

Adoption of the new EU Regulation on European Venture Capital Funds

By Max Welbes, Partner, Luther Luxembourg

The final text of the Regulation on European Venture Capital Funds ("**EuVECA Regulation**") was adopted by the European Council on 21 March 2013 and, pending its publication in the Official Journal of the European Union, shall apply as from 22 July 2013, i.e. simultaneously with the end of the transposition period of the Alternative Investment Fund Managers Directive ("**AIFMD**").

A European regulation is directly applicable in all EU Member States and does hence not need a transposition into national law.

The objective of the EuVECA Regulation is to simplify the capital raising exercise across Europe by introducing a marketing passport ("**EU Marketing Passport**") for European Venture Capital Funds ("**EuVECA**") in order to foster the growth and innovation of small and medium-sized enterprises ("**SMEs**") in the European Union.

In this context, the European Commission deemed it necessary to create a common framework of rules regarding the use of the designation "EuVECA" for qualifying venture capital funds, in particular with respect to the:

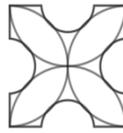
1. Registration of EuVECA managers;
2. Conditions to qualify as EuVECA;
3. Conditions to qualify as eligible investor;
4. Obligations of EuVECA managers; and
5. Supervision and cross-border cooperation.

The most salient features of the EuVECA Regulation can hence be summarised as follows:

1. Registration of EuVECA managers

Managers that plan to obtain the designation of EuVECA and benefit from the EU Marketing Passport for all or some of their EuVECA must:

- i. be established in the EU;
- ii. be subject to the supervision of the competent authority in their home Member State according to point (a) of Article 3 (3) of the AIFMD;
- iii. in total not exceed the threshold referred to in point (b) of Article 3 (2) of the AIFMD, i.e. the assets under management ("**AuM**") do not exceed 500 million Euro (if they are unleveraged and without redemption rights in the first 5 years). Nevertheless, an EuVECA manager that begins to exceed this threshold may continue to make use of the EuVECA label, provided it also complies with the AIFMD requirements; and
- iv. comply with certain administrative and organisational requirements with respect to portfolio management, human resources, skill, care and diligence and prevention of malpractices.



Adoption of the new EU Regulation on European Venture Capital Funds

2. Conditions to qualify as EuVECA

In order to qualify as a EuVECA, the fund must:

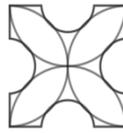
- i. qualify as an alternative investment fund (“**AIF**”) as defined in point (a) of Article 4 (1) of the AIFMD, i.e. be a collective investment undertaking, including investment compartments thereof, which:
 - raise capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and
 - do not require authorisation pursuant to Article 5 of the UCITS Directive;
- ii. intend to invest at least 70% of its aggregate capital contribution and uncalled committed capital in assets that are “qualifying investments” (as set out below);
- iii. invest no more than 30% of its aggregate capital contributions and uncalled committed capital in assets other than “qualifying investments”; and
- iv. is established within the territory of a EU Member State.

“*Qualifying investments*” are investments in “qualifying portfolio undertakings” (as set out below) that are:

- i. equity or quasi-equity instruments issued by “qualifying portfolio undertakings” (as set out below) or companies of which the qualifying portfolio undertaking is a majority-owned subsidiary;
- ii. secured or unsecured loans granted by the EuVECA to a qualifying portfolio undertaking in which the EuVECA already holds qualifying investments, provided that no more than 30% of the aggregated capital contributions and uncalled committed capital in the EUVECA are used for such loans;
- iii. shares of a qualifying portfolio undertaking acquired from existing shareholders of that undertaking; or
- iv. units or shares of one or several other qualifying EuVECA, provided that those have not themselves invested more than 10% of their aggregate capital contributions and uncalled committed capital in EuVECA.

“*Qualifying portfolio undertakings*” are:

- i. established in a EU Member State or in a third country which is (i) not listed as a non-cooperative country by the Financial Action Task Force (“**FATF**”) and (ii) with which a tax information exchange agreement exists in accordance with the OECD model;
- ii. not admitted to trading on the regulated market or on a multilateral trading facility (“**MTF**”);
- iii. SMEs, i.e. employ fewer than 250 persons and either have an annual turnover not exceeding EUR 50 million, or an annual balance sheet total not exceeding EUR 43 million; and
- iv. not themselves a collective investment undertaking, a credit institution, an investment firm, an insurance undertaking, a financial holding company or a mixed-activity holding company (as defined in the EuVECA Regulation).



Adoption of the new EU Regulation on European Venture Capital Funds

3. Conditions to qualify as eligible investor

In order to qualify as an investor in a EuVECA, managers shall market the units and shares of EuVECA exclusively to investors which are considered to be:

- i. professional clients pursuant to the Markets in Financial Instruments Directive (“MiFID”) or
- ii. other investors that:
 - o commit to investing a minimum of EUR 100,000; and
 - o state in writing that they are aware of the risks associated with the envisaged commitment/investment.

Executives, directors or employees involved in the management of a EuVECA manager qualify ipso jure as eligible investors.

4. Obligations of EuVECA managers

EuVECA managers must comply with certain obligations, which are lighter than the AIFMD requirements (e.g. no need to appoint a depositary), with respect to (list not exhaustive):

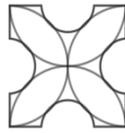
- i. skills, care and diligence;
- ii. prevention of malpractices;
- iii. conflicts of interest;
- iv. promotion of the interests of the EuVECA and its investors;
- v. portfolio management;
- vi. valuation;
- vii. own funds; and
- viii. human resources.

With reference to delegation, a EuVECA manager:

- i. may not delegate duties to third parties to an extent that, in essence, it can no longer be considered to be the manager of the EuVECA and to the extent that it becomes a letterbox entity;
- ii. shall not be affected by the delegation with respect to its liability towards the EuVECA and its investors; and
- iii. delegating functions to a third party may not undermine the effectiveness of supervision of the EuVECA manager, and in particular, may not prevent it from acting or the EuVECA from being managed in the best interests of its investors.

The EuVECA manager shall disclose certain pre-contractual information to potential investors, such as, *inter alia*:

- i. the investment strategy and objectives of the EuVECA;
- ii. the instruments to be invested in;
- iii. costs and related fees (including a cap);
- iv. the risk/reward profile of the investments; and
- v. the remuneration principles.



Adoption of the new EU Regulation on European Venture Capital Funds

Further, it must for each EuVECA establish an audited annual report and make it available to the competent authority. The auditor shall confirm that money and assets are held in the name of the EuVECA and that the EuVECA manager has established and maintained adequate records and checks in respect of the use of any mandate or control over the money and assets of the EuVECA and its investors.

5. Supervision and cross-border cooperation

Further to the registration as manager of a EuVECA, the competent authority shall notify the host Member State(s) accordingly of each additional registration of new EuVECA and the addition of new Member States where marketing is intended.

The host Member State where only marketing activities are performed shall not (i) impose any additional requirements or administrative procedures in relation to the marketing of the EuVECA or (ii) require any approval of the marketing prior to its commencement.

However, the EuVECA Regulation entails no prohibition on further regulation of the management of the EuVECA.

The European Securities and Markets Authority ("ESMA") shall maintain a central database, publicly accessible on the internet, listing all EuVECA managers and registered EuVECA.

The competent authorities shall have all supervisory and investigatory powers that are necessary for the exercise of their functions, e.g. to request access to any document or to require the relevant EuVECA manager to provide information without delay.

To receive additional information and details, please contact:

Max Welbes, LL.M., Partner
Luther Avocats à la Cour, Luxembourg
Phone +352 27 484 674
max.welbes@luther-lawfirm.com

Marie-Astrid Willems, Associate
Luther Avocats à la Cour, Luxembourg
Phone +352 27 484 663
marie-astrid.willems@luther-lawfirm.com