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Response to Commission Consultation Document: Review of the European Venture Capital Funds (EuVECA) and European Social Entrepreneurship Funds (EuSEF)

About Irish Funds

The Irish Funds Industry Association (Irish Funds) is the representative body for the international investment fund community in Ireland. Founded in 1991, Irish Funds represents fund managers, administrators, depositaries, transfer agents, professional advisory firms and other specialist firms involved in the international fund services industry in Ireland.

Irish Funds' 100+ members are responsible for in excess of 13,000 funds with a net asset value of €3.6 trillion. The objective of the Irish Funds is to support and complement the development of the international funds industry in Ireland, ensuring Ireland continues to be a location of choice for the domiciling and servicing of investment funds. Ireland is the leading global centre for the administration of alternative investment funds, servicing an estimated 40% of global alternative investment fund assets. Members of Irish Funds manage and service investment funds spanning the complete range of assets classes and strategies, including private equity and venture capital. The Commission's consultation on EuVECA and EuSEF funds is therefore of significance and relevance to the Association and we welcome the opportunity to respond.

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

   Yes. The EuVECA is restricted to AIFMs that manage less than €500 million, so called "sub-threshold" or "registered AIFMs". This restriction was intended to enable typically smaller scale venture capital managers to avail of an EU marketing passport without having to comply in full with the significant requirements of the AIFMD. However, this restriction significantly limits the scope of the type of manager that can use the structure and has hindered the growth of the EuVECA. The focus should be on re-calibrating the EuVECA so that it can serve the purpose of promoting investment in non-listed companies rather than restricting the type of managers that can avail of the structure. Authorised AIFMs will have the required investment expertise combined with knowledge of the European regulatory environment and access to a potentially suitable investor base. By promoting the EuVECA brand as one that can used by AIFMs, no matter what their level of AuM, we would hope that that its brand awareness would increase in private equity circles so that it could, in time, become recognisable in the same way that the UCITS brand has.

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

Yes, similar to above, we consider that any AIFM should be allowed to manage EuVECAs in order to encourage take-up of this product.

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 think that the effect would be positive. Firstly, this might incentivise managers to encourage the growth in size of EuVECAs or EuSEFs under their management and to establish new EuVECAs or EuSEFs without having to become subject to the obligations of an authorised AIFM. The current requirement to obtain authorisation as an AIFM once the €500 million is exceeded may be having the effect of discouraging managers from growing EuVECAs or EuSEFs under their management above a certain size or from establishing new EuVECAs or EuSEFs. Such behaviour to manage the fund to remain below the threshold is inconsistent with the original objective of promoting the growth and development of the cross-border venture capital industry in Europe.

It is appropriate that sub-threshold managers managing EuVECAs or EuSEFs should benefit from the relevant marketing and management passports which were created for these funds and they should certainly not be deprived of these passports because of the growth of EuVECAs or EuSEFs under management. This approach would also assist managers in developing a specific expertise in EuVECAs or EuSEFs. We therefore propose that for all sub-threshold managers, assets managed within EuVECAs or EuSEFs should be excluded from the regulatory AuM calculation for the purposes of the regulatory compliance threshold.

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?**

An ability to continue to set up EuVECA and EuSEF funds after exceeding the €500 million threshold would have a positive impact on the growth and development of the venture capital industry and would prevent the penalisation of managers for achieving success. In addition to the points raised above, the exclusion of EuVECA and EuSEF assets from the regulatory AuM calculation for all sub-threshold managers could incentivise existing managers in other sectors of the market to enter the venture capital sector by establishing EuVECAs or EuSEFs. This would enhance the level of expertise in the sector and create economies of scale as existing managers would not have to set up separate entities to establish and manage EuVECAs or EuSEFs.

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

The minimum investment of €100,000 is the standard minimum investment threshold for professional investors in the EU. EuVECA and EuSEF are targeted at investors with expertise, many of whom have a good degree of specialist experience that enables them to invest in high risk start-ups. We welcome the fact that in addition to the MiFID professional investor category of client, EuVECA permits another category of investor who can commit a minimum of €100,000. We think this investment threshold is appropriate for this type of product and investor (e.g. entrepreneurs, angel investors, high net worth individuals, managers of the company being invested in) rather than for retail type investors.

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?

Venture capital managers generally do not target retail investors and would not wish to introduce investor protections that are necessary to permit retail investment. Contrasting EuVECA and EuSEF with ELTIF, EuVECA and EuSEF do not have the same level of consumer protection rules. Consequently, it is clear that EuVECA and EuSEF are targeted solely at a more professional type of investor than ELTIF and, as a result, we do not believe that there would be much traction in seeking to lower the investment threshold. Lowering the investment threshold would inevitably lead to the imposition of further requirements either at the European or the domestic level or at both levels and these additional retail requirements would only serve to detract from the ultimate benefit of a lower compliance regime combined with an EU passport that EuVECA and EuSEF provide.

A more targeted way of achieving a higher take up of EuVECAs and EuSEFs (and indeed ELTIFs) would be to encourage investment by pension funds, insurance companies and credit institutions. Promoting greater investment from these types of institutions is a stated aim of CMU. In response to previous CMU consultations and submissions the Commission is already looking at amending the Solvency II capital regime to facilitate investment in ELTIFs and this regime should also be appropriately calibrated to promote rather than discourage the commitment of capital to private equity and venture capital funds generally in order to boost investment in European businesses.

All pension funds have a need for long term returns but many of them are effectively channelled towards potentially shorter term investment horizons by the bias toward listed open-ended funds (usually UCITS) by the investment principles set out in the IORP Directive. Of course it would be possible, in order to meet the IORP Directive/regulated market requirement by listing EuVECAs, EuSEFs and ELTIFs but they would then be subject to the Prospectus Directive, which is not desirable from a compliance perspective.

Using this opportunity to change the reference in the IORP Directive to “predominantly in regulated markets” to make it read “predominantly in regulated markets and/or EuVECAs, EuSEFs and ELTIFs” would enable pension funds to invest in EuVECAs, EuSEFs and ELTIFs without having to make a decision (that might later be subject to a regulatory test for prudence) that it was prudent to do so.

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?

Please see answer to Question 6.

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

Please see answer to Question 6.

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

This will ultimately come down to a cost-benefit analysis for each manager. The cost of compliance relative to being a MiFID regulated manager or an authorised AIFM is considerably lower and the EuVECA route may therefore be attractive to certain managers who otherwise may have needed to use these regimes to establish and market their funds.

However, the level of fees charged by some Member States for local registration has been noted by ESMA in its opinion on “the call for evidence on the functioning of the AIFMD EU passport and of the National Private Placement Regimes”. The imposition of additional fees or requirements on the use of the passport by individual Member States can act as a significant disincentive. To these costs, managers must also add legal and other professional advisory fees. Some regulators impose significant additional goldplating requirements on EuVECA managers relating to organisational and operational compliance which in some cases amount to full compliance with AIFMD and act as a barrier to cross-border marketing. For smaller AIFMs these costs are more significant to bear and the decision on whether to establish as a EuVECA and secure a marketing passport will come down to a cost-benefit analysis.

For many sub-threshold AIFMs seeking to market in only one or a few Member States, the cost of compliance may be higher than the benefit of the EuVECA passport. It is therefore important to also keep the National Private Placement Regimes open for sub-threshold AIFMs, for whom the passport does not make sense on a cost-benefit analysis.

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?**

The registration requirements for a sub-threshold AIFM are in line with the AIFMD requirements and have not been gold-plated to the extent that the AIFM is not managing AIFs falling under the Central Bank of Ireland’s domestic product requirements. This means that a sub-threshold AIFM can establish an unregulated AIF (e.g. an unregulated company or a 1907 Limited Partnership in Ireland) as a EuVECA or EuSEF with limited additional local requirements applying.

However, to set up an Irish regulated Collective Investment Scheme, EuVECAs or EuSEFs would need to be established as one of a range of legal structures regulated by the Central Bank (Irish Collective Asset-management Vehicle (ICAV), Variable Capital Company (VCC), Unit Trust, Investment Limited Partnership or Common Contractual Fund (CCF)). These are the generally the vehicles of choice for establishing investment funds in Ireland and if an AIFM seeks to establish these funds with the EuVECA label, a dual authorisation will apply as the Central Bank will require that these vehicles be established and authorised as Qualifying Investor AIFs (QIAIFs) in addition to EuVECAs. This amounts to a significant level of gold-plating.

Further gold-plating arises due to the Central Bank requirement that a QIAIF managed by a sub-threshold or “registered AIFM” (as opposed to an authorised AIFM) must appoint an authorised AIFM within two years of launch, even if the QIAIF’s AuM remains below the authorisation thresholds contained within AIFMD. The reason why AIFMD contains the thresholds for approval is because it considers that entities which operate below them do not pose a risk to the financial system and are appropriately regulated in a manner that avoids imposing a disproportionate compliance burden. However, the Irish regime for sub-threshold AIFMs managing QIAIFs imposes very significant cost and resource burdens on these AIFMs which are not proportionate and do not facilitate their growth in a sustainable manner.

This requirement runs contrary to the intended goal of EuVECA to allow a lighter regime and passport for sub-threshold AIFMs and is therefore not proportionate. Our recommendation is that the Central Bank's requirement for full compliance with AIFMD in the case of sub-threshold AIFMs managing QIAIFs be removed.

In a cross-border context, we would again draw the Commission's attention to the varying and sometimes disproportionate fee levels applied in relation to marketing notification across the EU. This has been identified in ESMA's opinion on "the call for evidence on the functioning of the AIFMD EU passport and of the National Private Placement Regimes". Prohibiting Member States from imposing such fees or setting a maximum fee range would be an important action to help reduce registration costs.

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?

Please see response to Question 10, as the same restrictions apply to EuSEF.

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?

We do not see the own funds statement prescribed under Article 13(1)(b) of the EuVECA Regulation and under Article 14(1)(b) of the EuSEF Regulation as overly onerous. However, national regulators have taken different approaches to the application of the own funds requirements which can create a significant burden and deterrent for smaller managers seeking to set up EuVECAs/EuSEFs and contribute to an uneven playing field. We understand that several EU regulators seek to apply to varying extents the AIFMD rules relating to yearly overhead costs and capital as set out under Article 9 of AIFMD while others set their own minimum standard.

In line with ESMA's mandate to promote supervisory convergence, we would encourage ESMA to take up an EU wide review of regulatory practices in this area to determine a common understanding and proportionate level of "sufficient own funds" applicable throughout the EU.

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

Yes, the global nature of capital markets and the need for CMU to fit within a global framework is recognised in the Commission's Green Paper. A key objective of CMU is also to attract global capital into Europe. Europe's private equity and venture capital industry is much smaller scale in comparison with the US. Analysis indicates that there are 1,765 private equity firms in Europe managing assets with over $741 billion. This compares with 3,972 firms in the US managing assets of $2.2 trillion, while there are 7,981 PE firms globally managing assets in excess of $3.5 trillion (Source: Prequin, 2014). The EU should not block itself off from this external expertise and investment by restricting EuVECAs only to mangers established in the EU. It is right that the EuVECA should be a European regulated and domiciled fund but non-EU managers with the necessary expertise and available capital should be able to establish EuVECAs and invest internationally (not just in the EU) according to their sector specific expertise.

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

Yes, please see answer to Question 13.

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 would favour less restrictive eligible asset criteria to facilitate the take-up of EuVECA.

Firstly, the requirement to invest 70% of fund commitments in qualifying investments is considered a deterrent for managers that do not want to take on the risk of guaranteeing that they can find that level qualifying investments. This then dissuades overall investment in SMEs out of a concern over compliance.

Secondly, certain innovative and rapidly growing SMEs can achieve the defined threshold quite quickly but would still require financing for growth. Such companies are typically too small for securing financing on the capital markets and excluding them from investment by EuVECAs at a critical growth stage is not conducive to the objectives of CMU. We would therefore welcome less restrictive criteria in the context of EuVECA through a doubling of the threshold to 500 employees, less than €100 million in annual turnover and a balance sheet of less than €86 million or potentially applying a "2 out of 3" test to the existing SME criteria.

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?**

Yes. We note that a qualifying venture capital fund is permitted to grant secured or unsecured loans to a qualifying portfolio undertaking in which the qualifying venture capital fund already holds qualifying investments, provided that no more than 30% of the aggregate capital contributions and uncalled committed capital in the qualifying venture capital fund is used for such loans.

We feel that whilst this – and also the quasi-equity investment capacity – are important, they do not go far enough. We are not seeking to convert EuVECA into true loan originating funds, rather we consider it essential to investment (and divestment) capacity to allow an EuVECA more flexibility to invest into a qualifying portfolio undertaking by way of loan. It should be possible to recognise that there is a distinction between funds which operate as true credit providers (i.e. loan origination funds) and other funds – often venture capital but also private equity or real estate funds – who are quite correctly not seen as credit funds but rather, primarily in order to facilitate a more advantageous exit mechanism or to be able to invest in a company where traditional equity investment may not be available (there may be other legitimate reasons so we do not see this as an exclusive reason), want to or need to invest by means of a loan.

There should not be a requirement to have an existing qualifying investment in the relevant company nor to limit such loan type investments to a maximum of 30% of the aggregate capital contributions and uncalled committed capital in the qualifying venture capital fund.

Whether a EuVECA is investing by means of equity, quasi equity, loan, debt instrument or debt security should not matter. The objective should be to improve the capacity of the qualifying venture capital fund to structure its investment and to facilitate access to its investment/return on investment in the most efficient (legally and fiscally) manner, bearing in mind the different legal regimes where the target companies are located. This should not be considered to cause such funds to be seen as loan origination funds or to be engaged in lending to SMEs etc. Rather, they are simply trying to invest into the target companies in a flexible manner – they are venture capital funds, not loan originators.

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?

Yes, further to our response to Q. 16, the requirement that secured or unsecured loans not exceed 30% of fund commitments is viewed as reducing the flexibility of the manager to determine the appropriate balance of debt and equity according the specific requirements of their investment strategy and the prevailing market conditions. Managers need flexibility to be able to structure their portfolio with the appropriate mix of assets to fulfil their objectives and we would therefore welcome the removal of the 30% requirement.

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

We would again draw the Commission's attention to common themes facing all kinds of AIFs as highlighted under ESMA's opinion on "the call for evidence on the functioning of the AIFMD EU passport and of the National Private Placement Regimes". These include the level of fees charged by some Member States for local registration and inconsistencies and uncertainties arising from the lack of sufficiently clear and detailed definition of marketing at EU level.

We would also highlight the fact that significant local gold-plating of requirements relating to the EuVECA has taken place across the Member States, in some cases amounting to effective full compliance with AIFMD. We would encourage the Commission or ESMA to undertake a review of the implementation of EuVECA across the EU with a view to identifying and removing disproportionate requirements which defeat the intended purpose of EuVECA to provide a lighter compliance regime and cross-border distribution opportunity for European venture capital.

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

Please see response to Question 18.

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?

The profile of EuVECA and EuSEF on the European investment landscape remains extremely low. An awareness raising initiative on the part of the Commission among investors and managers of the objectives and benefits of EuVECA could help to increase interest and increase visibility of the EuVECA "label". Information initiatives for regulators that enhance their understanding of the organisation and operation of venture capital activities could reduce unnecessary gold-plating provisions by national regulators.

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?

Further to the comments above in relation to the eligible portfolio assets criteria and making these less restrictive, we believe that consideration should be given to expanding the EuVECA to growth/expansion and buy-out funds, in addition to venture capital funds. Such additional categories of funds also act as drivers for growth within Europe. The lack of flexibility in the structure is reflected in the fact that as at the beginning of November 2015 only 34 funds throughout the EU had registered as EuVECA funds.

As mentioned above, the imposition of further controls on Member States around the additional requirements they can seek in relation to passporting (such as fees, local agents) may result in an increased uptake in the EuVECA as passporting becomes more streamlined.

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?

We would again draw the Commission's attention to our comments in our response to Question 6 regarding the calibration of the Solvency II, IORP and CRD/CRR regimes to facilitate investment by pension funds, insurance companies and other institutional investors.

We also propose that EuVECA and EuSEF funds should be exempted from the Prospectus Directive requirements where these funds are marketed only to professional and "semi-professional" investors. The Prospectus Directive regime is disproportionate for these funds would add an additional layer of disclosures without adding value for investors.

In relation to taxation, withholding taxes on payments of various income streams to EuVECAs and EuSEFs could adversely impact the attractiveness of these products. Consequently, we recommend that, at a minimum, these vehicles are given access to existing EU based reliefs such as the Parent-Subsidiary Directive and the Interest and Royalties Directive. Further, we recommend that additional EU based withholding tax reliefs are introduced specifically to benefit EuVECAs and EuSEFs so that payments of interest and dividends to such vehicles are exempted from withholding taxes where the source is an EU company.

Across the EU differences exist in the procedures used by Member States to grant relief from withholding tax under the provisions of domestic law or through the application of a double tax treaty. In some Member States the relief is granted 'at-source' (i.e. at the time of payment of the income) whilst other Member States require the full withholding tax be deducted 'at source' and the withholding tax be subsequently reclaimed. Procedures applicable to repayment of withholding tax can be very complex and may also differ considerably across Member States which can ultimately lead to the relief not being granted. We recommend that Member States improve and simplify their procedures for granting withholding tax relief on cross-border investments in both listed and non-listed companies within the EU to ensure EuVECAs and EuSEFs do not suffer inappropriate withholding taxes. Such improvements to procedures could include, inter alia, the broad adoption of granting withholding tax relief at source by all Member States and practical documentation procedures which are consistent across Member States and are clearly understood by both the issuer (e.g. the non-listed company) and EuVECAs claiming the relief.

Access to the benefits of double taxation agreements entered into by various member states will be a relevant factor in the success and attractiveness of EuVECA and EuSEF. While the negotiation and conclusion of such agreements is a matter for individual Member States, the Commission is in a position to influence the outcome of ongoing work with the OECD Base Erosion and Profit Shifting (BEPS) plan and, in particular, the ability for funds to access treaty benefits in the future. The circumstances and situations in which funds will be entitled to access treaty benefits is a matter of ongoing discussion in respect of the BEPS plan and we recommend that the Commission takes steps to ensure that EuVECAs and EuSEFs will be in a position to avail of double taxation agreements entered into by the Member State in which the vehicle is formed.

While the setting of taxation policy and rates is a matter for the Governments of individual Member States, we recommend that the Commission encourages Member States to introduce regimes which are attractive for potential investors in EuVECAs and EuSEFs and, in particular, eliminate any punitive tax measures that may exist in those countries for investors investing in fund vehicles. This would include, potentially encouraging Member States to simplify tax reporting regimes, the administration of which can create a significant cost for administrators and investors.