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Introduction

The European law on alternative investment fund managers (AIFMs) comes in three main parts:

- The Alternative Investment Fund Managers Directive (**AIFMD**);
- The European Venture Capital Funds Regulation (**EVCF Regulation**); and
- The European Social Entrepreneurship Funds Regulation (**ESEF Regulation**).

Our client alerts on the **AIFMD** and **Marketing a Fund under the AIFMD** explain the first. This alert is concerned with the second and third.

The European Venture Capital Funds Regulation

The EVCF Regulation allows the manager of a qualifying venture capital fund (QVCF) to use the designation *"EuVECA"* when it markets a QVCF. It also gives the manager a *"passport"* so that it can market the QVCF anywhere in the European Economic Area (EEA).

To qualify for these benefits:

- The manager must be:
  - A legal person, the regular business of which is managing at least one QVCF;
  - *"Sub-equivalent"* for AIFMD purposes;
  - Established in the EEA; and
  - Registered with the supervisory authorities in its home Member State; and
- The QVCF must be an alternative investment fund (AIF) that:
  - Intends to invest at least 70% of its aggregate capital contributions and uncalled committed capital in assets that are qualifying investments;
  - Does not use more than 30% of its net aggregate capital contributions and uncalled committed capital to acquire non-qualifying investments; and
  - Is established in the EEA.

If the manager chooses to register, it will be expected to comply with the requirements of the EVCF Regulation afterwards. In particular, the manager:

- Must not do anything, at the level of the QVCF, that will increase the exposure of the QVCF beyond the level of its committed capital;
- May only borrow, issue debit obligations or provide guarantees, at the level of the QVCF if the borrowings, debt obligations or guarantees are covered by uncalled capital commitments;

- May only market interests in the QVCF to:
  - *"Per se"* and *"elective"* professional investors;
  - Those who are willing to invest at least €100,000, and who sign an appropriate document to confirm that they are aware of the risks associated with their investment; and
  - Those who are executives, directors or employees involved in the management of a manager of a QVCF when investing in the QVCFs they manage.

For these purposes:

- *"Qualifying investments"* (QIs) include:
  - Equity or quasi-equity instruments issued by a qualifying portfolio undertaking (QPU), or an undertaking of which the QPU is a majority owned subsidiary;
  - Secured or unsecured loans granted by the QVCF to a QPU, in which the QVCF already holds QIs;
  - Shares of QPUs; and
  - Units or shares in other QVCFs;
- Provided that, in each case, certain additional tests are also met;
- A *"qualifying portfolio undertaking"* is an undertaking that:
  - At the time of investment by the fund:
    - Is not admitted to trading on a regulated market or a multilateral trading facility;
    - Employs less than 250 people;
    - Has an annual turnover not exceeding €50m, or an annual balance sheet total not exceeding €43m;
  - Is not a collective investment undertaking, a credit institution, an investment firm, an insurer or a financial or mixed-activity holding company; and
  - Is established in the EEA, or a third-country that meets certain tests.

Registration

To register, the manager will need to give its home Member State regulator:

- The names of the people who will *"effectively conduct the business of managing"* a QVCF;
- The name of the QVCF, and some information about the QVCF's investment strategies;
- Information about the systems and controls the manager will use to ensure that it meets the requirements of the QVCF Regulations; and
- A list of countries where the manager is proposing to establish and market a QVCF.

The regulator can only lawfully register the manager if those who will *"effectively conduct the business of managing"* a QVCF are of sufficiently good repute, and have sufficient experience of the QVCF's investment strategies. A single registration is sufficient for the whole of the EU.

If the manager wants to market a new fund, or it wants to market an existing fund in a country that was not included in the original list submitted to its home State Regulator, it can do so, if it tells its home Member State regulator first.

A manager that is *"sub-threshold"* when it registers, may continue to use the "*EuVECA*" designation when it markets a QVCF, even if its assets under management increase to such an extent that it no longer qualifies as a "*sub-threshold*" manager for AIFMD purposes, provided that it begins to comply with relevant parts of the AIFMD.

Uniform rules

EuVECA managers must (for example):

- Act honestly, fairly and with due skill, care and diligence;
- Have policies and procedures in place to prevent malpractice;
- Conduct their business in a way that promotes the best interests of the QVCFs they manage, their investors and the integrity of the market;
- Have adequate knowledge and understanding of the QPUs in which they invest;
- Treat their investors fairly;
- Ensure that no investor obtains preferential treatment, unless that treatment is disclosed in the rules or instruments of incorporation of the QVCF;
- Identify and avoid conflicts of interest. Where a conflict cannot be avoided, the manager must manage, monitor and disclose it in a way that will prevent the conflict adversely affecting the QVCF and the investors' interests;
- Have sufficient own funds, and use adequate and appropriate technical and human resources to properly manage their QVCFs;
- Give their potential investors prescribed information before they decide whether to invest; and
- Give their regulators and investors prescribed information at regular intervals thereafter.

Should I register?

ECVF Regulation registration is voluntary. The fact of registration, together with the ability to market across the EEA using the *EuVECA* designation may make it easier to raise a fund than might otherwise have been the case. However, registration brings compliance cost and risk, over and above the compliance costs and risks that would accompany being a non-*EuVECA* sub-threshold AIFMD manager. Careful consideration is therefore required, before an application to register is made.

Even if registration is completed, and the manager and fund are entitled to use the *EuVECA* designation and passport, host-Member State financial promotion and other rules *may* still apply, at least initially. If they do, that may reduce the apparent value of the passport.

Notwithstanding these issues, a small number of managers have registered. See the European Securities and Markets Authority's **register of *EuVECAs* (and *EuSEFs*)**.

European Social Entrepreneurship Funds Regulation

The ESEF Regulation allows the manager of a qualifying social entrepreneurship fund (QSEF) to use the designation "*EuSEF*" when it markets a QSEF. It also gives the manager a "*passport*" so that it markets the QSEF anywhere in the EEA.

The requirements of the ESEF Regulation are almost identical to those of the EVCF Regulation. It is therefore possible, in almost every case, to read the first part of this client alert as if "QVCF" had been replaced with "QSEF" (and so on), save that under the terms of the ESEF Regulation:

- A *"qualifying portfolio undertaking"* is an undertaking that:
  - At the time of investment by the fund, is not admitted to trading on a regulated market or a multilateral trading facility;
  - Has the achievement of measurable, positive social impact as its primary objective, where the undertaking:
    - Provides services or goods to vulnerable or marginalised, disadvantaged or excluded persons;
    - Employs a method of production of goods or services that embodies its social objectives; or
    - Provides financial support to social undertakings that meet either or both of the immediately preceding criteria;
  - Uses its profits *primarily* to achieve its primary social objective;
  - Is managed in an accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities;
  - Is established in the EEA, or a third-country that meets certain tests;
- In addition to complying with the obligations that would fall on it, if it was the manager of an EVCF, the manager of a ESEF must also have procedures in place that will enable it to measure the extent to which the *qualifying portfolio undertakings* in which the QSEF invests achieve the positive social impact to which they are committed.

Other matters

Each of the Regulations gives the European Commission the power to adopt delegated acts. The process for adopting the delegated acts has begun. **Read our most recent blog on these issues**.