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COMMISSION DELEGATED REGULATION (EU) .../...

of 1.2.2019

supplementing Regulation (EU) No 346/2013 of the European Parliament and of the Council with regard to conflicts of interest, social impact measurement and information to investors in the area of European social entrepreneurship funds

(Text with EEA relevance)

EXPLANATORY MEMORANDUM

1. CONTEXT OF THE DELEGATED ACT

Regulation (EU) No 346/2013 of the European Parliament and of the Council ¹ establishes a "European Social Entrepreneurship Fund (EuSEF)" label, which enables investors to identify investment funds that focus on social businesses. Regulation (EU) No 346/2013 sets out conditions in which investment fund use the EuSEF label provided that they demonstrate a high percentage of investments of at least 70% of the capital social businesses.

Articles 9(5), 10(2) and 14(4) of Regulation (EU) No 346/2013 lay down empowerments for the Commission to adopt delegated acts to specify the following:

- the types of conflicts of interest, as referred to in Article 9(2), which managers of qualifying social entrepreneurship funds need to identify, and the steps that managers of a qualifying social entrepreneurship funds must take, in terms of structures and organisational and administrative procedures, in order to identify, prevent, manage, monitor and disclose conflicts of interest (Article 9(5));
- the details of procedures to measure the extent to which the qualifying portfolio undertakings, in which the qualifying social entrepreneurship fund invests, achieve the positive social impact to which they are committed (Article 10(2)); and
- the content of certain information referred to in Article 14(1) points (c) to (f) and (l) to be provided to investors, as well as how such information can be presented in a uniform way in order to ensure the highest possible level of comparability (Article 14(4)).

2. CONSULTATIONS PRIOR TO THE ADOPTION OF THE ACT

On 27 May 2014, the Commission has requested the European Securities and Markets Authority (ESMA) to issue technical advice on the preparation of the delegated acts foreseen in Regulation (EU) No 346/2013. Throughout the process of drafting its advice, ESMA was in close contact with the relevant stakeholders.

ESMA published its Final Report on technical advice to the Commission on 3 February 2015.² The advice took into account the views expressed by stakeholders during the public consultation carried out between 26 September 2014 and 10 December 2014. An open hearing with experts organised by ESMA took place on 10 November 2014. In addition, the Securities and Markets Stakeholder Group of ESMA was consulted.

Throughout the process of the preparation of technical advice ESMA was in close contact with social entrepreneurs, impact investors, managers of social entrepreneurship funds and other stakeholders from Member States. The advice also took into account the work by the Commission's Expert group on social business, and other relevant information from the Organisation for Economic Co-operation and Development (OECD) and the Impact Measurement Working Group of the G8 Social Impact Investment Taskforce. ESMA's technical advice also included a cost-benefit analysis.

¹ Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds (OJ L 115, 25.4.2013, p. 18).

² Final Report, ESMA's technical advice to the European Commission on the delegated acts of the Regulations on European Social Entrepreneurship Funds and European Venture Capital Funds (2015/ESMA/227).

On 8 February 2016, the Commission services initiated the consultation of the Member States; the Expert Group of the European Securities Committee was duly consulted.

3. LEGAL ELEMENTS OF THE DELEGATED ACT

Regulation (EU) No 346/2013 provides a clear and consistent framework for the management and marketing of qualifying social entrepreneurship funds in the European Union. It establishes common rules for the use of the "EuSEF" label for qualifying social entrepreneurship funds.

The legal bases for delegated acts are set out in Articles 9(5), 10(2) and 14(4) of Regulation (EU) No 346/2013.

Given the need to guarantee a level playing field, uniform conditions of competition and the highest possible standard of investor protection and investor confidence, a Commission Delegated Regulation is deemed to be the most appropriate legal instrument. This Delegated Regulation contains uniform rules for all managers of social entrepreneurship funds. The risk of divergent implementation in different Member States is thus avoided.

This proposal consists of the following provisions.

Article 1 provides for a list of types of conflicts of interest in the context of qualifying social entrepreneurship funds. It covers situations that involve a manager of the qualifying social entrepreneurship fund, an employee of the management company, another qualifying social entrepreneurship fund, a collective investment undertaking or UCITS managed by the same manager or the investor therein. Article 2 sets out the rules pertaining to the obligation by the managers of qualifying social entrepreneurship funds to establish, implement and maintain an effective conflicts of interest policy, and specifies the conflicts of interest policy related requirements.

Further, Article 3 sets forth a list of steps required as part of the procedures and measures aimed at preventing, managing and monitoring conflicts of interest. Article 4 enumerates the required steps where the measures and procedures set out in the conflicts of interest policy are insufficient to prevent the risks to the interests of the qualifying social entrepreneurship funds and their investors.

Article 5 sets out the requirements pertaining to the strategies for the exercise of voting rights to prevent conflicts of interest. Article 6 specifies the requirements, the format and certain conditions pertaining to the disclosure of conflicts of interest.

Further, Articles 7 to 12 specify the content of certain information referred to in Article 14(1) points (c) to (f) and (l) of Regulation (EU) No 346/2013 to be provided to investors. More specifically, Article 7 lays down the rules as regards the procedures to measure positive social impact. Articles 8 to 12 provide for further details on pre-contractual disclosures to investors in qualifying social entrepreneurship funds. In particular, these provisions clarify elements that should be included in the description of the investment strategy and objectives and details specific information to be provided in relation to positive social impact, methodologies used to measure social impact, description of non-qualifying assets and business support services.

This Regulation does not provide for rules on a uniform way of presentation of information referred to in Article 14(1) point (f) of Regulation (EU) No 346/2013.

Article 13 defers the application of this Regulation to six months following the date of its entry into force in order to provide managers of the qualifying social entrepreneurship funds time to adapt to the new requirements.

This Delegated Regulation has European Economic Area (EEA) relevance and should hence extend to the EEA.

4. BUDGETARY IMPLICATIONS

This Delegated Regulation has neither budgetary implications for the European Union budget, nor for the budget of ESMA. No additional funding and no additional posts for ESMA will, therefore, be required in relation to this act.

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(Text with EEA relevance)

THE EUROPEAN COMMISSION,

Having regard to the Treaty on the Functioning of the European Union,

Having regard to Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds³, and in particular Article 9(5), Article 10(2) and Article 14(4) thereof,

Whereas:

- (1) Managers of qualifying social entrepreneurship funds should adopt procedures and measures to ensure that persons engaged in such business activities carry out those activities in the best interests of the qualifying social entrepreneurship funds and their investors. To achieve a harmonised level of investor protection in the Union, and to enable those managers to adopt and follow a consistent and effective practice to prevent, monitor and manage conflicts of interest, a minimum set of steps should be listed in their conflicts of interest policy. To avoid unnecessary administrative burdens while ensuring an appropriate level of investor protection, the conflicts of interest policies should be adapted to the nature, scale and complexity of the managers' businesses.
- (2) The procedures and measures set out in the conflicts of interest policies may be insufficient to protect the interests of the qualifying social entrepreneurship fund or its investors, in which case managers of qualifying social entrepreneurship funds should take necessary additional steps to protect those interests. Those steps should include informing the senior management or other competent internal body of the qualifying social entrepreneurship fund, and taking the necessary decisions or actions to act in the best interest of the qualifying social entrepreneurship fund or its investors.
- (3) Managers of qualifying social entrepreneurship funds may be active in the management of companies in which the qualifying social entrepreneurship funds invest. To prevent conflicts of interest and to ensure that those managers' voting rights are exercised for the benefit of both the qualifying social entrepreneurship fund concerned and its investors, it is necessary to specify detailed requirements in relation to the exercise of those voting rights. To ensure a sufficient standard of investor protection, managers of qualifying social entrepreneurship funds should develop adequate and effective strategies in that respect and provide upon request a summary of those strategies and the actions they have taken.

³ OJ L 115, 25.4.2013, p. 18.

- (4) To secure the effectiveness of the disclosure of conflicts of interest, the information provided should be regularly updated. Given the inherent risks of using a website as a tool to disclose conflicts of interest, it is necessary to lay down criteria for the publication of that information.
- (5) To ensure a consistent approach as regards procedures used by managers of qualifying social entrepreneurship funds to measure the achievement of positive social impact by the qualifying portfolio undertakings, specific elements should be incorporated in those procedures. The resources used by the qualifying portfolio undertakings as well as the products and services made available by those undertakings are key indicators of positive social impact, which should therefore form an integral part of those procedures. To distinguish social enterprises from undertakings that achieve social objectives only incidentally, an evaluation of the outcomes generated by the qualifying portfolio undertakings should also form part of those procedures.
- (6) It should be ensured that the pre-contractual information provided to investors contains sufficient details about the qualifying social entrepreneurship fund. The description of the investment strategy and objectives of the qualifying social entrepreneurship fund should therefore contain descriptions of the social sectors, the geographical areas and the legal forms of the qualifying portfolio undertakings in which the qualifying social entrepreneurship fund intends to invest, as well as information on the distribution of those undertakings' profits.
- (7) Investors should be provided with the information necessary to assess the underlying methodologies used by the manager of the qualifying social entrepreneurship fund to measure social impact. The pre-contractual information should therefore specify whether the manager of the qualifying social entrepreneurship relied upon internal methodologies, or used generally accepted methodologies. Pre-contractual information should also contain a description of the main features of the methodologies, including the screening criteria, the relevant indicators and an explanation of how the manager of the qualifying social entrepreneurship fund ensures compliance with those methodologies.
- (8) Investors should be able to verify whether the manager of the qualifying social entrepreneurship fund follows the investment policy when selecting non-qualifying assets. The pre-contractual information should therefore include information about the types of non-qualifying assets in which the qualifying social entrepreneurship fund invests, investment techniques, relevant restrictions, and the sector of activity and the geographical area in which those investments are made.
- (9) In the interest of transparency, investors should be provided with the information necessary to assess the nature and extent of the business support services and the other support activities the manager of a qualifying social entrepreneurship fund is providing or arranging through third parties. Pre-contractual information on business support services and the other support activities should therefore describe the types of the services and activities it provides.
- (10) To enable managers of qualifying social entrepreneurship funds to adapt to the new requirements, the date of application of this Regulation should be deferred by six months,

HAS ADOPTED THIS REGULATION:

Article 1

Types of conflict of interest

For the purposes of Article 9(2) of Regulation (EU) No 346/2013, the types of conflict of interest shall be situations where a manager of a qualifying social entrepreneurship fund, a person who effectively conducts the business of that manager, an employee, or any person who directly or indirectly controls or is controlled by that manager, by another qualifying social entrepreneurship fund or a collective investment undertaking, including an undertaking for collective investment in transferable securities (UCITS), managed by the same manager, or the investor therein,

- (a) is likely to make a financial gain, or avoid a financial loss, at the expense of the qualifying social entrepreneurship fund or its investors;
- (b) has an interest in the outcome of a service or an activity provided to the qualifying social entrepreneurship fund or to its investors which is distinct from the interest of the qualifying social entrepreneurship fund or its investors;
- (c) has an interest in the outcome of a transaction carried out on behalf of the qualifying social entrepreneurship fund or its investors which is distinct from the interest of the qualifying social entrepreneurship fund or its investors;
- (d) has a financial or other incentive to favour:
 - (i) the interest of an investor, a group of investors or another collective investment undertaking, including a UCITS, over the interest of the qualifying social entrepreneurship fund or its investors;
 - (ii) the interest of one investor in the qualifying social entrepreneurship fund over the interest of another investor or group of investors in that fund;
- (e) carries out the same activities for the qualifying social entrepreneurship fund, another collective investment undertaking, including a UCITS, or an investor;
- (f) pays or is paid any fee or commission, or provides or is provided with any non-monetary benefits, other than those laid down in Article 24(1) of Commission Delegated Regulation (EU) No 231/2013⁴;
- (g) influences and has a personal interest in influencing the development of a qualifying portfolio undertaking to the disadvantage of the qualifying social entrepreneurship fund or its investors or at the expense of the achievement of the objectives of the qualifying social entrepreneurship fund.

Article 2

Conflicts of interest policy

1. A manager of a qualifying social entrepreneurship fund shall establish, implement and maintain a written conflicts of interest policy that is appropriate to the size and

⁴ Commission Delegated Regulation (EU) No 231/2013 of 19 December 2012 supplementing Directive 2011/61/EU of the European Parliament and of the Council with regard to exemptions, general operating conditions, depositaries, leverage, transparency and supervision (OJ L 83, 22.3.2013, p. 1).

organisational structure of that manager given the nature, scale and complexity of its business.

2. The conflicts of interest policy referred to in paragraph 1 shall identify, in line with Article 1, the circumstances that may give rise to a conflict of interest and shall specify the measures to be adopted and the procedures to be followed on an ongoing basis.

Article 3

Procedures and measures to prevent, manage and monitor conflicts of interest

The measures to be adopted and procedures to be followed referred to in Article 2(2) shall include at least the following steps:

- (a) the prohibition of the exchange of information between the persons or entities referred to in Article 1, where such an exchange of information could lead to or facilitate a conflict of interest;
- (b) the separation of the supervision of persons or entities referred to in Article 1 whose interests may conflict;
- (c) the removal of the connection between or dependence on the remuneration of the persons or entities referred to in Article 1 principally engaged in one activity, and the remuneration of, or revenues generated by, persons or entities principally engaged in another activity, where a conflict of interest may arise in relation to those activities;
- (d) the prevention of persons or entities referred to in Article 1 from exercising inappropriate influence over the management of the qualifying social entrepreneurship fund;
- (e) the prevention or control of the involvement of persons or entities referred to in Article 1 in any activity that may lead to a conflict of interest.

Article 4

Managing the consequences of conflicts of interest

Where the measures and procedures set out in the conflicts of interest policy pursuant to Article 2(2) and Article 3 are insufficient to prevent, with reasonable confidence, the risks of damage to the interests of the qualifying social entrepreneurship fund or its investors, managers of a qualifying social entrepreneur fund shall take the following steps:

- (a) promptly inform their senior management or other competent internal body, or the senior management or other competent internal body of the qualifying social entrepreneurship fund, of the risk of damage to the interests of that fund or its investors;
- (b) take any decision or action to ensure that they act in the best interest of the qualifying social entrepreneurship fund or its investors.

Article 5

Strategies for the exercise of voting rights to prevent conflicts of interest

1. Managers of qualifying social entrepreneurship funds shall develop in writing adequate and effective strategies for determining when and how to exercise voting rights held in the qualifying social entrepreneurship fund portfolio for the benefit of both the qualifying social entrepreneurship fund concerned and its investors.
2. The strategies referred to in paragraph 1 shall determine the measures to be adopted and procedures to be followed and shall include at least the following steps:
 - (a) monitoring of relevant corporate actions;
 - (b) ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the qualifying social entrepreneurship fund;
 - (c) prevention and management of any conflicts of interest arising from the exercise of those voting rights.
3. Managers of qualifying social entrepreneurship funds shall upon request, provide investors with a summary description of the strategies referred to in paragraphs 1 and 2 and the details of the actions taken pursuant to those strategies.

Article 6

Disclosure of conflicts of interest

1. Managers of qualifying social entrepreneurship funds shall provide the information referred to in Article 9(4) of Regulation (EU) No 346/2013 in a durable medium as referred to in point (m) of Article 2(1) of Directive 2009/65/EC of the European Parliament and of the Council⁵ and keep that information up to date.
2. Managers of qualifying social entrepreneurship funds may provide the information referred to in paragraph 1 by means of a website, without addressing that information personally to the investor, provided that all of the following conditions are satisfied:
 - (a) the investors have been notified of the address of the website and of the place on the website where the information can be accessed;
 - (b) the investors have consented to the provision of that information by means of a website;
 - (c) the information is continuously accessible on the website for such period of time as the investors may reasonably need to access it.

⁵ Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (OJ L 302, 17.11.2009, p. 32).

Article 7

Procedures to measure positive social impact

1. Managers of qualifying social entrepreneurship funds shall ensure that the procedures referred to in Article 10(1) of Regulation (EU) No 346/2013 contain at least the following:
 - (a) an evaluation of resources used by the qualifying portfolio undertakings;
 - (b) an evaluation of products and services made available by the qualifying portfolio undertakings;
 - (c) an evaluation of outcomes attributable to the activities of the qualifying portfolio undertakings.

For the purposes of point (c) of the first subparagraph, outcomes which would have happened anyway and outcomes attributable to third parties shall not be attributable to the activities of the qualifying portfolio undertakings.
2. Evidence supporting the evaluations referred to in paragraph 1 shall be subject to audit in accordance with Article 13(3) of Regulation (EU) No 346/2013.

Article 8

Description of the investment strategy and objectives

1. The information referred to in point (i) of Article 14(1)(c) of Regulation (EU) No 346/2013 shall contain at least the following:
 - (a) the social sector or sectors in which the qualifying portfolio undertakings are active;
 - (b) the geographical area in which the qualifying portfolio undertakings are active;
 - (c) the legal forms of the qualifying portfolio undertakings;
 - (d) a detailed description of the distribution of the qualifying portfolio undertakings' profits.
2. The information referred to in points (ii) and (iii) of Article 14(1)(c) of Regulation (EU) No 346/2013 shall contain information about at least the investment profile of the other qualifying social entrepreneurship fund and the information supplied by the qualifying social entrepreneurship fund in accordance with paragraph 1 of this Article.
3. The information referred to in point (iv) of Article 14(1)(c) of Regulation (EU) No 346/2013 shall contain information about at least the types of assets in which the qualifying social entrepreneurship fund invests.
4. The information referred to in point (v) of Article 14(1)(c) of Regulation (EU) No 346/2013 shall contain information on, at least, whether the techniques include equity instruments, quasi-equity instruments, securitised or un-securitised debt instruments, secured or unsecured loans or any other type of participation in qualifying portfolio undertakings.
5. The information referred to in point (vi) of Article 14(1)(c) of Regulation (EU) No 346/2013 shall contain information on, at least, whether the investment strategy

of the qualifying social entrepreneurship fund contains any investment restrictions in terms of sectors, activities, geographical areas, investment percentages or limits, or any other restrictions.

Article 9

Information on positive social impact

1. The information referred to in Article 14(1)(d) of Regulation (EU) No 346/2013 shall specify targeted products and services to be provided by the qualifying portfolio undertakings in which the qualifying social entrepreneurship fund invests.
2. Where the information referred to in Article 14(1)(d) of Regulation (EU) No 346/2013 contains information on projections of positive social impacts, it shall describe the assumptions on the basis of which those projections are calculated.
3. Where the information referred to in Article 14(1)(d) of Regulation (EU) No 346/2013 contains information on past performance in terms of positive social impact, it shall contain a copy of the most recent annual report, or a summary of the relevant information contained in the annual report referred to in Article 13(2) of Regulation (EU) No 346/2013.

Article 10

Information on methodologies used to measure social impact

The information referred to in Article 14(1)(e) of Regulation (EU) No 346/2013 shall contain at least the following:

- (a) a declaration as to whether social impacts are measured on the basis of internal methodologies or other generally accepted methodologies;
- (b) a description of the main features of the methodologies including the screening criteria and the relevant indicators used to measure social impacts;

Article 11

Description of non-qualifying assets

The information referred to in Article 14(1)(f) of Regulation (EU) No 346/2013 shall contain at least a description of all of the following:

- (a) investment techniques and applicable investment restrictions;
- (b) the sector or sectors of activity of the non-qualifying portfolio undertakings;
- (c) the geographical area in which the non-qualifying portfolio undertakings are active;
- (d) the criteria to be used in selecting the types of assets.

Article 12

Information about support services

The information referred to in Article 14(1)(1) of Regulation (EU) No 346/2013 shall contain at least:

- (a) a description of the types of business support services and other support activities;
- (b) information about whether the business support services and other support activities are provided by third parties.

Article 13

Entry into force and application

This Regulation shall enter into force on the twentieth day following that of its publication in the *Official Journal of the European Union*.

It shall apply from [*OP: please insert a date six months following the date of entry into force*].

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels, 1.2.2019

For the Commission
The President
Jean-Claude JUNCKER