European Economic and Social Committee

ECO/413
Amendment of EuVECA and EuSEF

OPINION

European Economic and Social Committee

Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No 345/2013 on European venture capital funds and Regulation (EU) No 346/2013 on European social entrepreneurship funds
[COM(2016) 461 final]

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Consultation	Council of the European Union, 27/07/2016 European Parliament, 12/09/2016
Legal basis	Articles 114 and 304 of the Treaty on the Functioning of the European Union
Date of Bureau decision	12/07/2016
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
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Plenary session No	521
Outcome of vote (for/against/abstentions)	112/1/2

1. Conclusions and recommendations

1.1 The European Economic and Social Committee (EESC) welcomes the efforts of the European Commission and Member States in recent years to overcome economic stagnation. At the same time, it cannot but urge the EU institutions to show more determination in the establishment and implementation of a comprehensive strategy for financing the real economy.

1.2 The EESC believes that it is important to ensure that European investment primarily benefits the real economy that is characterised by innovativeness, growth and social responsibility.

1.3 Small and medium-sized enterprises (SMEs) are the backbone of the European economy. Ensuring satisfactory access to financing for SMEs and fast-growing companies is therefore a crucial precondition both for the development of these companies and for innovation, economic growth, employment, safeguarding Europe's competitiveness and assuming social responsibility. Loans are the main source of funding for SMEs in the EU. In the light of the need to develop new areas of growth and ensure that Europe is an innovation leader, it is necessary to develop new methods of financing to support start-ups, innovative SMEs and fast-growing enterprises (scaleups).

1.4 The EESC calls for the development of the European venture capital funds (EuVECA) and the European social entrepreneurship funds (EuSEF) and points out that investor protection must be guaranteed.

1.5 The EESC is therefore convinced that the traditional debt financing of the companies mentioned in point 1.2 needs to be complemented by alternative methods of financing, such as venture capital, crowdfunding, private equity etc. The EU therefore needs to adopt concrete and consistent measures, on the one hand to enable banks once again to perform their core task of financing the real economy, and on the other to substantially improve the opportunities for equity and capital market funding and to gradually reduce the existing barriers to this in the process of building a capital markets union.

1.6 The EESC therefore welcomes and supports the European Commission's initiative to anticipate the review of the Regulations on European venture capital funds and European social entrepreneurship funds.

1.7 The EESC believes that the instrument of a regulation can reduce the danger of different interpretations at national level, thus promoting the establishment of a capital markets union. It also calls for the existing differences of interpretation at national level to be eliminated.

1.8 The EESC also calls on the European Union to commit to strengthening synergies between the objectives of the Europe 2020 strategy, such as the digital single market and the energy union/COP 21, and the UN's 17 Sustainable Development Goals, in order to provide long-term investments with high impact. The deepening of economic integration to ensure the EU's global competitiveness must also have top priority in all investment strategies.

1.9 The EESC notes that parts of the financial sector, rather than investing in the real economy, prefer alternative investment objectives. These are often aimed at maximising ROI and associated with a high level of speculative risk. The capital adequacy requirements applicable to European banks, which clearly favour investment in government bonds rather than loans to companies, also contribute to this. It should also be noted that the EU legislation has so far done alarmingly little to regulate purely speculative financial enterprises (hedge funds, shadow banks). The EESC therefore recommends that the EU institutions strongly promote productive investment in the real economy and discourage high-risk financial speculation. A current example of this trend: at this year's IMF meeting in Washington the financing of the green economy - green finance - was a central theme. The Chinese recognised this new field early on and promoted it during their G20 presidency. The EU is therefore urged, also in the framework of the EuVECA/EuSEF, to adopt measures to promote and strengthen the financing of the green economy (in the wake of COP 21) in order to forestall financial speculation in this area[1].

1.10 In the specific case of the present Regulation, the EESC points out that at EU level there are now a large number of substantial financing sources, such as InnovFin under Horizon 2020, COSME and EaSI, to list only the main sources, alongside ESIF and EFSI. The EESC therefore expects there to be close coordination in connection with the new direction of EuVECA and EuSEF. It should be ensured that the hitherto very restrictive access criteria, as well as other restrictive conditions, are significantly relaxed by the Commission in order to enable the funds to achieve their objectives much more effectively. A high degree of flexibility should be the guiding principle.

1.11 The EESC hopes that the review will also lead to changes in the credit rules of the Basel III Accord, with the *SME supporting factor* being complemented by the introduction of a new *social enterprise supporting factor*. In this way investments in social enterprises would be given a lower credit-risk weighting when calculating minimum capital requirements.

1.12 In order to expand participation in such investment funds, the EESC proposes the establishment of "funds of funds". This could increase the involvement of non-institutional investors — including interest groups — by setting up guarantee funds supported by public money and managed at European level. Such funds should support investment in businesses and institutions with a strong social dimension.

1.13 The EESC considers it equally important to create an environment in which the financing objectives of social investment funds, such as Social Enterprises (SE) and Social Sector Organisations (SSO), can develop. This will require the removal of barriers that make it

1 www.blackrock.com/corporate/en-mx/literature/whitepaper/bii-pricing-climate-risk-international.pdf.

extremely difficult for these actors to operate in a "level playing field" market environment. There is a particular need for innovative instruments that enable the public sector to engage in socially orientated initiatives in association with SE/SSO.

1.14 The EESC, in line with its opinion TEN/584, e-seniors, a potential 25% of the European population, calls for the "Silver Economy's" access to financing to be made easier in connection with the EuVECA and the EusSEF. This will also have a positive impact on the budgets of the Member States, as pressure on the pensions system will be relieved by active older people starting up their own businesses. A new value chain will develop, which will open up new sources of revenue for the State. This also applies to women[2] as entrepreneurs and founders of start-ups, social entrepreneurs etc.

2. Gist of the Commission proposal

2.1 The proposal pursues the objective of coordinating the EuVECA and EuSEF funds with the measures already adopted at EU level to stimulate an economic upturn (e.g. Investment Plan for Europe, Action Plan on Building a Capital Markets Union, European Fund for Strategic Investments).

2.2 The Commission believes that access to venture capital and social entrepreneurship capital is key to financing the growth of EU start-ups, innovative SMEs and social enterprises.

2.3 However, with regard to its venture capital market, the EU is falling further behind the USA rather than closing the gap.

2.4 The Commission is therefore amending the framework of the EuVECA and the EuSEF even before the planned review (2017) to ensure that they - in coordination with other measures - do more to support venture capital and social investment throughout the EU.

2.5 The proposed amendment focuses on the following provisions: i) the way the funds invest in assets; (ii) the way the managers run the funds; (iii) how the two Regulations interact with other existing fund laws and (iv) the requirements funds comply with to benefit from the passport across borders.

2.6 The Commission proposal is based on Article 114 TFEU and follows an extensive impact assessment[3].

3. General and specific comments

3.1 The EESC welcomes the European Commission's initiative to anticipate the review of the regulations on European venture capital funds (EuVECA) and European social entrepreneurship

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2 http://www.imf.org/external/pubs/ft/sdn/2013/sdn1310.pdf.

3 The proposal is also based on previous public consultations - on the Green Paper on Building a Capital Markets Union (18 February 2015 to 13 May 2015), a public consultation on the review of Regulation (EU) No 345/2013 and Regulation (EU) No 346/2013 (30 September 2015 to 6 January 2016), a public consultation in the form of a call for evidence: EU regulatory framework for financial services (30 September 2015 to 31 January 2016) and a technical workshop (27 January 2016).

funds (EuSEF); as early as 2012, when the first suggestions to bring them in were made, it expressed its approval in opinions on European Venture Capital Funds[4] and European Social Entrepreneurship Funds[5], particularly in view of the EU action plan on building a capital markets union[6].

3.2 The EESC endorses and supports the endeavour to enhance the financing of new businesses. The target group consists of innovative SMEs, especially start-ups and one-person businesses, and not just in the initial phases, but mainly in the second and third growth phases. SMEs that have the potential to grow rapidly but are too small for the capital market and do not meet the criteria for loans should be a particular focal point. It is just as important to focus on businesses with social objectives and sustainable business models (social entrepreneurs).

3.3 The EESC is of the opinion that the EU institutions and the Member States must take measures to develop instruments providing capital, investment and financing for business activities as a complement to bank loans. Meanwhile, we have to recognise that many European banks – particularly regional banks such as cooperatives and savings banks in the Member States – have adopted measures to support new businesses and are among the most important lenders to social entrepreneurs and innovative start-ups[7].

3.4 However, it should be noted that in many cases SMEs, and also social entrepreneurs and start-ups, have limited capital. For this reason, they are unable to meet the creditworthiness criteria – which CRR/CRD IV in particular have made radically more stringent – for bank loans. Basel IV risks making this unsatisfactory situation even worse.

3.5 In this context, the EESC believes that, while updating the EuVECA and EuSEF regulations is a useful step, it is not the only necessary measure. As well as improving these regulations, further steps are needed to create a more dynamic investment culture that is oriented towards all business forms currently present on the market. This will strengthen entrepreneurship while also helping to bring about the EU's social pillar.

3.6 It is unfortunately evident that a section of the financial world has absolutely no interest in sustainably financing the real economy, instead only investing in ways that allow an immediate and high rate of return. This is often done in a very short space of time, such as between the purchase and resale of a business. The EU institutions have done little to limit the impact of these kinds of purely speculative investment funds/banks (hedge funds, shadow banks) and to subject them to robust regulations.

4 OJ C 191, 12.6.2012, p. 72.

5 OJ C 229, 31.7.2012, p. 55.

6 OJ C 133, 14.4.2016, p. 17.

7 See the report of the Italian Ministry of Economic Development, which concludes that funding granted to innovative start-ups by small banks, and especially by cooperative banks, has increased significantly (figures are given below in the text).

3.7 The EU institutions should make investment in the entrepreneurial activities of the real economy - and not only in financial instruments - increasingly attractive, by means of tax incentives, for example, and put forward an ambitious development agenda.

3.8 The EESC agrees with the Commission's view that further development of the EuVECA and EuSEF funds will give innovative enterprises and social entrepreneurs – as well as SMEs more generally – access to bank loans and will enable financing by means of loans and venture capital to be combined, exerting a positive leverage effect. The EESC recommends developing a "European way of venture capital funding".

3.9 Furthermore, analysis of the European venture capital funds shows that 8 of the 11 most active funds are supported by public funds or at least count on the significant involvement of public bodies. Each Member State acts differently in this regard. The EESC therefore recommends that key European projects, such as the action plans for the digital single market and the energy union as well as establishing the EU social pillar, should be taken into consideration when setting a direction for the funds.

3.10 The new direction for the EuVECA and EuSEF measures must be rapidly brought into line with the following instruments: a) the European Investment Fund; b) the initiative for a capital markets union; c) the European Fund for Strategic Investments (which is becoming ever more important but should perhaps be taken more into consideration by national economic and banking systems, which are not yet harnessing its full potential).

3.11 The proposed review of the EuVECA and EuSEF regulations contributes to achieving a central EU policy goal: improving SMEs' and social enterprises' opportunities to access loans. The EESC is therefore convinced that the credit regulations in this regard set out in the Basel III Accord – which are enacted within the EU by means of a directive (CRD IV) and a regulation (CRR) – must be revised: alongside the "SME supporting factor", an additional "social enterprise supporting factor" should be included in the CRR so as to drastically reduce the capital requirements for credit risk with regard to financial involvement in social enterprises. The coefficients involved are easily calculated and do not represent an expense for Member States' public finances. The EESC considers this to be essential, as SMEs are the backbone of the EU economy and safeguard the EU's global competitiveness. As such, they are key to growth and employment.

3.12 It should be remembered that it is frequently not just social economy enterprises, but also various SMEs that display strong links to the local community and might be interested in investing in social amenities or in community energy supply using renewable energy sources, for example[8]. The current regulations governing the EuVECA and EuSEF funds only allow the involvement of professional investors. However, if efforts are to be made to further expand

8 For example, the cooperative banks in Italy ("banche di credito cooperativo" – BCC) used their national umbrella organisation to create the "Consorzio BCC Energia" energy consortium, which involves more than 110 credit unions and uses public procurement to acquire energy (generated exclusively from renewable sources) on the free market at 5-10% lower costs. The energy is now also offered to members of the cooperative and to customers (households, businesses, local authorities) in the communities where the various credit unions are active.

investment, the EESC is of the view that the range of potentially interested investors should be broadened.

3.13 Notwithstanding the need to ensure appropriate investor protection, motivated non-institutional investors could be permitted to participate in this fund. Alternative methods to raise capital such as crowdfunding – methods that are often completely informal and do not have clear rules – are already on the rise. It could therefore be appealing to give some opportunity to non-institutional investors to participate in the EuVECA and EuSEF funds. The possibility of organising non-institutional investors in homogeneous groups might even be considered.

3.14 The attention paid to medium-sized enterprises (up to 499 employees) is also welcome; they must not be neglected so that their growth – which is often due to the development of businesses that originally started as SMEs – can be consolidated and even, if possible, further enhanced.

3.15 The principle of subsidiarity is duly respected in the proposal; thus measures at EU level (as opposed to national level) via the EuVECA and EuSEF funds are welcome so as to create a harmonised framework at European level without overly constraining Member States' freedom as regards their general approach to the issue of venture capital. In this context, the EESC welcomes the approach of adopting a regulation. A more harmonised framework could help to prevent the concentration of venture capital in a small number of Member States and could contribute to a broader geographical spread and a more marked effect. Investment in the form of venture capital currently constitutes only 0.1% of the EU's GDP and is concentrated in a small number of Member States.

3.16 Allowing alternative investment fund managers (under Directive 2011/61/EU) access to EuVECA and EuSEF funds seems to be an appropriate solution to ensure that these funds are used and are effective by linking in with existing provisions at European level.

3.17 The qualitative and quantitative expansion of enterprises' opportunities to access the funds is therefore fully in line with the Commission's general approach to strengthening the two funds.

3.18 The decision to retain a minimum investment threshold for access to the funds also makes sense, although mechanisms to widen participation should be promoted: one conceivable suggestion would be to enable the creation of "funds-of-funds" – a possibility that is also raised in the European Commission's analysis that accompanies the proposal to review these regulations.

3.19 The proposed reduction of administrative costs for registration is very welcome, especially in so far as this aims to remove bureaucratic obstacles to the full implementation of the measures promoted by the Commission so that potentially interested investors are not deterred by the entry costs. They should be able to focus on the development potential of the businesses that are being granted access to venture capital, and not on the cost of accessing an over-complicated system.

3.20 Technical regulation in terms of own funds that investors must possess in order to be granted access to the funds is rightly given over to a technical body such as the ESMA. It is best placed to guarantee a high standard of regulation in a very technical field. The EESC expects that this secondary implementing regulation can come about in dialogue with stakeholders and with the involvement of the social partners, giving them the opportunity to make observations and comments on a provisional version of the text, including with regard to the simplification of occasionally excessive rules.

3.21 The EuVECA and EuSEF funds could have a particularly important role to play in terms of orienting and organising investments in the areas of innovation, social innovation and environmental sustainability, in line with the European Commission's current priorities. In this regard, the introduction of "guarantee funds" – supported by public funds and ideally managed at European level – to promote investment in areas that are highly valuable in social, employment or environmental terms could be extremely useful. Finally, the EESC stresses that the European Commission must support comprehensive measures to promote the development of an overarching and holistic strategy. The sum of the individual measures is no longer sufficient to improve the competitiveness of the European economies in an increasingly complex global environment.

Brussels, 14 December 2016

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President of the European Economic and Social Committee