF labels, but not the marketing and management passports established in these Regulations ("limited grandfathering")[7].

An extension of the "grandfathering" rule for the EuVECA and EuSEF passports would mean that where a manager's total assets under management, post registration of the fund manager, exceed the €500 million threshold, the manager could continue to offer EuVECA and EuSEF while benefitting from both the label and the passport granted in the EuVECA and EuSEF Regulations. This could be the case in two possible scenarios:

- Managers continue to benefit from the EuVECA/EuSEF passport, even if their EuVECA or EuSEF portfolios, post registration, exceed € 500 million.

- Managers continue to benefit from the EuVECA/EuSEF passport, even if their total assets under management, post registration, exceed € 500 million[8]

This consultation seeks evidence on the impact on the take-up would be if managers that offer EuVECA or EuSEF funds were, irrespective of their size, exempted from authorisation under the AIFMD and subject to the EuVECA and EuSEF Regulations only.

### Questions

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?**

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?**

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7 The relevant provision reads as follows: "Where the total assets under management of managers of qualifying venture capital funds registered in accordance with Article 14 subsequently exceed the threshold referred to in point (b) of Article 3(2) of Directive 2011/61/EU, and where those managers are therefore subject to authorisation in accordance with Article 6 of that Directive, they may continue to use the designation 'EuVECA' in relation to the marketing of qualifying venture capital funds in the Union, provided that, at all times in relation to the qualifying venture capital funds that they manage, they: (a) comply with the requirements laid down in Directive 2011/61/EU; and (b) continue to comply with Articles 3 and 5 and points (c) and (i) of Article 13(1) of this Regulation.

8 In this scenario, only funds that comply with either EuVECA or EuSEF will benefit from the marketing and management passports provided for in both Regulations. The remaining portfolio will not obtain a marketing or management passport, but its existence will not stop the manager from enjoying the benefit of the EuVECA or EuSEF passports.

***Who can invest in EuVECA or EuSEF funds?***

EuVECA and EuSEF funds can only be marketed to non-professional investors able to subscribe a minimum of €100,000. This "entry ticket" was introduced to ensure consumer protection. However, the entry ticket has been criticised as being prohibitively high, particularly by managers interested in setting up EuSEF funds.

Traditional investors in venture capital comprise entrepreneurs, family offices, angel investors, members of the management teams, industry sector experts, venture capital experts, finance sector experts and wealthy individuals.

The rationale for the €100,000 minimum was to allow for a broader investor base to have access to venture capital funds or social entrepreneurship funds. In some Member States domestic funds with similar profiles are marketed with lower minimum investment. For example, the minimum investment in France is €30,000 provided some other fund-related requirements are met. One possible policy approach could therefore be to reduce this threshold. This would also reduce the risk that investors commit too much capital into this type of investments or take too much risk in trying to assemble the sums necessary to reach the threshold amount.

A lower threshold could attract more private investors and reduce the risk of any potential call for public resources to be used to make up any shortfall experienced by EuVECA or EuSEF funds. Moreover, a lower entry ticket into the funds might expand the range of investors from Member States with less experience in venture capital.

Any proposal to reduce the minimum subscription from €100,000 should take the need to ensure appropriate investor protection into consideration.

**Questions**

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

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?**

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?**

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

***Is it too expensive to set up EuVECA or EuSEF funds?***

Fund registration fees vary considerably between Member States and may affect take-up by fund managers. As already noted in the Commission's impact assessment, venture capital activities are not homogenously spread across the European Union. Around 90% of all venture capital fund managers are concentrated in seven Member States. In addition, funds managed and managers domiciled in these jurisdictions account for roughly 90% of all venture capital assets managed by funds. Early experience with EuVECA indicates that the fund raising passport has not fundamentally altered the geographical distribution of venture capital funds.

Moreover, in the framework of the CMU consultation, some respondents referred to different treatment in some Member States in relation to the level of "own funds" (as specified in Article 10 and 11 of the EuVECA and EuSEF Regulations respectively) required for EuVECA and EuSEF managers to be authorised.

In these circumstances, suggestions are sought on how to balance the take-up and domiciliation of venture capital funds across the EU and, in particular, how the issue of differing registration fees should be tackled - without sacrificing the level of investor protection.

**Questions**

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

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?**

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?**

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?**

***Should third country managers be able to use the EuVECA or EuSEF designations?***

The Commission is required to review the option of allowing venture capital and social entrepreneurship funds established in a third country to use the designation EuVECA/EuSEF, taking into account experience in applying the Commission Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters.

The following questions explore these issues and in particular whether targeted changes to the EuVECA and EuSEF Regulations would make a contribution towards increasing the number of such funds being offered. These changes could be introduced in accordance with Articles 26 and 27 EuVECA and Articles 27 and 28 EuSEF on the review of both of the Regulations.

**Questions**

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

14) **Should the use of the EuSEF Regulation be extended to third country**

**managers and if so, under what conditions?**

***Should the range of eligible assets available to EuVECA funds be broadened?***

EuVECA funds can currently only invest in unlisted SMEs which are defined as companies that employ fewer than 250 people and have annual turnovers of no more than €50 million or annual balance sheets of not more than €43 million. Some respondents to the CMU Green Paper were concerned that this is too narrow and unnecessarily restricts the type of firms EuVECA can invest in. They suggest broadening the definition of eligible assets.

Respondents are asked to take into consideration the effect of any extension of eligible assets, funds or financial instruments, including whether any such change would undermine the validity of the EuVECA label which is currently designed to address only venture capital funds. The focus is to provide finance to undertakings that are generally very small, that are in the initial stages of their corporate existence and that display a strong potential for growth and expansion. Respondents should consider this issue in the broad context of Commission policies and programs[9] which support SMEs and small mid-caps in Europe through the provision of venture capital and exclude buyouts or replacement capital. These funds remain subject to relevant state aid rules.

**Questions**

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?**

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?**

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?**

***Barriers to cross-border activity***

Many respondents to the consultation argued that a number of factors restrict cross-border activity of these funds, including discriminatory tax treatment, varying national requirements on the marketing of funds and fees for cross-border notifications. Eliminating unjustified barriers would incentivise fund managers to engage more in cross-border marketing of their funds and reduce costs for investors.

[9] E.g., COSME and Horizon 2020

**Questions**

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

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

*Other issues*

In addition, stakeholders are requested to consider the following, broader questions.

**Questions**

**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?**

**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?**

**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?**