

**The EuVECA Label – New Opportunities ahead for Venture Capital and Luxembourg**

The Council of the European Union published an amended proposal for a Regulation on European Venture Capital Funds on 26 March 2012 (the "**Regulation**") which was originally released on 7 December 2011. The purpose of the Regulation is to facilitate the access of small and medium-sized enterprises ("SMEs") to financing their growth and sustainable development by establishing a single rulebook that applies to venture capital fund managers ("VCFM"):

- established within the European Union,
- registered with the competent authority of their home Member State in accordance with Directive 2011/61/EU on Alternative Investment Fund Managers (the "**AIFMD**"), and who want to market the units of their venture capital funds ("**VCF**") to eligible investors within the European Union.

VCFM willing to use and distribute VCF across the European Union will be conducting their activities by using the designation "**EuVECA**".

The Regulation also sets forth requirements applicable to VCF in relation to the type of investments and the type of undertakings that must compose a predominant part of the portfolio of a VCF.

With the purpose of being a solid alternative to the current dependence of SME's financing towards bank loans and a cornerstone piece of legislation to boost the venture capital industry within the European Union, the Regulation allows VCFM to raise monies from professional clients and other investors who have the experience, knowledge, expertise and minimum investment capacities.

The Regulation provides essential benefits to the current venture capital business models which may have to comply with new legal and administrative requirements. However, many of these requirements are familiar to professionals of the Luxembourg

fund industry for being already part of their administrative, auditing or counselling activities.

The discussions below aim at highlighting how some of the key requirements of the Regulation can be addressed from a Luxembourg perspective.

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1. The Regulation is addressed to the managers of alternative investment funds (“AIFM”) which are first subject to the registration procedure set forth under article 3 of the AIFMD and whose assets under management do not exceed EUR 500 million in total. The registration under the AIFMD implies for the VCFM to first report – and on a regular basis – to national regulators on the alternative investment funds (“AIF”) they manage, including on the investment strategies, instruments that they trade or their principal exposures. VCFM shall also be prohibited from employing any method by which the exposure of the VCF is increased, whether through borrowing of cash or securities, the engagement into derivative positions or by any other means. It is to be noted that the Regulation currently does not impose on the qualifying VCF to exclude the redemption rights of unitholders<sup>1</sup>.

As provided for under the AIFMD for qualifying AIFM, the Regulation makes a distinction between internally<sup>2</sup> and externally<sup>3</sup> managed VCF and prohibits any internal VCFM from engaging in activities other than the internal management of the VCF. External VCFM must engage solely in the investment management of VCF and may extend their licence to be allowed to manage UCITS funds (subject to authorisation under Directive 2009/65/EC).

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<sup>1</sup> An amendment has been proposed to include the closed-ended structure in the VCF-related requirements.

<sup>2</sup> Internal VCFM refers to a structure where the legal form of the VCF permits an internal management and where the VCF's governing body has chosen not to appoint an external VCFM. In that case, the Regulation states that the VCF itself shall be the VCFM and the VCF will then have to be authorised as a VCFM. This is typically the case with an investment company where its board of directors is in charge of the management of the affairs of the company.

<sup>3</sup> Reference to external and internal VCFM is currently only made in the Recitals of the Regulations. External VCFM is not further detailed in the text of the Regulation itself but should respond to the definition thereof given in the AIFMD for an external AIFM.

2. While the AIFMD is principally regulating the manager, the Regulation aims at introducing requirements at the level of the VCF such as the composition of its investment portfolio, investment techniques and eligible undertakings that a VCF may target. To this extent, the use by a VCFM of the designation EuVECA is limited to the management of VCF that invest into one or several non-listed undertakings<sup>4</sup> whose annual turnover or annual balance sheet do not exceed EUR 50 million or EUR 43 million, respectively. A VCFM shall further be compelled to dedicate at least 70 percent of the aggregate capital contributions and uncalled committed capital of the VCF to investments in the above qualifying undertakings. The Regulation further specifies that the investments should be in the form of equity and quasi equity instruments, i.e. whose return is linked to the profit or loss of the qualifying undertaking and where the repayment of the instrument in case of default is not fully secured.

VCFM are also required, in relation to the VCF they manage, to comply with further transparency obligations, including the publication of an annual report, the provision of information to investors prior to their investment by means of an offering memorandum or otherwise and to report to regulators.

Most of these requirements will not imply significant changes for existing Luxembourg structures because they are already subject to similar requirements under their current regulated status.

3. To this extent and for Luxembourg, as one of the world's leading financial centres for investment funds and companies, the Regulation can be considered as a new opportunity further to that recently offered by the AIFMD.

The Regulation will permit Luxembourg to continue to develop its fast growing venture capital industry. Supervised investment companies in risk capital (commonly referred to in their French abridged form as "**SICAR**") subject to the amended law of 15 June 2004 on investment companies in risk capital (the "**SICAR Law**") will be put in a competitive position to raise monies among an investor base that is well known by SICAR under the SICAR Law. The Regulation goes indeed beyond the fundraising scope of the AIFMD as it allows VCFM operating under the EuVECA label to raise

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<sup>4</sup> Unless for those listed on an SME growth market as provided for under article 35 of COM(2011) 656 final (MiFid 2).

capital from professional clients, whether qualifying or treated as such under Directive 2004/39/EC on markets on financial instruments, as well as from other investors who commit to invest a minimum of EUR 100,000 and state in writing, in a separate document from the commitment agreement, that they are aware of the risks associated with the investment. The Regulation provides also for an assessment by the VCFM of the well-informed status of the investor.

The flexibility offered under the regime of specialised investment funds ("**SIF**") subject to the amended law of 13 February 2007 on specialised investment funds (the "**SIF Law**"), whose base of eligible investors is the same as that of SICAR, can also be considered as a tailor-made product by those sponsors willing to develop their venture capital activities across the European Union.

SICAR or SIF may thus be treated as ready-to-use by VCFM. Collective investment structures supervised by the Luxembourg *Commission de Surveillance du Secteur Financier* (the "**CSSF**"), indeed do not only already fulfil most of the sound operating and administrative requirements imposed by the Regulation, but are also subject to additional requirements protecting the interests of investors. This includes the mandatory appointment of depositaries in charge of safekeeping or supervising their respective assets. It is to be noted that amendments in this regard have been proposed in order to require VCFM to appoint depositaries for the assets of their VCF<sup>5</sup>.

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Based on the above considerations, the Regulation appears as a real opportunity (i) to promote venture capital across the European Union by promoting VCF and their managers as a solid alternative to credit institutions for financing SMEs, and (ii) for Luxembourg to establish its fast growing venture capital industry as one of the best jurisdictions to take advantage of its different legal structures and the long and well recognised experience of the CSSF in dealing with cross-border distribution.

Xavier Le Sourné, 18 June 2012

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<sup>5</sup> Amendments 135 through 137 dated 29 March 2012.