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EuVECA
Regulation



EuVECA Regulation

Introduction

The European Venture Capital Funds Regulation [EU 2013/345] (EuVECA Regulation) was adopted in 2013 with the aim of making it easier for venture capital managers to raise funds across Europe by creating a pan-European marketing passport for managers registered under the EuVECA designation.

The European Commission considers that venture capital has a key part to play in supporting growth within the EU and the EuVECA Regulation (together with the EuSEF Regulation relating to social entrepreneurship funds) sought to improve access to funding for unlisted small and medium-sized enterprises (SMEs) and other start-up companies and also to increase non-bank finance for the EU economy. The Commission is currently consulting on both the EuVECA and EuSEF Regulations as part of its Capital Markets Union Action Plan (as to which, please see further under 'Commission Consultation' below), confirming the Commission's intention to take forward a comprehensive package to support venture capital and risk capital financing in the EU.

For more detail on the Capital Markets Union, please see our publication entitled 'Capital Markets Union' on our website at: www.cummingslaw.com/publications.

This Legal Long provides a brief overview of the EuVECA Regulation only (and not, for the avoidance of doubt, the EuSEF Regulation), its scope and application and a short summary of the current consultation being undertaken by the Commission.

Purpose of the EuVECA Regulation

The EuVECA Regulation came into effect on 22 July 2013 (the same date as the AIFMD) and created a marketing passport for venture capital managers. The EuVECA passport permits such managers to market funds with EuVECA status to institutional and high net worth investors

in the EU without the need to comply with national private placement rules, which are often divergent between Member States.

The EuVECA Regulation lays down a common framework of rules regarding the use of the designation 'EuVECA', which ensures uniform conditions across the EU in order to boost investor confidence and eliminate competitive distortions. Only those funds and managers which conform with the qualifying conditions set out in the Regulation will be able to raise capital using the EuVECA designation.

Scope of the EuVECA Regulation

Article 1 of the EuVECA Regulation states that the Regulation "...lays down uniform rules for the marketing of qualifying venture capital funds to eligible investors across the Union, for the portfolio composition of qualifying venture capital funds, for the eligible investment instruments and techniques to be used by qualifying venture capital funds as well as for the organisation, conduct and transparency of managers that market qualifying venture capital funds across the Union."

The Regulation therefore sets out the qualifying conditions for the managers, the funds and the investors to whom the funds can be marketed, as follows:

(1) Qualifying venture capital funds

A qualifying venture capital fund (QVCF) is a collective investment undertaking, a collective investment undertaking being defined as an AIF (as defined in Article 4(1)(a) of the AIFMD), that meets the following conditions:

- (i) the QVCF intends to invest at least 70% of its aggregate capital contributions and uncalled committed capital in assets that are *qualifying investments* (after deduction of all relevant costs and holdings of cash and/or cash equivalents);



- (ii) the QVCF does not use more than 30% of its aggregate capital contributions and uncalled committed capital for the acquisition of assets other than qualifying investments after deduction of all relevant costs and holdings of cash and/or cash equivalents); and
- (iii) is established within a Member State.

Leverage must also be controlled.

'Qualifying investments' mean any of the following:

- equity or quasi-equity instruments that are issued by: (a) a qualifying portfolio undertaking and acquired directly by the QVCF from the qualifying portfolio undertaking; (b) a qualifying portfolio undertaking in exchange for an equity security issued by the qualifying portfolio undertaking; or (c) an undertaking of which the qualifying portfolio undertaking is a majority-owned subsidiary and which is acquired by the QVCF in exchange for an equity security issued by the qualifying portfolio undertaking; or
- secured or unsecured loans granted by the QVCF to a qualifying portfolio undertaking in which the QVCF already holds qualifying investments, provided that no more than 30% of the aggregate capital contributions and uncalled committed capital in the QVCF is used for such loans; or
- shares of a qualifying portfolio undertaking.

'Qualifying portfolio undertaking' is essentially the small and medium-sized business enterprises (SME) definition and means an undertaking that:

- at the time of an investment by the QVCF: (a) is not admitted to trading on a regulated market or MTF; (b) employs fewer than 250 persons; and (c) has an annual turnover of less than €50 million or an annual balance sheet total of less than €43 million;
- is not itself an AIF;
- is not one or more of the following: a credit

institution, investment firm, insurance undertaking, financial holding company or mixed activity holding company; and

- is established within a Member State or third country, provided that third country: (a) is not listed as a FATF non-cooperative country and territory (NCCT); and (b) has signed an agreement with the home Member State of the QVCF manager and with each other Member State in which the shares of the QVCF 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 tax information.

For more information on the definition of an AIF and the AIFMD in general, please see our various publications on the AIFMD at:

www.cummingslaw.com/publications.

Leverage

The use of leverage is limited in respect of a QVCF. Pursuant to Article 5 of the Regulation, managers may:

- (a) not employ any method by which the exposure of the QVCF will be increased beyond the level of its committed capital, whether through borrowing of cash or securities, the engagement into derivative positions or by any other means (Article 5(2)); or
- (b) only borrow, issue debt obligations or provide guarantees where such borrowings, debt obligations or guarantees are covered by uncalled commitments (Article 5(3)).

(2) Qualifying managers

A manager of a qualifying venture capital fund must meet the following conditions:

- (i) total AUM do not exceed the threshold as set out in Article 3(2)(b) of the AIFMD i.e. €500 million;
- (ii) the manager is established in the EU;
- (iii) the manager is subject to registration in



their home Member State in accordance with the AIFMD; and

- (iv) the manager manages portfolios of *qualifying venture capital funds*.

The manager may either be an external manager appointed by the QVCF or the QVCF may manage itself i.e. an internally managed QVCF. This is similar to the concept of an external AIFM or internally managed AIF under the AIFMD.

According to the Q&As published by ESMA on the EuSEF and EuVECA Regulations [ESMA/2014/1354], a sub-threshold manager which subsequently exceeds the €500 million threshold, and is required to apply to become a full-scope AIFM for the purposes of the AIFMD, is still permitted to manage and market QVCFs under the EuVECA designation, provided they ensure compliance with Article 3 (Definitions), Article 5 (rules on non-qualifying assets, leverage and borrowings) and Article 13(1)(c) and (i) (information to investors) of the Regulation. In this case, the EuVECA marketing passport will no longer apply to such managers, as the AIFMD passport will come into effect.

(3) Eligible investors

Units or shares in a QVCF may be marketed to:

- (i) investors which are considered to be professional clients or elective professional clients pursuant to Annex II of MiFID; or
- (ii) investors who commit to investing a minimum of €100,000 and state in writing that they are aware of the risks associated with their investment in the QVCF.

Please note that directors, officers, executives and employees of the manager are also able to invest in the QVCF(s) they manage.

Registration

A manager which satisfies the relevant conditions set out in the EuVECA Regulation must register with the relevant regulatory authority in its home Member State, such as the FCA, before it can

market a QVCF under the EuVECA designation. Upon application for registration, the manager is required to provide the regulatory authority with the information set out in Article 14(1) of the Regulation and the regulatory authority may only register the manager if the manager meets the conditions set out in Article 14(2). The regulatory authority is not permitted to impose any additional approval process, but must register the manager if Articles 14(1) and (2) are complied with.

The current application fee for registering with the FCA is £750.

It should be noted that EuVECA managers are required to register twice i.e. once in accordance with the AIFMD and once in accordance with the EuVECA Regulation, but it is envisaged that the double registration can take place simultaneously.

Finally, managers that market QVCFs under the EuVECA designation are also permitted:

- (i) to manage and market AIFs which are not QVCFs at the same time, provided however that they do not market or attempt to market AIFs (i.e. non-QVCFs) under the EuVECA designation; and/or
- (ii) to manage and market UCITs, subject to being appropriately authorised.

Regulatory requirements

Once registered, the manager is required to comply with certain conduct of business rules as set out in Articles 7 to 13 (inclusively) of the Regulation, which can be briefly summarised as follows:

- (i) to act honestly, fairly and with due skill, care and diligence (Article 7(a));
- (ii) to apply appropriate policies and procedures for preventing malpractice that can reasonably be expected to affect investors (Article 7(b));
- (iii) to conduct their business activities so as to



promote the best interests of the QVCF, the investors and the integrity of the market (Article 7(c));

- (iv) to apply a high level of diligence in the selection and ongoing monitoring of investments (Article 7(d));
- (v) to possess adequate knowledge and understanding of the undertakings in which they invest (Article 7(e));
- (vi) to treat their investors fairly (Article 7(f));
- (vii) to ensure that no investor obtains preferential treatment, save where that treatment is disclosed in the QVCF's constitutional documents (Article 7(g));
- (viii) to not delegate to the extent the manager becomes a mere 'letter-box entity' (as per the AIFMD) (Article 8);
- (ix) to identify, avoid, manage, disclose and monitor conflicts of interest appropriately (Article 9);
- (x) to maintain sufficient own funds (Article 10);
- (xi) to ensure a sound and transparent valuation process (Article 11);
- (xii) to report annually to the home regulatory authority (Article 12); and
- (xiii) to provide prior disclosure to investors (which reflects Article 23 of the AIFMD and refers to information generally included in the fund's offering documents) (Article 13).

Advantages of the EuVECA designation

A manager of an AIF is required to be authorised as an AIFM pursuant to the AIFMD; thus, a manager of a QVCF will either already be authorised as a sub-threshold AIFM or will need to be authorised as a sub-threshold AIFM. A sub-threshold AIFM is, however, currently unable to avail itself of the AIFMD passport and can only market its AIFs under the national private placement regimes (NPPRs). A manager of a QVCF may therefore take advantage of the EuVECA marketing passport and market its QVCF(s)

throughout the EU without the need to comply with various NPPRs as required under the AIFMD.

A point to note is that there is no obligation for a manager of a QVCF to register under the EuVECA Regulation; the manager has the option to register if it wishes to take advantage of the EuVECA marketing passport.

Commission consultation

The Commission published a consultation paper on 30 September 2015 entitled '*Review of the European Venture Capital Funds (EUVECA) and European Social Entrepreneurship Funds (EUSEF) Regulations*'. The aim of the consultation was twofold: firstly, to collect further information on the performance of the current legislation and secondly, to identify measures the Commission could propose to increase take-up of the EuVECA and EuSEF marketing passports without reducing the existing levels of investor protection.

Although the Commission was not required to review the Regulations until July 2017, it brought its review forward to coincide with publication of its CMU Action Plan (referred to above).

The Commission identified six potential issues limiting the broader take-up of the EuVECA and EuSEF marketing passports and sought views on these issues in the consultation, as follows:

- (1) *whether full-scope AIFMs should be permitted to set up, manage and market EuVECAs and EuSEFs* – as discussed above, the Regulations are currently designed for sub-threshold managers, albeit that sub-threshold managers who subsequently exceed the threshold are permitted to continue to market their EuVECA and EuSEFs using the EuVECA and EuSEF labels;
- (2) *the consequences of a manager exceeding the €500 million threshold post registration* – currently, the Regulations only provide for the continued use of the EuVECA and EuSEF labels, but not the marketing (and managing) passports, as the AIFMD passport comes into effect. The Commission asked for views on whether EuVECA and



EuSEF managers should be exempted from authorisation under the AIFMD, irrespective of size;

- (3) *whether to lower the minimum investment threshold of €100,000 to broaden the number of private investors;*
- (4) *whether to reduce the costs of establishing EuVECA and EuSEF funds;*
- (5) *whether to allow third country managers to use the EuVECA and EuSEF designations*
– the designations can currently only be taken up by EU managers and EU funds;
and
- (6) *whether to broaden the range of eligible assets available to EuVECA funds.*

The consultation closed on 6 January 2016 and the Commission has not provided feedback on the responses to date.

**This document is for general guidance only. It does not constitute advice
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