European Commission's Review of the European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF) Regulations

Contribution to the Public Consultation by AIFI, the Italian Private-Equity and Venture-Capital Association, and FeBAF, the Italian Banking Insurance and Finance Federation

This contribution, prepared by AIFI and FeBAF, represents the common point of view of the Italian venture capital industry and of the wider banking, insurance and finance community in Italy.

FeBAF in fact contributes also on behalf of its member organisations that represent Italy's main business associations in the field of investment and finance (see below).

It is our hope that this consultation will provide useful information and suggestions contributing thereby to the most effective and swift possible planning and implementation of the Capital Markets Union. We regard in fact the CMU as a fundamental pre-requisite for setting the financing of the real economy and investment on a stronger and more sustainable footing, and thereby leading to higher economic growth and employment in Europe.

We are strongly committed to a continuing dialogue and cooperation among our institutions and organisations, at the national and the international level, and remain open to providing further input, clarification and information if needed. For convenience, our e-mail address is: info@febaf.it.

AIFI, founded in 1986, promotes and institutionally represents private equity and venture capital activity in Italy (and, since 2014, also private debt players).

FeBAF, active since 2008, aims at providing a 'common home' of savings and finance institutions in Italy. It includes among its members the Italian Banking Association (ABI), the Insurers' Association (ANIA), the Asset Management Industry Association (Assogestioni), and the Italian Private-Equity and Venture-Capital Association (AIFI). Aggregate members are the Fiduciary Services Association (Assofiduciaria), the Real-Estate Association (Assoimmobiliare), the Supplementary Pensions and Assistance Association (Assoprevidenza), and the Securities Brokerage Association (Assosim).

a. Introduction

Private equity and fund managers undertake a particular role to play in providing finance to smaller companies – particularly innovative ones and represent the highest potential in growth and job creation.

AIFI and FeBAF welcome the opportunity given by the European Commission to provide comments to the Review of the European Venture Capital Funds Regulation (EuVECA).

As the Consultation document invited to report on experiences with the new passport and on potential obstacles in relation to their take-up that can be addressed further by legislative or other means, we report in an Appendix some statistics about the Italian venture capital market.

Italian venture capital market is characterized by players managing smaller amount than the European competitors. The average amount invested is also smaller compared to both other countries and startup financial needs. This taxonomy of our venture capital market is functional to the Italian entrepreneurial ecosystem composed mostly by SMEs.

We want to remark the importance and the need to preserve a proportionally regulatory approach in order to preserve our domestic players, also at national level. In this direction, a significant step was taken by Fondo Italiano d'Investimento SGR, sponsored by Italian Ministry of Treasury and Finance, which in 2014 set up a fund of fund dedicated to Italian venture capital market with a total amount of Euro 150 Million.

Below, we show four priority for Italian venture capital industry in order to support the launch of new players and the development of existing operators:

- *i.* Provide a deregulatory regime for managers of EuVECA funds with a total asset under management less than Euro 30 Mln.
- *ii.* Remove fees and charges applied by Member States such as the other significant obstacles to cross-border fundraising by qualifying venture capital funds.
- *iii.* Extend the scope of EuVECA Regulation to strategies with common objectives, enhancing the growth and innovation of small and medium-size enterprises (SMEs) in the Union such as growth, development or small buy-out funds.
- *iv.* Promote financial inducements in order to support exit opportunities for venture investors and reduce the length of time to exit.

In any case, we would like to highlight that decisions on the possible revision of the EuSEF and EuVECA Regulations on the aspects mentioned above and on possible other issues should be made taking into account the necessity to ensure, where possible, levelling of conditions between these products and other similar and strategic products to support long-term, infrastructure and SME financing, such as ELTIFs.

Indeed, such levelled conditions could contribute to develop an armonized regulatory framework for long term investment products whose objective is sustaining the real economy and fostering economic growth in Europe.

b. Issue: Managing and marketing EuVECA funds

1. Should managers authorized under the AIFMD be able to offer EuVECA to their clients? Please explain

The legal and regulatory framework resulting from the transposition of the AIFMD into national law differs in material aspects in the various Member States, and this affects the potential answers to the above questions. For example, Italy has gold plated the provisions of section 3, paragraph 3, of the AIFMD by requiring that all national AIFMs, including sub-threshold managers, should be authorized by the Bank of Italy and comply with the same organizational and supervisory requirements (except that sub-threshold managers can benefit from certain limited exemptions). Italian managers of EuVECA and EuSEF funds are treated as sub-threshold AIFMs for regulatory purposes[1].

This regulatory approach has the following implications:

(i) on one hand, Italian managers of EuVECA and EuSEF funds faced longer time to market[2] and incur in heavier establishment and organizational burdens than many of their EU competitors;

(ii) on the other hand, sub-threshold AIFMs authorized to manage closed-end funds (other than RE funds) which may be marketed exclusively to professional investors and certain other eligible investors[3] are also licensed to establish and manage EuVECA and EuSEF funds.

We believe that a greater effort should be made at EU level to improve effective competition within the Union among fund managers which can benefit from the EuVECA and EuSEF passports. This will probably require reconsidering the interaction between the EuVECA and EuSEF Regulations and section 3, paragraph 3, of the AIFMD allowing Member States to adopt stricter rules in regulating sub-threshold managers. Indeed, a corollary of this freedom, insofar as it applies to managers of EuVECA and EuSEF funds, is that conditions of use of the EuVECA and EuSEF passports can differ in material respects depending on the county of establishment of the managers. Allowing managers authorized under the AIFMD to set up and offer EuVECA and EuSEF funds and/or extending the “grandfathering” rule for the EuVECA and EuSEF passports will not solve these regulatory discrepancies and will further worsen their consequences for certain market players.

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

See above.

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?

We are not against the possibility for EuVECA or EuSEF funds to continue 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 Euro Mln.

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?

[1] While these managers are formally registered (not authorized) by the Bank of Italy, the conditions to meet to obtain registration as a manager of EuVECA or EuSEF funds are substantially the same as apply to the release of an authorization to a sub-threshold AIFM (including, for instance, the appointment of a custodian). This point is further developed in section d. (*Set up costs for EuVECA funds*) below.

[2] As a matter of fact, recent experiences indicate that more than 8 months may be necessary for a manager of EuVECA funds to obtain the registration from the date of filing of the relevant application.

[3] Investors making a commitment to 500,000 Euro or more as well as AIFMs’ directors and employees.

We have no objections about the possibility for EuVECA or EuSEF funds to continue 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 Euro Mln.

One of the priorities for the Italian market of venture capital is to provide a proportionality regime for EuVECA funds in order to allow the activity of smaller players. In particular, we believe that is important to provide a deregulatory regime for managers of EuVECA funds with a total asset under management less than Euro 30 Mln. Other characteristic that could be considered for the exemption is, for example, number of investors.

c. *Issue: Investors in EuVECA funds*

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

See answer to question nr. 6.

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

A reduction of the minimum subscription by non-professional investors from Euro 100,000 to Euro 50,000 is considered a strong point to increase the EuVECA funds market.

We agree with the point of view reported in the consultation document according to which a lower threshold could attract more private investors already close to the venture capitalist world. In order to ensure appropriate retail investor protection it can be considered the subscription of a voluntary declaration of adequate knowledge of financial instruments (as in US market).

Indeed, different sets of measures currently exist for EuVECAs/EuSEFs and ELTIFs offered to retail clients, not only in terms of investible amounts, but also on obligations for fund managers. In this sense, an assessment on the possibility to reduce the minimum threshold should have a broader scope and analyze the whole set of possible measures for the protection of retail investors. Once a certain degree of measures is deemed appropriate for certain types of products, such as EuSEFs and EuVECAs, the same level could then be applicable to other types of products such as ELTIFs (or vice-versa), as these products encompass similar characteristics and pursue equally relevant policy objectives.

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

See answer to question nr. 6.

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

See answer to question nr. 6.

d. *Issue: Set up costs for EuVECA funds*

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

Pursuant to the Italian laws and regulations implementing AIFMD, EuVECA and EuSEF Regulations, an Italian EuVECA or EuSEF funds manager has almost the same organizational and structuring requirements and burdens required for an Italian AIFM. Accordingly, the setting up of EuVECA or EuSEF funds in Italy is more expensive if compared with other European jurisdictions. Indeed, within the Italian framework setting up of EuVECA or EUSEF is *de facto* a full authorization process, rather than a simple registration. Moreover, the Bank of Italy applies to such managers the same capital and supervisory requirements required to managers qualified as "below the threshold" and AIFs manage reserved to professional investors.

According to our experience, the Italian market may privilege, in the next future, traditional AIFM structures, considering that no preferential treatment is now granted to EuVECA funds managers in terms of registration, organizational and supervisory requirements. The only advantage relies on the possibility for EuVECA funds to be marketed, under certain conditions, to private individuals investing at least Euro 100,000.

Registration fees, extensively applied by Member States represent, in general, hindrance for any typology of marketing 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?

A venture capital fund manager wishing to use the designation "EuVECA" and passport must comply with a number of operational, organizational and transparency requirements, including those related to the composition of portfolio, and concerns regarding borrowing, delegation, conflicts of interest, organizational requirements and valuation. These obligations and compliance requirements bear additional costs to the setting up of such funds for manager.

As for Italian registration regime in accordance with AIFMD-implementing legislative framework, it is abolished any regime different from the AIFMD authorization regime for alternative funds manager, including venture capital ones.

Sub-threshold managers who also decide to obtain EuVECA passport, must then comply with the full set of obligations and requirements of the AIFMD, a costly and onerous exercise for smaller AIFMs including those due to:

i. authorization process (such as legal and advisory costs);
ii. AIF depositary costs (such as the arrangements made for the appointment of the AIF depositary);
iii. initial marketing notification and documentation.

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?

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e. Issue: Third country managers

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

A general principle of reciprocity should apply to third country managers in order to be admitted to the EuVECA regime. Accordingly, third country managers might prefer to establish a EU manager. At the moment, we do not believe that the extension to third country managers is perceived as a priority.

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

See above.

f. Issue: Eligible assets

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?

We believe that the current definition of "qualifying portfolio undertaking" may lead to conflicts with typical investment situation venture capital funds may encounter and therefore may limit its investments by excluding companies that would be considered "small or medium" sized by fund managers.

In addition, in order to optimize the returns for the funds' investors, fund managers may be interested in diversifying by investing into related activities such as later stage investing or small-cap public stocks.

As correctly pointed put by EVCA in its "Response to the European Commission Green Paper on Building a Capital Markets Union", even funds with an investment strategy targeting portfolio assets different from "qualifying portfolio undertakings" (such as growth, development or small buy-out funds) can play an important role in the long-term success of an European SME; therefore, the voluntary EuVECA regime could be extended to funds with this type of strategy.

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?

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 before deciding to make itself an equity investment in such undertaking. Giving the possibility to EuVECA funds 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 EU. In fact, for start-ups venture debt may represent an efficient source of capital when the only real alternative is equity being less dilutive for all current stakeholders. Venture debt provides working capital allowing early stage companies to extend their financial runways in order to hit next milestones and improve the company's valuation for their next round of equity financing.

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?

We do not believe that the 30% rule reduce the attractiveness of the scheme. Loan origination is an ancillary activity for a venture capital fund and strictly connected to the equity investment that has to remain the prevalent activity also to avoid misuse and abuse of the EuVECA scheme.

g. Issue: Cross-border activity

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

Several European Supervisory Authorities (included CONSOB) require the payment of supervisory fees in relation to the offer of AIFs or EuVECA funds under the applicable passport regime. Accordingly, some Italian managers are reluctant to request extensive passport authorization and focus only on those jurisdictions where they consider having a realistic prospective investors' base. In this scenario, EU managers shall not exploit to its maximum extent the EuVECA regime.

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

See above.

h. Other Issues

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?

A more proportional approach could be created in particular in favor of smaller EuVECA or EuSEF funds such as reducing regulatory burden especially during the first year.

Furthermore, we consider extremely important to promote financial incentives in order to support exit opportunities for venture investors and reduce the length of time to exit.

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?

We believe that the cost burdens deriving from AIFMD regime constitute a barrier to the growth of EuVECA and EuSEF. This barrier could be removed by exempting from AIFMD regime all funds registered as EuVECA or EuSEF. In any case, when assessing the impact of AIFMD requirements on these products, the Commission should bear in mind the necessity to a coherent regulatory framework following CMU guidelines.

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?

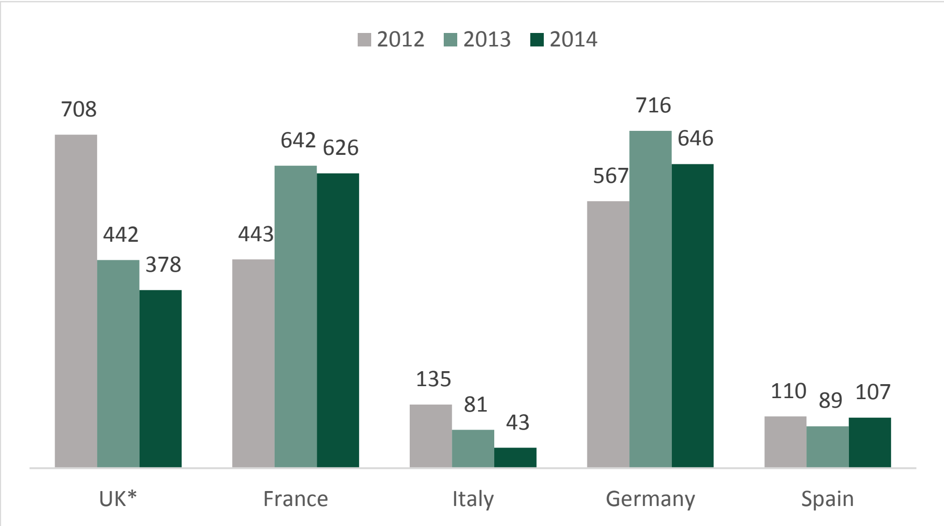
A favorable tax regime for EuVECA or EuSEF investments is crucial to increase investments in European SMEs.

Appendix: statistical tables

Considering the period 2012-2014, data based on the National Venture Capital Associations statistics showed that the Italian venture capital market is the smallest (both in terms of amount invested and companies financed) among the main European ones: UK, France and Germany are the most developed countries in the venture capital activity.

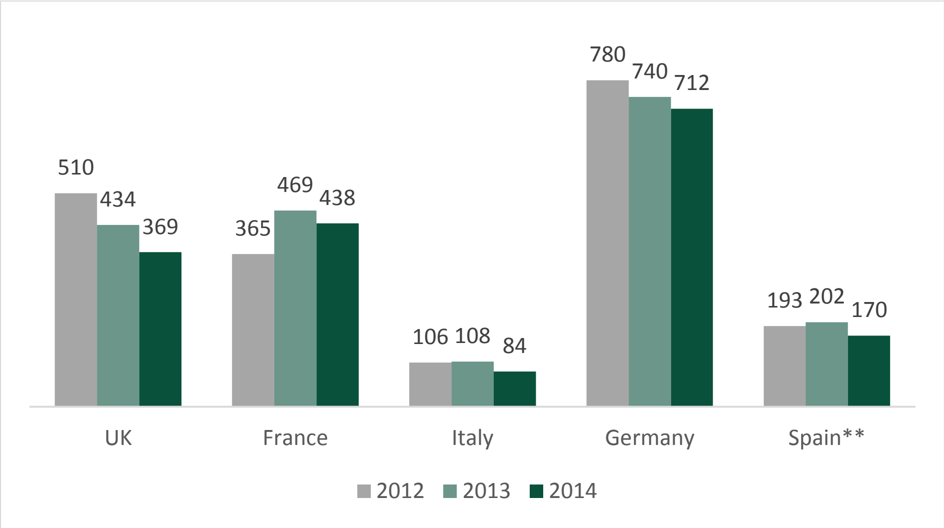
In 2014, the amount invested in Italy was equal to 43 Euro Mln involving 84 companies (figure 1 and 2). In line with the above considerations, another noteworthy aspect is that, in the same year, the average invested amount in the most developed VC markets (UK, France and Germany) was double the Italian one (figure 3). Concerning the number of players, in 2014, 25 venture capitalists were active in our market, with respect to 151 in UK, 110 in France, 160 in Germany and 154 in Spain (figure 4).

Figure 1: Amount invested in venture capital (Euro Mln)



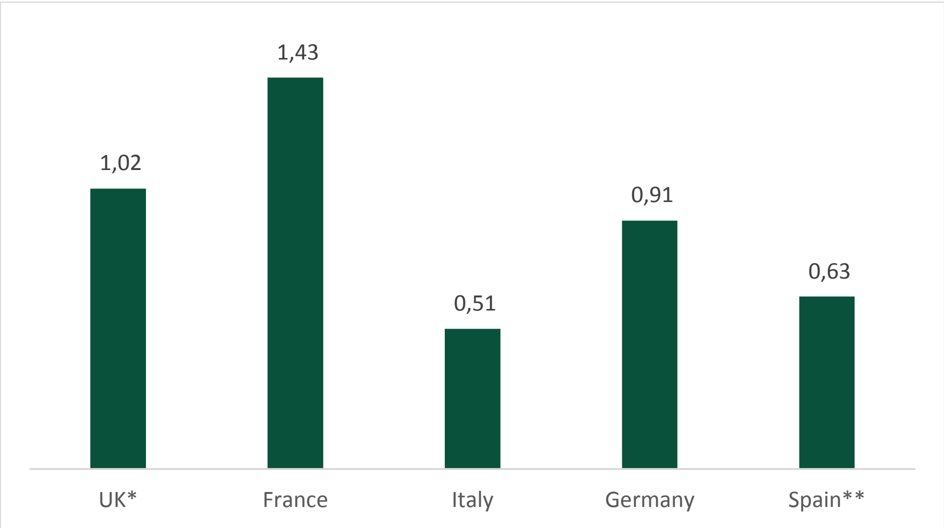
*£ Mln
Source: AFIC (France), AIFI-PwC (Italy), ASCRI (Spain), BVCA (UK), BVK-PEREP_Analytics (Germany)

Figure 2: Number of venture backed companies



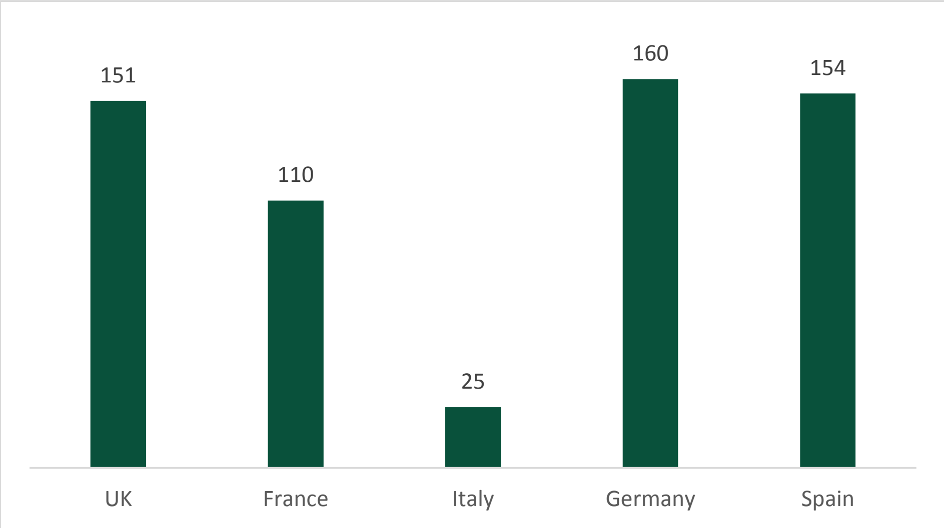
**Number of investments
Source: AFIC (France), AIFI-PwC (Italy), ASCRI (Spain), BVCA (UK), BVK-PEREP_Analytics (Germany)

Figure 3: Average amount invested (Euro Mln, 2014)



*£ Mln
**related to investments and not to companies financed
Source: AFIC (France), AIFI-PwC (Italy), ASCRI (Spain), BVCA (UK), BVK-PEREP_Analytics (Germany)

Figure 4: Number of venture capitalists (2014)



Source: AFIC (France), AIFI-PwC (Italy), ASCRI (Spain), BVCA (UK), BVK-PEREP_Analytics (Germany)