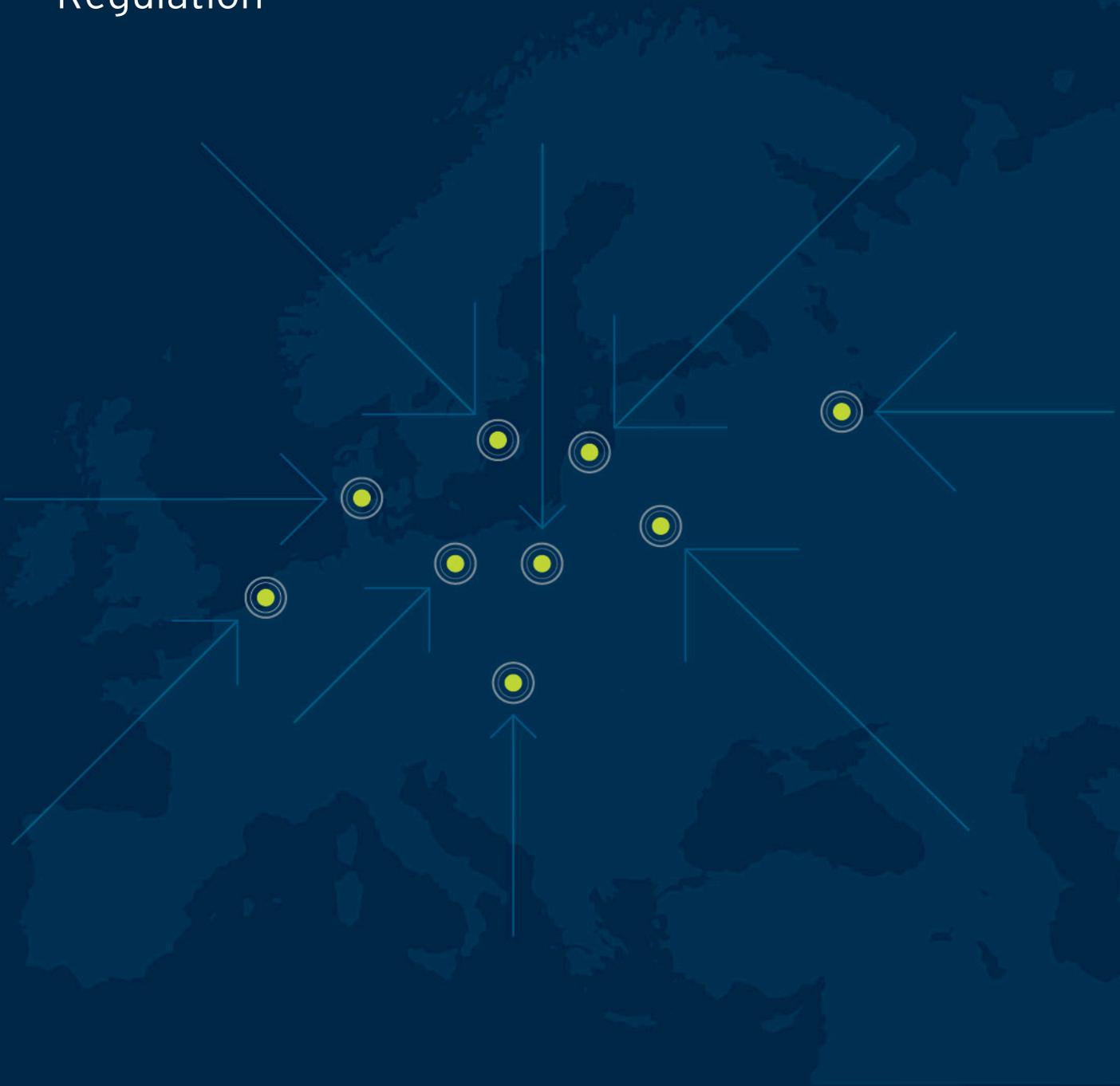




EUROPEAN PRIVATE EQUITY AND
VENTURE CAPITAL ASSOCIATION

EuVECA Essentials

An introduction to the
European Venture Capital Fund
Regulation



Foreword

From Dörte Höppner, EVCA



A voluntary marketing passport, the European Union Venture Capital Funds Regulation (EuVECA) facilitates cross-border fundraising while sparing smaller funds the disproportionate costs of authorisation under the Alternative Investment Fund Managers Directive (AIFMD).

The EuVECA also represents recognition by EU policymakers of the importance of venture capital (VC) investment to Europe and in particular Europe's innovative high-growth companies and SMEs.

That recognition was brought about by a campaign of constructive dialogue with policymakers by the European Private Equity & Venture Capital Association (EVCA) and its members. We made the case that VC needed a tailored regulation of its own if it was to continue commercialising innovation, which is so vital for jobs and growth.

The EVCA was able to use the experience, goodwill and contacts made during our work on the AIFMD. Thanks to the expertise of the EVCA and our VC members, European legislators listened, understood and reacted. The EuVECA is a great example of a regulation that will encourage investment in Europe's businesses and of what can be achieved when policymakers and industry work together.

I expect more and more VCs to become EuVECA-registered when they come to raise their next fund. It has great potential to become an internationally recognised quality label and forthcoming EU legislation may also grant favourable treatment to EuVECA-designated funds. We will continue to press for the regulation to be extended to third country funds and to ensure that the EuVECA regime meets the needs of the industry as it is implemented and - in due course - amended.

EuVECA Essentials is your members-only guide to this important regulation that can bring real benefits to European VC, the businesses it supports, and those that invest in the asset class. I would like to thank all of our members who dedicated their valuable time to help make this guide possible.

A handwritten signature in black ink, appearing to read 'Dörte Höppner', written over a light grey background.

Dörte Höppner
EVCA Chief Executive

Introduction

This briefing provides an introduction to the European Venture Capital Fund Regulation.

The Regulation provides significant potential benefits to venture capital funds, offering a single, pan-European, marketing passport for those that meet the requirements that it sets out and thereby achieve the 'EuVECA' designation.

While some uncertainties remain about its application, this Regulation is a tangible demonstration of the EU's commitment to promoting European venture capital and should assist managers in raising capital across borders within the EU.

Note: This briefing does not intend to give legal advice or be an exhaustive or definitive explanation of the EuVECA. For further information please visit www.evca.eu.

Summary

The **European Venture Capital Fund Regulation (EuVECA)** came into effect on 22 July 2013 to complement and coincide with the implementation of the AIFMD. As the EuVECA is a Regulation (and not a Directive) it does not need to be transposed into national law and so it has immediate effect in all Member States.

The European Commission first published its proposal for a European Venture Capital Fund Regulation in December 2011 as part of its action plan to **improve access to finance for SMEs**.

The Regulation includes measures to allow qualifying venture capital managers to market their funds to investors across the EU under a new **“European Venture Capital Fund” label**.

It sets out the **requirements** relating to the investment portfolio, investment techniques and eligible undertakings which a qualifying fund needs to comply with. It also establishes **uniform rules** on which categories of investor qualifying funds may target and on the **internal organization of the managers** that market such qualifying funds.

The EuVECA regime will only be available to managers of **Collective Investment Undertakings** established in the European Union falling **below** the Alternative Investment Fund Managers Directive **threshold of €500 million of AUM** (applicable to managers managing unleveraged, closed-ended Alternative Investment Funds) and which are subject to registration with the competent authority of their home Member State.

Every fund using the label will have to prove that it intends to invest a high percentage of investments (at least 70% of the capital commitments) in **supporting young and innovative companies**.

The Regulation is **not compulsory**. If a fund manager does not wish to use the EuVECA designation, 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, always **elect to voluntarily apply** the AIFMD and acquire an EU marketing passport via that route.

1. WHAT IS THE EUVECA?

The European Venture Capital Fund (EuVECA) Regulation ([Regulation \(EU\) No 345/2013](#)) sets out the criteria which managers of venture capital funds must meet in order to market their funds to investors across the EU under a new “European Venture Capital Fund” label and without needing to comply with the demands of the Alternative Investment Fund Managers (AIFM) Directive.

The proposal was originally submitted in December 2011 and is part of the European Commission’s action plan to improve access to finance for SMEs.

The Regulation, which unlike the AIFMD is purely a marketing regulation, aims to provide a voluntary EU-wide passport for qualifying venture capital funds and their managers. It is intended as an alternative regime to that set out in the AIFM Directive, which provides a compulsory regime and a marketing and management passport for private equity managers whose assets under management are above a threshold of €500 million (or €100 million if certain conditions are not met).

In order to qualify for this EuVECA designation the Regulation introduces requirements relating to the investment portfolio, investment techniques and eligible undertakings that a qualifying fund needs to meet. It also sets out uniform rules on which categories of investor a qualifying fund may approach and on the internal organization of the managers that market such qualifying funds.

As the EuVECA is set out in a Regulation, it does not require separate national legislation for its implementation and is directly applicable. There is, however, in some member states, a need to change some domestic laws and regulations in order for the national competent authority to be able to oversee the EuVECA regime and to organise local registration and so venture capital managers interested in using this designation should also investigate any local requirements.

2. WHICH COUNTRIES DOES IT APPLY TO?

The EuVECA Regulation applies in all EU member states and in the three EEA countries (Norway, Iceland and Liechtenstein)¹ but not in Switzerland.

3. WHO CAN APPLY FOR EUVECA AUTHORISATION?

The European Venture Capital Fund Regulation is an entirely voluntary regime, designed to sit alongside the AIFMD. It allows smaller funds access to a marketing passport without the full compliance cost and regulatory burden of the AIFMD.

The use of the EuVECA label is not compulsory. No manager is obliged to comply with the EuVECA.

Any manager who is:

- below the €500 million threshold for the AIFMD; and
- who does not wish to comply with the EUVECA

can continue to operate (manage and market) under the existing respective national rules (and under any other EU rules that might be applicable to their business).

The Regulation applies to fund managers who meet certain criteria:

- being established in the EU;

¹ For the purposes of this briefing, references to the EU include the three EEA countries (Norway, Iceland and Liechtenstein), as well as the 28 EU member states.

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- managing portfolios of EuVECAs (i.e. qualifying venture capital funds);
 - being registered with the competent authorities of their home member state in accordance with point (a) of Article 3(3) of the AIFMD;
 - having assets under management that in total do not exceed the threshold² referred to in point (b) of Article 3(2) of the AIFMD (i.e. €500 million for closed-ended and unleveraged funds).

4. HOW DOES A FUND QUALIFY?

What are the main qualifying criteria?

- The EuVECA Regulation applies on a **fund by fund, vehicle by vehicle basis**. It is on that basis that the qualifying criteria need to be applied.
- The manager should be below the *de-minimis* size threshold under the AIFMD. The **€500 million threshold** only applies if all funds managed by the manager are not considered to be leveraged for the purposes of the AIFMD.
- The Regulation is intended to be available for venture and growth capital. Recital 11 of the Regulation expressly says that the Regulation is not intended to facilitate the cross-border marketing of buy-out funds.
- The starting point for applying the criteria is the definition of a Qualifying Investment Fund in Article 3 of the Regulation. A **Qualifying Investment Fund** is an Alternative Investment Fund (AIF), as defined under the AIFMD, with an additional key condition that it must respect a 70/30 ratio of **qualifying to non-qualifying investments**.

Note:

- Venture capital fund managers that are registered under the EuVECA Regulation but who *subsequently* exceed the €500 million AUM threshold - and therefore become subject to the AIFMD requirements - may continue to use the 'EuVECA' designation in relation to the marketing of qualifying venture capital funds in the EU, provided that:
 - they comply with the requirements laid down in the AIFMD; and
 - they continue to comply at all times with certain requirements for the use of the 'EuVECA' designation that are specified in the Regulation.
- This applies both to existing qualifying venture capital funds and to qualifying venture capital funds established after exceeding the threshold.

What are qualifying investments?

- equity or quasi-equity instruments issued by "qualifying portfolio undertakings", principally SMEs, defined as unlisted organisations with fewer than 250 employees and an annual turnover not exceeding €50 million or a balance sheet of less than €43 million.
- the SME may *either* be established in the EU *or* in another jurisdiction, provided that third country meets certain conditions:
 - it must have signed an agreement with the home member state of the manager of the 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 that ensures that it complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements.

² The calculation of the threshold for the purposes of this Regulation is the same as for the AIFMD threshold. Please also see the [AIFMD Essentials](#).

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- it must not be listed as a non-cooperative country or territory by the Financial Action Task Force (FATF) on Anti-Money Laundering and Terrorist Financing.
 - The qualifying portfolio undertaking must not itself be a fund nor a financial business entity (bank, collective investment undertaking, insurance company, etc.).
 - The nature of the fund's interest in the SME must be either equity or quasi-equity as those terms are defined in Article 3(e) of the Regulation.
 - Equity: shares in the SME which are issued by the SME to the fund or shares acquired by the fund from existing shareholders (shares acquired in the secondary market are allowed).
 - Quasi-equity: secured or unsecured loans by the fund to the company provided the fund already holds qualifying investments in that company. Secured and unsecured loans must not exceed 30% of the aggregate capital contributions and uncalled committed capital in the fund.
 - Interests in other EuVECAs are also qualifying investments provided that those underlying EuVECAs have not themselves invested more than 10% of their capital contributions and uncalled capital in other EuVECAs.

When and how should the '70/30' test be applied?

- The 70% element is assessed by reference to intention. It should be the manager's intention to invest at least 70% of the aggregate capital contributions and uncalled committed capital of the fund into qualifying investments. This should be enshrined in the constitutional documents of the fund (e.g. PPM).
- The 30% element is a continuous, ongoing requirement. There should never be more than 30% of capital invested in non-qualifying investments at any point in the life of the fund.
- The thresholds are to be calculated on the basis of amounts investible after the deduction of all relevant costs and holdings of cash and cash equivalents. As such, all fees, charges and relevant expenses, borne directly or indirectly by the investors and provided for in the fund's constitutional documents, are to be deducted from commitments when calculating the amounts investible.
- Short-term borrowings that do not exceed the fund's uncalled committed capital (bridge financings) are permitted, as well as cash advances from investors of qualifying venture capital funds that are fully covered by capital commitments from those investors.

5. WHAT IS 'MARKETING'?

Marketing is defined in the Regulation as

'a direct or indirect offering or placement at the initiative of the manager of a qualifying venture capital fund, or on its behalf, of units or shares of a venture capital fund it manages to or with investors domiciled or with a registered office in the Union'.

Although this is a Regulation the precise way in which this definition will be applied and interpreted may vary from member state to member state.

Some national authorities may take the view that actual marketing starts rather late in the process (e.g. when the almost final PPM is submitted to investors or when the manager permits the investor to submit the subscription form for an interest in the fund). However, while everything before that stage (e.g. making investor presentations or submitting term sheets) would not be considered as marketing for the purpose of the EuVECA Regulation, it may still be subject to license requirements under a different regulation in the respective member state where that activity is conducted.

6. WHO CAN YOU MARKET TO?

Unlike the AIFMD, managers of qualifying venture capital funds can not only market to professional investors under Directive 2004/39/EC (MiFID) but also to an additional category of investor with an entry ticket of minimum €100,000.

More specifically, eligible investors under the EuVECA Regulation include:

- investors considered to be professional clients in accordance with Section I of Annex II to MiFID;
- investors who may, on request, be treated as professional clients in accordance with Section II of Annex II to MiFID;
- investors that commit to investing a minimum of €100,000 AND have stated in writing that they are aware of the risks associated with the envisaged commitment or investment.

Investments by executives, directors or employees involved in the management of a manager of a qualifying venture capital fund should be possible when investing in the qualifying venture capital fund that they manage. Such individuals are considered knowledgeable enough to participate in venture capital investments.

7. WHAT ABOUT REGISTRATION & COMPLIANCE?

Unlike the AIFMD, which mainly regulates managers, the EuVECA Regulation's initial focus is on the fund (investment vehicle). There are requirements for managers, but these only apply once the fund for which the manager is responsible has become an EuVECA, subject to the exceptions below (Registration requirements).

Every fund using the EuVECA label will have to prove that a high percentage of investments (at least 70% of the aggregate capital contributions and uncalled commitment capital) is (intended to be) spent in supporting young and innovative companies.

Registration requirements

Managers that intend to market a qualifying venture capital fund under the EuVECA label must first inform the competent authority in their home member state of their intention and provide to it the **information listed in Article 14 of the Regulation**.

This includes details about the owners and relevant staff of the Manager, as well as about the Fund and its marketing intentions.

The manager must also give a narrative description of the arrangements which have been made with a view to fulfilling the on-going compliance requirements of the Regulation.

Information requirements

Managers of EuVECA regulated funds need to provide investors with a **minimum level of information** during the marketing process or prior to investors taking an investment decision (i.e. deciding to invest in the fund).

Managers of EuVECA funds need to:

- inform the investor of the identity of that manager and any other service provider used when managing the fund;
- disclose the amount of own funds available and a statement as to why that amount is considered to be sufficient;
- describe the investment strategy and types of portfolio undertakings;
- describe the (types of) non-qualifying investments the fund intends to make;
- disclose investment restrictions and techniques the fund intends to use;

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- describe the risk profile of the qualifying funds;
 - describe valuation procedures and how the fund values its portfolio undertakings;
 - describe how the remuneration of the manager is determined/calculated (but note that the EuVECA regulation does not contain remuneration guidelines);
 - describe all relevant costs and the maximum (expected) amounts thereof;
 - where available, the historical financial performance of the fund;
 - disclose any business support services and other support activities provided by the manager;
 - give a description of the policy or procedures in case the investment strategy can be amended.

It is expected that information provided to investors is kept up-to-date and reviewed regularly where relevant.

Compliance requirements

Unlike the AIFMD, there is no need for a depositary nor is there any regulation of remuneration under the EuVECA framework.

The requirements that apply are relatively light touch and are described in **Chapter II** of the Regulation:

- **Article 5** includes a restriction on **the use of leverage** in the qualifying venture capital fund: leverage in the fund must not increase the exposure of the fund beyond the level of committed capital (Article 5(2)).
- **Article 7** sets out some **high-level governance requirements** about acting honestly and fairly. The article also lists requirements on appropriate policies and practices to prevent malpractice, to run the fund in a way which promotes the interest of the fund, to apply due diligence and to have the right skills and experience for managing the fund.
- In addition, there are obligations to treat investors fairly and to ensure that no investor obtains preferential treatment unless the preferential treatment is disclosed in the constitutional documents of the fund. These provisions could have an important bearing on any proposed use of side letters in the fund (transparency about the use of side letters entered into or discussed with prospective investors and any interaction with most favoured nation provisions).
- **Article 8** contains **restrictions on delegation** by the manager. The premise is that delegation must not undermine proper supervision of the manager and must not affect the manager's liability.
- **Article 9** includes provisions requiring the manager to identify, manage, avoid, monitor and disclose **conflicts of interest**, and to have procedures embedded within the firm which help the firm to manage conflicts of interest. This Article is not only about having a high-level policy; the emphasis is on the actual procedures instituted to support those controls.
- **Article 10** contains a **requirement for regulatory capital**. The requirement is not prescriptive on the amount of regulatory capital the manager must hold; the requirement is simply to have "sufficient" own funds/equity. The manager is obliged to be able to justify the sufficiency of his capital to regulators and (probably) to investors.
- **Article 11** has provisions requiring the manager to provide in the constitutional documents of the fund a description of its **approach to the valuation** of assets and an ongoing obligation on the manager to make sure that assets are valued properly. In addition, asset values should be calculated at least on an annual basis.

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- **Article 12** contains a requirement to publish an **annual report**. The report is subject to content requirements and must be audited. It should be made available to national regulators and also to investors on request [but does not need to be made public].

8. WHAT ARE THE BENEFITS OF EUVECA?

The myriad of different rules in EU member states have increased costs for raising venture capital funds across the EU. This has in turn contributed to reduced levels of investment in such funds. The new EuVECA regime addresses these issues and complements the AIFMD so that smaller funds can improve their access to capital.

Fund managers who comply with the Regulation and achieve EuVECA status will reduce the costs they incur in raising capital across the EU. Managers will not have to comply with the full requirements of the AIFMD and will have simplified compliance procedures.

Marketing venture capital funds across the EU will also be easier, as there will be no obligation to comply with the national laws of each individual member state.

Achieving EuVECA designation may also bring other benefits, if - as seems likely - this status becomes a cross-reference in other pieces of legislation with an impact on venture capital. For example, in its recent proposal on reforms to the structure of EU banks the European Commission has proposed an important exemption for venture capital funds, but only if they have the EuVECA designation. If this is accepted by the European Parliament and the Council of Ministers this could become a powerful precedent.

9. NEXT STEPS

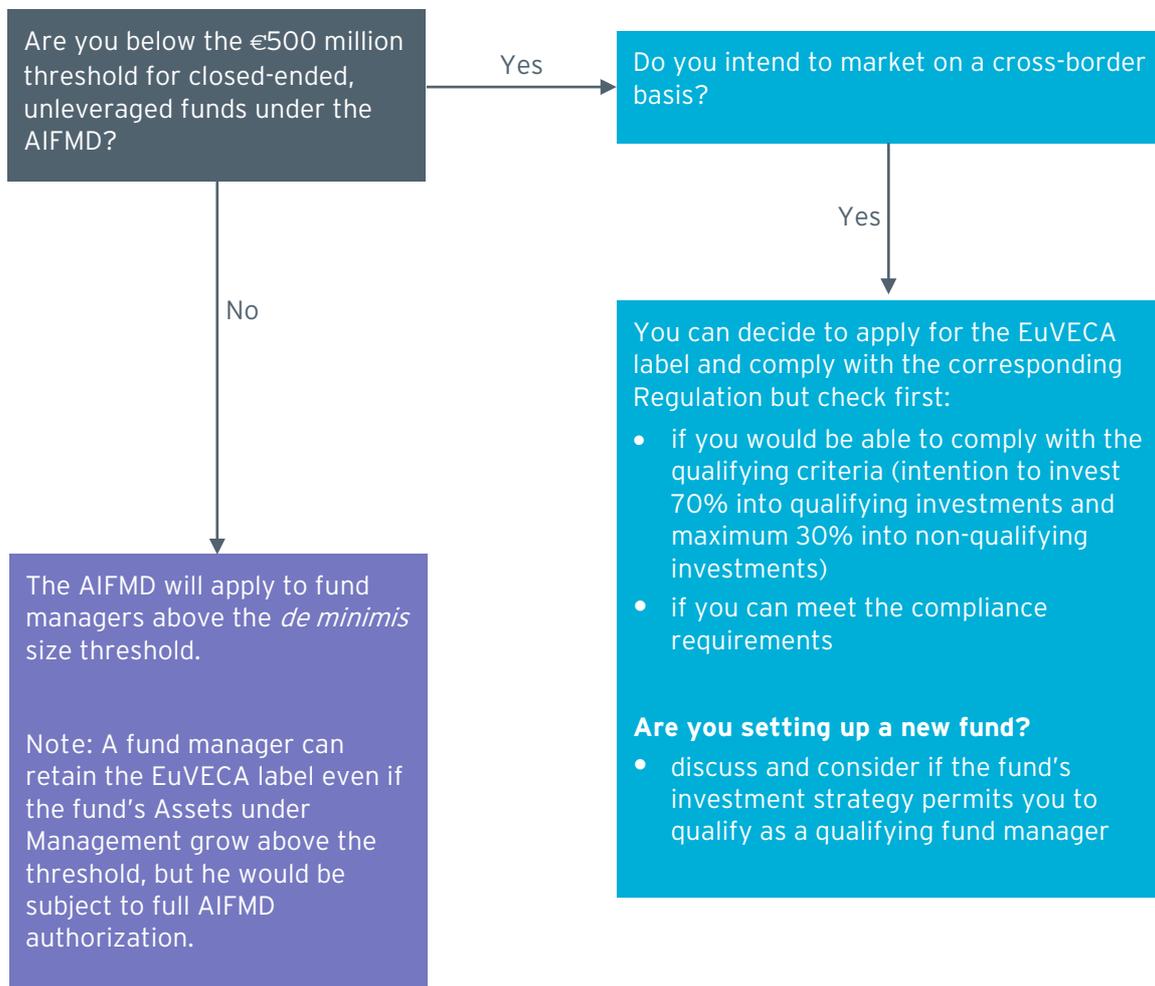
Although the EuVECA Regulation has entered into force, the European Commission is yet to come up with a limited number of Delegated Acts (for example, on the types of conflicts of interest managers of qualifying venture capital funds need to avoid and the steps to be taken in that respect).

At present the EuVECA Regulation is only available to EU vehicles being managed by European managers. The European Commission will review the Regulation in 2015, including the possibility of allowing venture capital funds established in third countries to benefit from the Regulation.

In conducting that review the experiences gained during the first two years of implementation in the EU will be taken into account as well as the Commission's attempt to encourage third countries to apply minimum standards of governance in tax matters.

Finally, by 22 July 2017, the European Commission is due to start a review of the interaction between this Regulation and other rules on collective investment undertakings and their managers, in particular those laid down in the AIFMD.

10. THINGS TO CONSIDER NOW



11. MORE INFORMATION

For further information on any of the issues covered in this document, or to discuss any EU public affairs or regulatory issue, please contact any member of the EVCA PA Team.

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You can also find additional information on the [EVCA website](#) or on the website of the [European Commission](#).



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