



EUROPEAN  
PRIVATE EQUITY &  
VENTURE CAPITAL  
ASSOCIATION

## Smart regulation for smart growth

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## EU Strategy 2020 and Venture Capital



### EU Strategy 2020

#### Making an efficient European venture capital market a reality

- Facilitating cross-border investments by Venture Capital funds
- Attracting institutional investors to fund innovation

**Accumulation of regulatory measures  
resulting in less capital to fund innovation and support EU companies**

#### Venture capital has a strong potential to put forward the EU Strategy 2020

- long-term approach
- in-depth understanding of companies
- emphasis on active engagement to add value and generate superior growth

**Urgent need to address and avoid the negative impact of several regulatory measures  
and assess related impact**



## Regulatory measures hindering VC's development

Pension funds, banks and insurance companies account for a significant proportion of investment into PE/VC funds in Europe – almost 40% in 2009.

1. **AIFM Directive** is the primary regulatory concern for the industry
2. The continuous reforms of the **rules on capital adequacy for financial institutions**.  
  
Inappropriate risk weightings for the PE asset class, forcing investors to hold more capital against their investments than necessary to protect their solvency, could make fund raising even tougher in the years to come.
3. **Solvency II**

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## Impact of the AIFMD on VC

- Y Application of **thresholds** to non-listed companies that are defined for quoted companies (10%, 20%, 30% or 50%).
- Y Discriminatory **disclosure requirements** which would shatter the level-playing field for vulnerable, high-potential businesses, placing them at a disadvantage to competitors.  
  
-> Particularly disadvantageous for VC-backed businesses that very often face fierce competition from much larger rivals, capable of exploiting innovative ideas and ultimately damaging value, company growth and jobs.
- Y **Companies with 50 or more employees** will be obliged to disclose board-level, commercially-sensitive information.  
  
-> An onerous burden on small companies in terms of competitive and administrative capacity, rendering it unattractive to entrepreneurs to use VC as a means to fund growth.
- Y **A fixed duration of investment in a company** (lock-in period)  
  
-> Would affect the level playing field between investors, and eliminate the opportunity of entrepreneurs and SMEs to raise VC over a number of funding rounds.  
  
-> Important late stage or pre-IPO funding rounds would become impossible under the suggested lock-in period.

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## Impact of the AIFMD on VC



- Y A VC fund investing in early-stage businesses would face major outlay for advisory services such as **independent evaluation** and **depository** (no proportionality or tailoring)
- Y **Capital requirements** will significantly increase set-up costs.
  - > In significant contradiction with the objectives of the EU to develop VC funding for young innovative companies, as it will mean less money to be invested in European start-ups.
- Y Third country rules would damage the returns of Europe's pension funds and institutional investors, and restrict the freedom of European investors to invest in AIFs outside the EU
  - > **Threat to the competitiveness of the European VC industry vis-à-vis its North-American and Asian equivalents.**
- Y Third country rules could alienate Europe's major trading partners to take a defensive and protectionist stance on bilateral investment with Europe, at a time when such investments are badly needed in the wake of the financial crisis.
  - > **Inward investment into Europe's economies and SMEs would be inhibited or slowed down.**

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## Impact of the AIFMD on VC



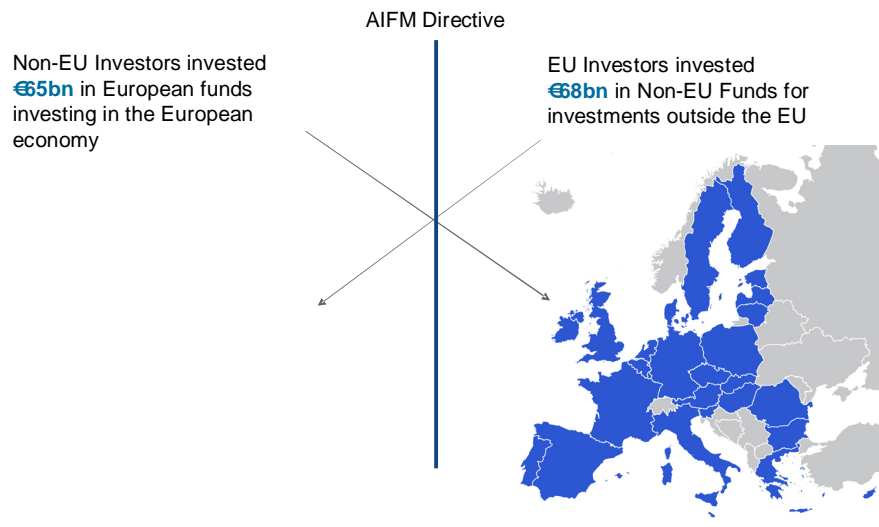
### Effect of the AIFM Directive

- Y a major obstacle to new fund creation
- Y a threat to the viability of existing funds
- Y an unfair burden to portfolio companies

**Result:** Less capital for financing European innovation, with a knock-on effect on job creation and growth

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## Capital Flows, **by Investor Location**, from and to the EU (2007-2008)



## Solvency II



Insurance companies represent around 10% of the European private equity industry's money under management (around 6% of VC).

⇒ The solvency capital requirements suggested by CEIOPS as regards the category « other equities » will result in regulatory capital that will be higher than the economic capital that insurance companies usually allocate to venture capital.

⇒ Insurance companies will invest more in less risky and more liquid assets that attract lower capital requirements, with an over-cautious risk weighting for PE distorting rational asset allocation decisions.

### Future problem

The European Commission is currently examining how suitable solvency requirements can or should be developed for pension funds, the largest source of capital for the EU PE industry (25%). If increased, the capital adequacy requirements will seriously inhibit institutional investment into VC.