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EuVECAs

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We always knew that the Alternative Investment Fund Managers Directive (AIFMD) suffered from the "one size does not fit all" problem. When devising any new fund proposal it is vital to work through the AIFMD parameters – whether there is indeed an AIF and if so which entity is its AIFM and work through the sub-threshold issues for new start-ups. There is though one positively helpful initiative which was introduced by way of a separate Regulation (No. 345/2013) with effect from 22 July 2013 for European Venture Capital Funds. For sub-threshold AIFMs with venture capital funds, the Regulation may provide some useful assistance.

This Regulation in a sense sits under the framework of AIFMD – dealing with AIFs and AIFMs which would otherwise be subject to AIFMD. The Regulation can apply only to:

- managers of collective investment undertakings other than UCITS – in other words those funds which are within the scope of the AIFMD,
- which are AIFMs which manage collective investment undertakings which have assets under management in total which do not exceed the threshold of €500,000 for unleveraged funds in which investors have no redemption rights within 5 years, in Article 3(2)(b) of the AIFMD.

If a manager can fit within the scope of the Regulation and comply with its AIFMD light provisions, and chooses to register its venture capital funds with the EuVECA designation, there is a useful marketing facility offered by Article 16 of the Regulation which facilitates cross-border marketing even when the main AIFMD passport will not be available (because there is not a full scope AIFM).

Registration is not compulsory for those who fit within the Regulation's terms. If a fund manager does not wish to use the EuVECA designation for its funds, it need not do so. It is more an optional extra approach which might be helpful for those who can fit within it and so who select to do so.

Qualifying venture capital funds

The EuVECA regime is designed to require essential features that differentiate qualifying venture capital funds under the Regulation from the broader category of AIFs which trade in issued securities on secondary markets. Qualifying venture capital funds make investments primarily into directly issued instruments but to do so in a way which do not contribute to the development of systemic risks – hence the use of leverage at the level of the fund is not permitted.

In order to designate a fund an EuVECA in relation to marketing of qualifying venture capital funds in the EU there are various conditions for use:

- Essentially qualifying investments are equity or quasi equity instruments issued by qualifying portfolio undertakings. A "qualifying portfolio undertaking" is an undertaking that, at the time of investment by the qualifying venture capital fund, is not admitted to trading on a regulated market or an MTF; employs fewer than 250 people; has an annual turnover not exceeding €50 million or an annual balance sheet not exceeding €43 million and which itself is not a collective investment undertaking (i.e. another fund). Aside from equity or quasi equity instruments it is possible to have secured or unsecured loans granted by the fund 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 contribution and uncalled committed capital in the qualifying venture capital fund is used for such loans.

- Article 5 provides that managers shall ensure that, when acquiring assets other than qualifying investments, no more than 30% of the fund's aggregate capital contributions and uncalled committed capital is used for the acquisition of such assets (the 30% threshold is calculated on the basis of amounts investable after the deduction of all relevant costs).

- At the fund level, managers should not employ any method by which the exposure of the fund will be increased beyond the level of its committed capital, whether through borrowing of cash or securities, engaging in derivative positions or any other method of gearing.

- Managers of qualifying venture capital funds may only borrow, issue debt obligations or provide guarantees at the level of the fund where such borrowing, debt obligations or guarantees are covered by uncalled commitments.

Essential safeguards

The AIFMD light territory set out in the Regulation for EuVECAs requires essential safeguards – and so there are various conduct of business and conditions imposed, including in the following areas:

- Article 7 requires managers to act honestly fairly and with due skill care and diligence in conducting their activities; apply appropriate policies and procedures for preventing malpractices that might affect investors' interests and the qualifying portfolio undertakings; conduct their business activities so as to promote the best interests of the funds they manage and their investors, and the integrity of the market; apply a high level of diligence in the selection and ongoing monitoring of investments in qualifying portfolio undertakings; possess adequate knowledge and understanding of the qualifying portfolio undertakings in which they invest; treat investors fairly; and ensure that no investor obtains preferential treatment unless this is disclosed in the rules of the fund.

- Although delegation of functions is possible, the manager must remain the manager and not become a letterbox entity. Despite any delegation, the manager remains fully liable towards the fund and its investors.

- There must be conflicts of interest policies put in place. Conflicts must be disclosed. Also conflicts must be managed so as to prevent them adversely affecting the interests of the funds and their investors and to ensure the funds they manage are fairly treated in accordance with Article 9. (ESMA's Final Report providing technical advice to the European Commission on delegated acts was published on 3 February 2015 and includes advice on the details of the types of conflicts of interest and the necessary conflicts of interest policies in relation to EuVECA managers which will be utilised by the Commission as necessary in their development of the delegated acts to be prepared on the basis of this advice. For those which are already registered EuVECAs, the Commission might consider the introduction of a grandfathering clause.)

- Managers must have sufficient own funds and use adequate and appropriate human and technical resources as necessary for the proper management of the qualifying venture capital funds they manage. At all times managers of qualifying venture capital funds shall ensure that they are able to justify the sufficiency of their own funds to maintain operational continuity and disclose their reasoning as to why those funds are sufficient as specified in Article 13. (Whilst requiring sufficient own funds, this is much less onerous than the funding requirements for a full scope AIFM under AIFMD.)

- There must be rules for valuation of assets laid down in the rules of the qualifying venture capital fund which should ensure a sound and transparent valuation process. The procedures must ensure assets are valued properly and that the asset value is calculated at least annually.

- There must be an annual report from the managers of qualifying venture capital funds to the relevant home state regulator for each qualifying venture capital fund they manage within six months of the end of each financial year providing certain information relating to the qualifying venture capital funds – and funds must be audited at least annually.

No depositary is however required to be appointed.

All of this makes up an AIFMD light regime which, for those new AIFM entrants into the market place, should in the most part summarise good practice - and it may also be helpful for them to anticipate and reflect, so far as is practicable, the essence of some of the AIFMD provisions at an early stage.

Investor relations

The benefit of fitting within the EuVECA regime is that there is a convenient marketing tool made available under the Regulation where there is marketing to:

- professional investors as classified for MiFID Directive purposes;

- other investors that commit to investing a minimum of €100,000 and who have stated in writing, in a separate document from the contract to be concluded for the commitment to invest, they are aware of the risks associated with the envisaged commitment or investment; and

- it is possible for executives, directors or employees involved in the management of the manager of the qualifying venture capital fund to invest in funds they manage. The Article 6 requirement about exclusive promotion to those investors in the two categories mentioned above does not apply to such connected party investment.

Article 13 sets out the details of the scope of the information which should be provided to investors in a clear and understandable manner. Any marketing materials should be checked to ensure that they include all of this required information in a fair, clear and not misleading manner.

Further it is important for managers to ensure that this is kept up-to-date and reviewed regularly where relevant. One cannot simply do a fundraising and then not bother to update the PPM or other information memorandum document. As with AIFMD it is necessary to maintain up-to-date information about the funds in a suitable format.

Reporting to regulators

The EuVECA system is predicated on the basis that the manager is sub-threshold for AIFMD purposes, and a similar registration process applies.

In the case of reporting in the UK to the FCA, you should refer to the FCA's helpful website page regarding registering as an EuVECA manager and complete:

- the relevant manager registration form

  The application for entry on registration of the EuVECA managers is tailored to refer to the various articles of the EuVECA Regulation including those mentioned above. There is a need to provide a regulatory business plan which should include reference to the long term business strategy and expansion plans for the business, not least so the FCA can understand whether this is an initial start-up model and one which is likely to be relevant to managers entire fund range. The regulatory business plan is used as a tool to provide commentary and explanation on the responses on the whole raft of topics covered by the EuVECA Regulation.

- for each of the individuals who effectively conduct the business of the firm, a senior person form.

Note that this is not simply a registration but an application for entry on a register. Under Article 14 the relevant regulator should only register the manager of a qualifying venture capital fund if certain conditions are met, which include that the persons who effectively conduct the business of managing qualifying venture capital funds are of sufficiently good repute and are sufficiently experienced also in relation to the investment strategies pursued by the manager of a qualifying venture capital fund; the information provided is complete; the arrangements notified are suitable for complying with the conditions for use of the designation EuVECA; and the list of funds notified reveals that all of the qualifying venture capital funds are established within the territory of an EU member state.

Assuming such registration is made by the relevant regulator, the registration is valid in the entire territory of the EU and shall allow managers of qualifying venture capital funds to market qualifying venture capital fund under the designation EuVECA throughout the EU. Article 15 requires managers to inform the home member state where they intend to market a new qualifying venture capital fund or an existing one. The home member state regulator notifies the relevant other member states and ESMA. ESMA maintains a central register of EuVECAs.

For those thinking of setting up as an AIFM in the UK with EuVECA funds, please see the link below to the relevant FCA website page:
http://www.fca.org.uk/firms/markets/international-markets/aifmd/eusef-euveca

Also please consider the full terms of the Regulation which is directly applicable in EU Member States and which is available at:
http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32013R0345&from=EN

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