

# An overview of the European Venture Capital Funds (EuVECA) regime

This Note provides a high-level overview of the regulatory regime for European Venture Capital Funds (**EuVECA**) with respect to proposed fund structures.

The EuVECA regime is intended to make it easier for qualifying venture capital funds (**VCFs**) to be established in the European Union (**EU**) and to establish a framework for distribution of VCFs on a passported basis throughout the European Economic Area (**EEA**).

The EuVECA Regulations are complementary to the [Alternative Investment Fund Managers Directive \(AIFMD\)](#) and, inter alia, permit a sub-threshold alternative investment fund manager (**AIFM**) to market VCFs on a passported basis throughout the EEA.

The applicable legislative framework consists of:

- the EU's [EuVECA Regulation](#) (EU) No. 345/2013, as subsequently amended by:
  - [Regulation \(EU\) 2017/1991](#) and
  - [Regulation \(EU\) 2019/1156](#) (the Cross-Border Funds Distribution Regulation)
 and as supplemented by:
  - [Commission Delegated Regulation \(EU\) 2019/820](#) (together the **EuVECA Regulations**).

This Note addresses the following questions:

1. What do the EuVECA Regulations cover?
2. What is a qualifying VCF?
3. What is a qualifying investment?
4. What is a qualifying portfolio undertaking?
5. To whom may EuVECAs be marketed?
6. What organisational, operational and transparency rules apply to managers wishing to market EuVECAs?
7. How is the EuVECA marketing passport obtained?

## 1. What do the EuVECA Regulations cover?

The EuVECA Regulations apply to managers of alternative investment funds (**AIFs**) - as defined for AIFMD purposes (and so excluding UCITS funds) - who:

- manage portfolios of VCFs
- manage AIF assets (**AUM**) which in total do not exceed:
  - EUR 500 million (for unleveraged AIFs which have no redemption rights exercisable during a period of five years following the date of initial investment), or otherwise
  - EUR 100 million
- are established in the EU and
- are subject to registration in their home Member State in accordance with the sub-threshold manager exemption under Article 3(3)(a) of the AIFMD. (The thresholds are those set out under the second bullet point above.)

For the purposes of these thresholds, AUM is calculated in the same way under the EuVECA Regulations as it is under the AIFMD.

It is possible to exclude outstanding capital commitments for these purposes (i.e., only contributed capital is counted towards AUM).

## 2. What is a qualifying VCF?

To be a VCF, a fund must:

- be a collective investment undertaking that intends to invest at least 70% of its aggregate capital contributions and uncalled committed capital in **qualifying investments** (see below)
- not use more than 30% of its aggregate capital contributions and uncalled committed capital to acquire assets other than qualifying investments and
- be established in an EU Member State.

## 3. What is a qualifying investment?

Qualifying investments are any of the following:

- equity or quasi-equity instruments issued by:
    - a qualifying portfolio undertaking (see below) and acquired directly from it by the VCF
    - a qualifying portfolio undertaking in exchange for an equity security issued by the qualifying portfolio undertaking or
    - an undertaking of which the qualifying portfolio undertaking is a majority-owned subsidiary, and which is acquired by the VCF in exchange for an equity instrument issued by the qualifying portfolio undertaking
  - secured or unsecured loans granted by the VCF to a qualifying portfolio undertaking in which the VCF already holds qualifying investments, so long as no more than 30% of the aggregate capital contributions and uncalled committed capital in the VCF may be used for such loans
- Note:** if a regulated Irish Fund is used to originate loans, then the L-QIAIF rules would apply
- shares of a qualifying portfolio undertaking acquired from existing shareholders of that undertaking and
  - units or shares of one or several other VCFs, provided that those VCFs have not themselves invested more than 10% of their aggregate capital contributions and uncalled committed capital in VCFs.

A fund of VC funds is therefore permitted under the EuVECA Regulations but 70% of the underlying funds would need to be VCFs. You should consider if this restriction inhibits your investment universe to an extent that a VCF is not a viable option.

A public register of EuVECA managers and VCFs, maintained by ESMA, is available [here](#).

## 4. What is a qualifying portfolio undertaking?

A qualifying portfolio undertaking is an undertaking which:

- at the time of an investment by the VCF complies with one of the following conditions:
  - it is not admitted to trading on a regulated market or multilateral trading facility (as defined under the EU's [Markets in Financial Instruments Directive \(MiFID\)](#) and
  - it employs up to 499 persons or
  - it is an SME listed on an SME Growth Market
- it is not itself a collective investment undertaking, a credit institution, a MiFID firm, an insurance undertaking, a financial holding company or mixed activity holding company and
- it is established:
  - in an EU Member State or
  - in a third country which:
    - is not listed as a FATF Non-Cooperative Country and Territory and
    - has signed an agreement with:
      - the VCF manager's home Member State and
      - each Member State into which the VCF is to be marketed,
 which ensures that the third country fully complies with the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters.

## 5. To whom may a VCF be marketed?

VCFs can be marketed to:

- 'professional clients' as defined for the purposes of MiFID (whether 'per se' or 'elective') and
- other investors provided that each such investor
  - commits to investing a minimum of EUR100,000 and
  - states in writing that they are aware of the risks associated with the envisaged investment.

The above requirements do not apply to executives, directors or employees involved in the management of a manager in respect of a VCF that they manage.

A VCF, which is either:

- not yet established or
- established but not notified for marketing

may be pre-marketed to potential investors in the EU in order to test interest in the VCF, so long as the information provided is not sufficient to allow the potential investors to commit to acquiring units or shares in a particular VCF and does not amount to a subscription form, prospectus or similar document (whether in draft or a final form).

## 6. What operational, organisational and transparency rules apply to managers wishing to market EuVECAs?

A manager wishing to use the EuVECA brand and passport must comply with a number of operational, organisational and transparency requirements, including the following:

- **Composition of portfolio**
  - no more than 30% of the aggregate capital and uncalled committed capital may be used to acquire assets which are not qualifying investments (see above)
  - at the level of the VCF, the manager
    - may not increase the VCF's exposure beyond the level of its committed capital (for example, through the borrowing of cash or securities or use of derivatives) and
    - may only borrow, issue debt obligations or provide guarantees where these are covered by uncalled commitments.
- **Delegation**
  - where a manager delegates functions to a third party, the manager's liability towards the VCF and/or its investors remains unaffected
  - as under the AIFMD, the manager cannot delegate functions to the extent that it becomes a 'letter-box' entity – it must retain substantive control of the VCF.
- **Conflicts of interest**
  - the manager must identify and avoid conflicts of interest
  - where a conflict cannot be avoided, the manager must manage and monitor it and disclose its general nature to the investors promptly and 'in clear terms'.
- **Conduct of business**
  - in relation to the VCF, the manager must
    - act honestly fairly and with due skill and diligence
    - apply appropriate policies and procedures to prevent malpractices which might reasonably be expected to affect the interests of the investors and qualifying portfolio undertakings and
    - promote the best interests of the VCF, the investors and the integrity of the market.

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- **Organisational requirements**

- the manager must:
  - have sufficient own funds, invested in liquid assets or assets readily convertible to cash at short notice and not including speculative positions and
  - use adequate resources (both human and technical) as to ensure the proper management of each VCF.

- **Valuation**

- rules for the valuation of assets must be laid down in the VCF's constitutive documents
- these rules must ensure a "sound and transparent" valuation process
- the procedures used must ensure that the assets are valued properly, and at least annually.

- **Annual report**

- for each VCF which it manages, the manager must make an annual report available to the VCF's home regulator (and provide it to investors on request), within a period of six months following the end of the relevant financial year
- the annual report must:
  - describe the composition of the portfolio of the VCF
  - describe the VCF's activities of the previous year
  - disclose the profits earned by the VCF at the end of its life
  - where applicable, disclose the profits distributed during its life and
  - contain the fund's audited financial accounts.

- **Investor disclosure**

- the EuVECA Regulations require that a manager must inform investors in a clear and understandable manner of a number of matters, prior to their investment decision. These include:
  - the identity of the manager and other service providers and a description of its/their duties
  - the amount of own funds available to the manager for maintaining adequate human and technical resources necessary for the proper management of the VCF
  - a description of the VCF's investment strategy and objectives, including:
    - the types of the qualifying portfolio undertakings in which it intends to invest
    - the techniques that it intends to employ and
    - any applicable investment restrictions
  - a description of a VCF's risk profile and any risks associated with the assets in which the VCF's may invest or investment techniques that may be employed
  - a description of a VCF's valuation procedure and the pricing methodology for the valuation of assets
  - a description of how the manager's remuneration is calculated
  - a description of all relevant costs and of the maximum amounts thereof and
  - where available, the historical financial performance of a VCF
- any such information must be disclosed in a way which is 'fair, clear and not misleading'. It must also be kept up to date, being reviewed regularly where relevant.

## 7. How is the EuVECA marketing passport obtained?

A manager who intends to market a VCF under the 'EuVECA' designation must inform its home state regulator of its intention and provide it with certain information, including the following:

- the identity of the persons who effectively conduct the business of managing the VCF
- the identity of the VCFs to be marketed and their investment strategies
- information on how the manager complies with the operational, organisational and transparency requirements referred to above and
- a list of the Member States in which the manager intends to market each VCF.

The manager must notify its home state regulator of any material changes to the information provided before such changes are implemented.

Subject to certain conditions being met, (e.g., as to the suitability of the manager) the home state regulator must then register the manager and immediately inform any relevant host Member State regulator (and ESMA) of that registration.

Registration allows the manager of a VCF to market that VCF throughout the EU under the EuVECA designation.

### **AIFMs authorised under Article 6 of the AIFMD (Authorised AIFMs)**

As a result of a review of the EuVECA Regulations, Authorised AIFMs (AIFMs which are fully AIFMD compliant as opposed to a sub-threshold AIFM) may now also manage and market VCFs under the EuVECA designation.

Such managers continue to be subject to the requirements of the AIFMD but must comply with the EuVECA Regulations' requirements regarding eligible investments, targeted investors and information to be disclosed (see above).

An Authorised AIFM which intends to use the EuVECA designation for a VCF must apply to its home state regulator to register the VCF.

The application must include:

- the constitutive documents of the VCF
- information on the identity of the depositary
- the identity of the persons who effectively conduct the business of managing the VCF
- the identity of the VCFs to be marketed and their investment strategies
- information on how the manager complies with the operational, organisational and transparency requirements referred to above
- a list of the Member States in which the manager intends to market each VCF
- a list of the Member States in which the manager has established (or intends to establish) VCFs.

The Authorised AIFM will not, though, be required to provide documents which it has already submitted under the AIFMD.

### **Further information**

For further information, please visit our [Private Funds – Ireland website](#), which contains webinars and articles related to the revised framework for the establishment of closed-ended funds in Ireland. See also our [note on the review of the Irish limited partnership law](#), with reference to EuVECA's.

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