

# EUROPEAN VENTURE CAPITAL FUNDS (EUVECA)

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## Abstract

European law lays down a diversity of rules for undertakings for collective investment which operate on the principle of risk-spreading. First tier of legislation regards undertakings for collective investment in transferable securities (UCITS) which are tailored for low-risk appetite (Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities).

Such undertakings provide a way of investing money alongside other investors in transferable securities or in other liquid financial assets. UCITS distributes units or shares which are, at the request of holders, repurchased or redeemed, directly or indirectly, out of those undertakings' assets. Such UCITSs may be constituted in accordance with contract law (as common funds managed by management companies) or statute (as investment companies).

Second tier of legislation regarding collective investment comprises alternative investment funds (AIFs), with a large range of juridical forms and repurchasing options. A specific type of AIF is European venture capital fund (EuVECA). European law reserves designation 'EuVECA' in relation to the marketing of venture capital funds in the Union. Qualifying venture capital fund with qualifying investments are established for the delimitation of these entities (EuVECA). [Regulation (EU) no. 345/2013 of the European Parliament and of the Council on European venture capital funds].

**Keywords:** capital market, investment funds, undertakings for collective investment in transferable securities (UCITS), alternative investment funds (AIFs), European venture capital funds (EuVECA).

## 1. Introduction

**Undertakings for collective investment.** First tier of legislation regards undertakings for collective investment covers undertakings for collective investment in transferable securities (UCITS) which are tailored for low-risk appetite. (Directive 2009/65/EC of the European Parliament and of the Council on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities)<sup>1</sup>.

The essential characteristics of the UCITS are underlined by the law: the purpose of the entities (sole purpose pursued is conducting "collective investment", investing of fund money collected in financial instruments under conditions prescribed by law, including the principles of risk diversification and prudential management) and financial instruments issued (units are redeemable continuously to a value determined by reference to net assets value, at the request of holders)<sup>2</sup>.

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UCITSs may be constituted in accordance with contract law (as common funds managed by management companies) or statute (as investment companies).

Redeemable character (continuous) of units issued by UCITS is a "registered trademark", the essential element of the definition of these entities. This feature explains the open-ended approach of the UCITS. Issuance and redemption of units, in a continuous manner, is the main mechanism of these investment vehicles.

**Beyond open funds. Alternative investment funds.** Second tier of legislation regarding collective investment comprises alternative investment funds (AIFs), with a large range of juridical forms and characteristics.

Alternative investment funds (AIFs) are defined complementary to UCITS. AIFs means collective investment undertakings 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 as UCITS<sup>3</sup>.

European legislator appreciates that it would be disproportionate to regulate the portfolios of AIFs (managed by AIFMs) at Union level and it would be problematic to provide for any harmonisation due to the very diverse types of AIFs. AIFs should therefore be

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<sup>1</sup> GEO no. 32/2012.

<sup>2</sup> GEO no. 32/2012, art. 2, para. 2.

<sup>3</sup> Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (AIFMD), art. 4 para. 1 a.

regulated and supervised at national level<sup>4</sup>. Although national requirements additional to those applicable in other states on AIFs may exist, this fact should not prevent the exercise of rights of AIFMs authorised in accordance with this European Directive<sup>5</sup> in other Member States to market to professional investors in the Union.

## 2. Paper content

### 2.1. Alternative investment funds managers (AIFMs)

European legislator lays down the rules for the authorisation, ongoing operation and transparency of the managers of alternative investment funds (AIFMs) which manage or market alternative investment funds (AIFs) in the European Union. If investment funds are subject to national regulation only, their managers are regulated uniformly at European level.

Disclosure to investors is a specific obligation for investment funds administrators. AIFM, as a particular administrator, shall (for each of the AIFs that they manage and for each of the AIFs that they market in the Union) make available to AIF investors a description of the investment strategy and objectives of the AIF, a description of the kinds of assets in which the AIF may invest, the techniques it may employ and risks, any applicable investment restrictions including the use leverage (the types of leverage accepted and the maximum level of leverage which the AIFM are entitled to employ on behalf of the AIF)<sup>6</sup>.

### 2.2. Types of alternative investment fund (AIF)

FIA open ended and closed ended. The concept of AIF is very broad (as opposed to UCITS) and contains several species. In the case of the AIF, European regulation states that this notion includes open-ended or closed-ended entities. On the other hand, AIFs are clearly outside the notion of UCITS. In this context, we must admit that there are open-ended investment funds (AIF), which are not open-ended investment funds of the UCITS type.

The disambiguation was made by a European regulation of the European Commission (delegated act) which explained the notions of opened and closed AIF. An open-ended AIF is understood to be an AIF whose shares or units are, at the request of any holders,

repurchased or redeemed (before the liquidation or any termination procedure), directly or indirectly, from the assets of the AIF and in accordance with the procedure laid down in its rules or articles of association, prospectus or tender documents<sup>7</sup>. These redemption requests must be read in the context of the redemption procedures and frequency established by the statutory acts. In conclusion, there is no typical UCITS continuous redemption, but only one with a previously imposed rhythmicity, with a plan included in the AIF documents. This clarifies the distinction between open-ended AIF and open-end investment funds (UCITS).

Complementary, a closed-ended AIF shall be an AIF other than of the type described above (open ended AIF).

1. *AIFs of a contractual and corporate type.* Alternative investment funds (AIF) are a generic notion, the UCITSs pair. The AIFs species are symmetrically with the UCITS species, the contractual type AIF, the investment funds (AIF in the contractual fund version is essentially also a closed-ended investment fund from the perspective of the lack of a continuous issue and repurchase periodically only) and corporate type AIF, (closed) investment companies. National regulation, following the European archetype, no longer operates with the respective species, closed fund and closed companies but remains at the level of the higher notion of AIF, contractual and corporate type<sup>8</sup>. This general approach cannot hide the fact that the specific entities remain in fact the funds - based on the civil contract - and the companies with legal personality, the closed-end investment companies.

2. AIFs intended for retail investors (AIFRI) and AIF intended for professional investors (AIFPI).

AIF intended for retail investors may be established either as AIF of contractual type, whether AIF of corporate type (investment companies). Several types of such funds are regulated, depending on the particulars of the investments made: AIFs specialized in investments in shares, bonds or equity securities of the UCITS or other AIFs intended for retail investors, but also AIFs in real estate investments or government securities (issued by the Ministry of Finance). To these funds are added diversified portfolios AIFs, also monetary funds and long-term funds<sup>9</sup>.

AIFRI cannot be transformed into an AIF intended for professional investors and the modification of the investment policy requires the authorization of the ASF (Romanian authority) in order

<sup>4</sup> Law no. 243/2019 on Alternative Investment Funds (AIFs).

<sup>5</sup> Directive 2011/61/EU (AIFMD).

<sup>6</sup> Art. 32 Directive 2011/61/EU.

<sup>7</sup> Art. 1 para. 2 Commission delegated Regulation (EU) no. 694/2014 of 17 December 2013 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to regulatory technical standards determining types of alternative investment fund managers.

<sup>8</sup> Art. 6, 17 Law no. 243/2019.

<sup>9</sup> Regulation (EU) 2015/760 of the European Parliament and of the Council of 29 April 2015 on European long-term investment funds.

to be included in another category of investments, with the corresponding modification of the incorporation documents.

AIFRI involves certain restrictions: cannot make short sales and cannot invest in financial instruments issued by the AIFM who administers it<sup>10</sup>.

AIF intended for professional investors (AIFPI) know several normatively defined species<sup>11</sup>: AIFs with private capital, speculative AIFs, AIFs specialized in investment in goods and commodities, AIFs specialized in real estate investing, venture capital AIFs (EuVECA)<sup>12</sup>, AIFs of social entrepreneurship (EuSEF)<sup>13</sup>. AIFPI, after incorporation, may amend its statutory documents so as to fall into one of the categories of AIFRI (retail investors) so that its investment policy complies with the investment requirements allowed for the such funds.

### 2.3. Venture capital AIFs (EuVECA)

A specific type of AIF is European venture capital fund (EuVECA). European law reserves designation 'EuVECA' in relation to the marketing of venture capital funds in the European Union. Qualifying venture capital fund with qualifying investments are established for the delimitation of these entities (EuVECA)<sup>14</sup>.

European Regulation provides for a common EU framework for the managers of EuVECA that are registered with the competent authorities, so that they can benefit from the EU passport in order to manage and market funds in the Union with the specific EuVECA (and EuSEF) labels.

European legislator lays down a common framework of rules regarding the use of the designation 'EuVECA' for qualifying venture capital funds. Those rules aim the composition of the portfolio of funds that operate under that designation, eligible investment, the investment tools they may employ and the categories of investors that are eligible to invest in them.

A qualifying venture capital fund should, as a first step, be established in the Union in order to be entitled to use the designation 'EuVECA'.

Second, managers of collective investment undertakings (EuVECA kind) are subject to registration with the competent authorities of their home state (in the Union)<sup>15</sup> and they manage portfolios of qualifying venture capital funds<sup>16</sup>.

### 2.4. Qualifying portfolio undertaking and qualifying investments

Venture capital funds provides support and finance to undertakings usually small, that are in the initial stages of their corporate existence but with a strong potential for growth and expansion. To this end European regulation defines 'qualifying portfolio undertaking' means an undertaking whose equity are permitted for EuVECA managers.

'Qualifying portfolio undertaking' means an undertaking that is not admitted to trading on a regulated market or on a multilateral trading facility (MTF)<sup>17</sup>, employs no more than 250 persons, and has an annual turnover not exceeding EUR 50 million or an annual balance sheet total not exceeding EUR 43 million<sup>18</sup>. Further, such undertakings are not itself a collective investment undertaking or a credit institution<sup>19</sup>, an investment firm<sup>20</sup>, an insurance undertaking<sup>21</sup>, a financial holding company<sup>22</sup> or a mixed-activity holding company.<sup>23</sup>

'Qualifying investments' for EuVECA managers mean equity that are issued by a qualifying portfolio undertaking (acquired directly from undertaking or from existing shareholders of that undertaking), secured or unsecured loans granted by the venture capital fund to a qualifying portfolio undertaking or other means of financing qualifying portfolio undertaking.<sup>24</sup>

Managers of venture capital funds that comply with the requirements set out in European regulation shall be entitled to use the designation 'EuVECA' in relation to the marketing of qualifying venture capital funds in the Union.

Managers of qualifying venture capital funds shall market the units and shares of EuVECA venture capital funds exclusively to investors which are

<sup>10</sup> Art. 33 para. 2 Law no. 243/2019.

<sup>11</sup> Art. 46 Law no. 243/2019.

<sup>12</sup> Regulation (EU) no. 345/2013 of the European Parliament and of the Council on European venture capital funds (EuVECA).

<sup>13</sup> Regulation (EU) no. 346/2013 on European social entrepreneurship funds (EuSEF).

<sup>14</sup> Regulation (EU) no. 345/2013 on European venture capital funds.

<sup>15</sup> Art. 3(3) point (a) of Directive 2011/61/EU.

<sup>16</sup> The assets under management, in total, do not exceed the threshold referred to in point (b) of art. 3(2) of Directive 2011/61/EU.

<sup>17</sup> Defined in art. 4(1) points (14) and (15) of Directive 2004/39/EC and Directive 65/2014/UE (MiFID II) today.

<sup>18</sup> Art. 3 (d), of Regulation (EU) no. 345/2013 of the European Parliament and of the Council on European venture capital funds.

<sup>19</sup> Art. 4 point (1) of Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions.

<sup>20</sup> Art. 4 (1) point (1) of Directive 2004/39/EC and Directive 65/2014/UE (MiFID II) today.

<sup>21</sup> Art. 13 point (1) of Directive 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

<sup>22</sup> Art. 4 point (19) of Directive 2006/48/EC.

<sup>23</sup> Art. 4 point (20) of Directive 2006/48/EC.

<sup>24</sup> Art. 3 (e) of Regulation (EU) no. 345/2013 of the European Parliament and of the Council on European venture capital funds.

considered to be professional clients<sup>25</sup>, or to other investors who invest at least 100 000 euro and consent to be treated as a professional investor. These investors state (in a separate document from the contract to be concluded for the commitment to invest) that they are aware of the risks associated with the expected investments<sup>26</sup>.

### 2.5. Authorisation

Managers of alternative funds that intend to use 'EuVECA' title for the marketing of their qualifying venture capital funds shall inform the competent authority of their home Member State (ASF in Romania) of their intention and shall provide compulsory documents: the identity of the persons who effectively conduct the business of EuVECA managers with the identity of the EuVECA venture capital funds, the units or shares of which are to be marketed and their investment strategies and a list of states where the manager of the fund intends to market each qualifying venture capital fund<sup>27</sup>.

Where managers of EuVECA are external managers and are registered in accordance with EuVECA regulation, they may, additionally, manage undertakings for collective investment in transferable securities (UCITS) (subject to authorisation under Directive 2009/65/EC, AIFMD).

EuVECA managers have to register with the competent authority of their home state twice, once in accordance with the AIFMD, and once in accordance with the EuVECA Regulations. However, taking into account that the purpose of the EuVECA Regulations is to create a light regime that facilitates the cross-border activity of these managers, the double registration could take place simultaneously and would be simplified by national competent authority in order to avoid unnecessary repetition in the registration process<sup>28</sup>.

### 3. Conclusions

European secondary law on Alternative Investment Fund (AIF) continues a modernization process with a view to approximating the conditions of competition between those undertakings at Union level, while at the same time ensuring more effective rules for share or unit holders protection.

Venture capital funds that wish to operate across the Union would be subject to different rules in different jurisdiction, creating obstacles to the proper functioning of the internal European market. Moreover, diverging requirements on portfolio composition, investment targets and eligible investors could lead to different levels of investor protection and generate misperception as to the investment proposition associated with venture capital funds.

The Regulation no. 345/2013 on European venture capital funds (EuVECA) entered into force on 22 July 2013. This Regulation provides for a common EU framework for the managers of EuVECA that are registered with the competent authorities, so that they can benefit from the EU passport in order to manage and market funds in the Union with the specific EuVECA designation

A common framework of rules regarding the use of the designation 'EuVECA' for qualifying venture capital funds comprises rules for the composition of the portfolio of funds that operate under that designation, the investment tools they may employ and the categories of investors that are eligible to invest in them by uniform rules in the Union.

Investors should, furthermore, be able to compare the investment propositions of different venture capital funds (with EuVECA label). In this way significant obstacles to cross-border fundraising are removed. Moreover, distortions of competition between those funds are avoided, and any further likely obstacles to trade are prevented in the future.

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<sup>25</sup> Section I of Annex II to Directive 2004/39/EC (Directive 65/2014/UE (MiFID II) today) or which may, on request, be treated as professional clients in accordance with Section II of Annex II to Directive 2004/39/EC.

<sup>26</sup> Art. 6 Regulation (EU) no 345/2013 of the European Parliament and of the Council on European venture capital funds.

<sup>27</sup> Art. 14 Regulation (EU) no 345/2013 of the European Parliament and of the Council on European venture capital funds.

<sup>28</sup> ESMA Questions and Answers Application of the EuSEF and EuVECA Regulations, [https://www.esma.europa.eu/sites/default/files/library/2016-774\\_qa\\_eusef-euveca.pdf](https://www.esma.europa.eu/sites/default/files/library/2016-774_qa_eusef-euveca.pdf).

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