ICAEW REPRESENTATION
01/16

Public consultation on the review of the EuVECA and EuSEF regulations

ICAEW welcomes the opportunity to comment on the *Review of the EuVECA and EuSEF regulations* published by European Commission on 30 September 2015, a copy of which is available from this link.

ICAEW is listed in the EU Transparency Register (ID number: 7719382720-34).

This response of 6 January 2016 has been prepared on behalf of ICAEW by the Corporate Finance Faculty. Recognised internationally as a source of expertise on corporate finance issues and for its monthly *Corporate Financier* magazine, the Faculty is responsible for ICAEW policy on corporate finance issues including submissions to consultations. The Faculty's membership is drawn from professional services groups, advisory firms, companies, banks, private equity, law firms, consultants, academics and brokers.

The Institute of Chartered Accountants in England and Wales
Chartered Accountants' Hall
Moorgate Place
London
EC2R 6EA UK

T +44 (0)20 7920 8100
F +44 (0)20 7920 0547
DX 877 London/City
icaew.com

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 144,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

For more information, please contact representations@icaew.com

icaew.com

MAJOR POINTS

1. We welcome this review which will play a part in the European Commission's Capital Markets Union initiative. Our contribution focuses on the regulation for EuVECA funds only (the Regulation).

2. The capital-raising passport, available by way of authorisation under the EuVECA Regulation, is a recent tool for attracting capital into European SMEs and start-ups. Venture investment in European companies is growing yet the Regulation has had negligible success in altering the domestic (local or regional) nature of venture activity in the major economies in Member States. In fact, according to European industry data, the proportion of cross-border investments within Europe has fallen as a proportion of all European venture investment, while much of the growth in venture activity stems from outside Europe.

3. The potential of the Regulation to channel non-bank finance into European businesses, could be improved by the following:

   (i) opening the market to the range of venture capital providers;
   (ii) recalibrating the Regulation; and
   (iii) through efforts to increase the visibility of European businesses to potential investors.

4. In relation to (i), UK and European industry data[1] shows and market commentators[2] report that early stage needs are increasingly being met by a breadth of funders – not just venture capital managers. Reports from the US suggest that most of the venture activity in 2014 came from different types of vehicles including hedge funds and asset managers. To deepen the pool of investment available for early stage needs, it would thus seem timely to recalibrate the Regulation to focus on this investment activity, rather than on the current location and size eligibility criteria for managers.

5. We believe that there is a case for opening the Regulation to non EU venture capital managers. Crucially, this would also signal that Capital Markets Union does not aim to 'close' EU markets to venture investment from third countries. European venture managers that, due to size, are authorised under the AIFM Directive (AIFMD) should also be able to market EuVECA funds. In addition to linking them with a deeper pool of capital, these moves will help European businesses access valuable expertise, and will increase the clout of the venture fund sector.

6. As far as (ii) is concerned, actions can focus on mitigating barriers to cross border activity that arise from the Regulation. For example, it is onerous and complicated for a manager to establish the existence of OECD-compliant information exchange agreements between the their home Member State, the Member States in which their fund is intended to be marketed and the territories in which the fund's qualifying portfolio undertakings are established (Article 3d(iv)). Country-specific differences such as 'supervision fees' charged by some host Member States and set-up costs in host countries are also barriers and clarification to the Regulation is necessary in these areas.

7. Country-specific differences that discourage cross-border activity include tax, patent and insolvency laws and the existence of domestic, tax-advantaged investment opportunities. Examples in the UK are the Enterprise Investment Scheme and Seed Enterprise Investment Scheme. The fiscal treatment of cross border activity would be worth exploring. For example,

[1] Small Business Investment: Equity Tracker, March 2015, published by Department of Business, Innovation and Skills and British Business Bank, http://british-business-bank.co.uk/wp-content/uploads/2015/03/050315-Equity-tracker-FINAL.pdf and 2014 European Private Equity Activity, May 2015, published by Invest Europe, http://www.investeurope.eu/media/385581/2014-european-private-equity-activity-final-v2.pdf

[2] http://thrive.london/opinion/what-the-london-co-investment-fund-learned-about-the-early-stage-ecosystem/; http://www.ft.com/cms/s/0/d6420472-7f0f-11e5-a1fe-567b37f80b64.html#axzz3uOvIq7tV and http://www.mondaq.com/article.asp?articleid=450654&email_access=on

certain cross-border investments could be classified as eligible investments for a Member State's local tax-advantaged venture capital scheme.

8. Regarding (iii) we repeat the proposals made in our submission to the Commission's *Green Paper on Capital Markets Union*; namely, for a Europe-wide investor map and for promotion of market-led mechanisms and networks, that facilitate investor contact and engagement with businesses seeking funding. Implementation of measures such as these would yield valuable insights into cultural and structural barriers faced by businesses and investors.

RESPONSES TO SPECIFIC QUESTIONS

Who can manage and market EuVECA and EuSEF funds?

Q1: Should managers authorised under the AIFMD be able to offer EuVECA to their clients?

9. European industry data for 2014 suggest that the existence of the AIFMD passport has not increased cross-border, total private equity investment in Europe. It is unlikely that enabling all AIFMD managers to offer EuVECA will contribute to an increase in the uptake.

10. Under the EuVECA Regulation, private equity firms that do not exceed the threshold for EuVECA could, subject to other criteria, choose to offer EuVECA to their clients. At the date of this response, according to the ESMA database, there were two private equity firms listed as having registered EuVECA funds. This is unsurprising. As firms generally do not combine venture and buyout strategies, enabling AIFMD private equity managers to offer EuVECA is not likely to lead to a greater flow of capital to European SMEs. The need to comply with different regulations for different funds is also likely to be unappealing.

11. However, the assets under management (AUM) threshold also precludes larger venture firms from offering EuVECA to their clients. If the objective is to increase venture capital financing, then it would seem logical to allow larger venture firms to offer EuVECA and, to the extent that venture activity is not considered to pose systemic risk, a threshold may not be necessary. This is consistent with the current ability of EuVECA managers that were initially registered under the Regulation and, subsequently, come within the remit of AIFMD due to an increase in their assets, to continue to use the EuVECA labels.

12. In the consultation paper the Commission reports (page 6) that a consultation revealed that managers authorised under AIFMD would also like to set up EuVECA. It is not stated, however, whether those firms are larger venture fund managers or private equity managers. In the absence of such evidence, it is unclear that allowing all AIFMD firms to offer EuVECA would incrementally increase available capital from AIFMD venture firms doing so.

13. We would observe that, if third country managers are to be permitted to offer EuVECA (question 13), this will need to be on the same basis as European managers, so as to ensure a level playing field.

What happens when a EuVECA or EuSEF manager, post registration, exceeds the 500,000 threshold?

Q3: What would 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 €500,000?

14. Continuity of the relevant passports would enable longer-term commitment to a venture strategy and would provide incentives for scaling up. Over time, this can be expected to deepen the expertise within firms including, where provided, in the non-financial support to investee companies.

Q4: What would 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 €500,000?

15. The positive impact described in our response to question 3 would apply in this instance too. In addition, barriers faced by EuVECA managers to making good, but potentially non-qualifying, investments would be removed.

Who can invest in EuVECA or EuSEF funds?

Q5: What has been the effect of setting the current threshold at €100,000?

Q6: 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?

Q8: How would any reduction of the minimum €100,000 investment be balanced against the need to ensure appropriate retail investor protection?

16. The current threshold is not a barrier for institutions interested in venture activity, or for the managers marketing to those investors.

17. It may, however, be a deterrent for the manager to attract private investors, as marketing the funds on a mass scale will not be efficient. Unless a manager has local operations in other Member States, marketing is most likely to reach domestic private investors. A reduction in the minimum investment could also lead to undesirable fragmentation in funding rounds, and costs. This situation could change if larger, better-resourced managers become eligible to enjoy the passports and can market to individuals seeking alternative opportunities to diversify.

18. Private investment in venture may be discouraged by the threshold but it is just as likely that crowdfunding and domestic tax-advantaged schemes are crowding out venture opportunities. A reduction in the minimum investment could attract more private investors and increase diversification as well as mitigate the competition from crowdfunding platforms. The threshold appears anomalous in comparison, in the UK, to the £10 that can be invested through major platforms such as Crowdcube and Seedrs.

19. Thanks to government initiatives and European Investment Fund programs, private investors already have access to domestic, alternative opportunities, many of which carry tax advantages. Despite such support, venture capital investment from private individuals is not growing: at European level, the proportion of total venture capital raised from private individuals fell in 2014.

20. In summary, a reduction in the minimum investment would be inappropriate as the principal effect will be to extend the eligible investor base beyond professional investors. Other appropriateness tests would be needed to ensure adequate investor protection, with associated burdens on managers that would probably not be mitigated by increased take-up by private individuals.

Is it too expensive to set up EuVECA and EuSEF funds?

Q9: Are the costs relating to fund registration proportionate to the potential benefits for funds from having the passport?

Q10: 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?

21. Some ICAEW members report that, for an established manager, the registration costs and requirements are not overly onerous. However our members report being charged supervision fees, for each fund that they have expressed an intention to market in the host Member State.

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

Q13: Should the use of the EuVECA Regulations be extended to third country managers and if so, under what conditions?

22. Much of the increase in total venture investment in 2014 stemmed from non-European firms. If the objective is to deepen the pool of venture capital, this trend would justify opening the Regulation to non-EU venture managers. Non-European managers should have to meet the same eligibility criteria as European ones.

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

Q15: 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?

23. The current profile of eligible assets is appropriate and consistent with similar schemes.

Barriers to cross-border activity

Q18: What are the key issues or obstacles when setting up and marketing EuVECA or other types of venture capital funds across Europe?

24. A key issue is the lack of clarity regarding a host Member State's ability to charge supervision fees. The cost is also an obstacle given that it arises on every EuVECA fund marketed in the Member State by the manager. The requirement to define at registration the Member States in which the fund may consider marketing, simply diminishes the purpose of the passport.

Other issues

Q20: 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?

25. We refer to our submission to the Commission's *Green Paper on Capital Markets Union*, in which we suggested measures that could help to increase access to funding and channelling of funds to businesses; examples included a Europe-wide investor map and promotion of market-led mechanisms and networks, that facilitate investor contact and engagement with businesses seeking funding.

Q22: What changes to the regulatory framework that govern[s] EuVECA or EuSEF investments (tax incentives, fiscal treatment of cross-border investments) would make EuVECA or EuSEF investments more attractive?

26. Cross-border investments would be potentially more attractive (and comparable) if fiscal incentives existed. It would be worth exploring how qualifying investments in one Member State's tax-advantaged venture capital schemes, might also include investments made in other Member States.