
1 August 2005

Introduction

EVCA represents the European private equity and venture capital industry. The association has well over 900 members, including the leading fund managers, and supports a wide range of initiatives designed to encourage an entrepreneurial environment in Europe, and establish high standards of business conduct and professional competence.¹

EVCA welcomes the consultation opened by the European Commission on its Green Paper on Financial Services Policy (2005-2010), and the opportunity to contribute to this dialogue.

EVCA comments on the Green Paper

Section 1

Priorities for the next 5 years

Much progress over has been made over the last 6 years towards achieving an integrated EU financial market, notably in the area of retail financial services, helping to enhance EU economic growth. However, despite its economic and business impact being both pan-European and global in nature and despite the previous “Risk Capital Action Plan” (RCAP), the private equity and venture capital industry is currently unable to benefit from a similar level (or stage) of integration within the EU. Indeed, EVCA’s own statistics for 2004 show that only 14% of the

¹ Private equity and venture capital supports the development of businesses by providing financing and assistance in their management and growth. Last year alone, over 8,000 European businesses benefited from private equity and venture capital funding, creating many thousands of jobs across all industry sectors and all sizes of companies in both new and existing companies. Many of the companies financed stimulate the research, development and innovation, essential to sustainable economic growth. In 2004, the private equity industry raised €27.4 billion from institutional investors and invested €36.9 billion in Europe's growth companies.
The total number of investments by the private equity and venture capital industry in Europe were outside the country of origin.²

The private equity and venture capital industry still suffers from a situation where non-aligned, national regulatory approaches hinder competition, pan-EU operations and financial and economic integration. This is not only the case for fund raising, but also for investments, impeding the industry’s ability to support the creation and development of European SMEs, as well as to reinvigorate existing businesses.

In short, from an industry perspective, the European private equity and venture capital market is underperforming in the face of a lack of pan-European administrative, fiscal and legal coherence. Contrary to what has been promoted and achieved to benefit the ‘harmonised’ side of the financial services industry, no policy or legislative initiatives have so far led to the creation of a legal framework to address the significant economic impediments to the free flow of capital and financial services across the EU for ‘non-harmonised’ asset classes such as private equity and venture capital.

EVCA therefore welcomes the commitment of the European Commission to identify and address priorities for further initiatives to stimulate the ‘risk capital’ (private equity and venture capital) market.

Regarding other horizontal and complementary policy areas, the European private equity and venture capital industry has made great efforts in shaping and implementing self-regulation measures concerning transparency, market integrity and efficiency through different guidelines.

Throughout its 22 year history, EVCA has strongly supported and promoted the development of professional standards, and the European private equity and venture capital industry is now at the forefront, worldwide, on self-regulation in “alternative” or non-harmonised asset classes. Moreover these initiatives are in line with the Commission’s desire to make wider policymaking more forward looking and drawing more on market participants input. Such an approach, in a wider context, will not only help to improve coordination between other horizontal and complementary policy areas, but when combined with industry dialogue and evidenced-based policymaking, will also enable Europe to strengthen its position in shaping international regulatory policy.³

EVCA therefore fully supports the overall, broader objectives and key political orientation of the Green Paper, and the ‘three-step’ evolutionary approach⁴, to policymaking. Particularly, EVCA welcomes the commitment of the European Commission to identify priorities for (any) further initiatives through “better regulation”, using a mixture of regulatory and non-regulatory measures on the basis of an evidence-based approach, including focused impact assessments and cost/benefit analyses, whilst avoiding the potentially negative impacts of legislative ‘gold plating’. This will help to facilitate cross border business, and

---

² EVCA 2005 Yearbook
³ As noted on page 7 of the Green Paper, issues such as Corporate Governance are outside the scope of the Green Paper but form an essential complimentary part of the package. In this respect, EVCA has recently introduced further corporate governance guidelines for the industry as well as IFRS compatible valuation guidelines, which have already been endorsed by over 25 countries around the world.

⁴ Enhance the Lisbon agenda and maintain the highest standards; Maximise the current framework, Identify gaps and develop existing tools; Develop new structures
create a more integrated market with a level playing field for all market participants.

**Section 2- Better regulation, transposition enforcement and continuous evaluation**

The priority measures and their broad concepts as identified and outlined by the Commission are supported by EVCA and are also in line with EVCA’s own public policy priorities. The approach as outlined in this section seems to be the only way to create a level playing field for financial services across the EU, and to facilitate best practises and financial innovation, whilst also encouraging and supporting growth and fair competition.

Furthermore, as noted by the Commission, “supervisory requirements should accurately reflect the risks run in the market while converged supervisory practices and powers are crucial to ensure a level playing field and to avoid regulatory arbitrage”.

**Section 3- Consolidation of financial services legislation over the 2005-2010 period**

Whereas virtually all of the measures referred to in the consultation, either ongoing or in preparation, are dedicated to retail financial products or services, the objective as outlined in section 3.3 is to enable further cross-border investment and competition. This directly addresses EVCA’s and the private equity and venture capital industry’s concerns, as costs and barriers to cross-border transactions constitute a formidable obstacle to economic rationalisation in Europe.

EVCA can provide many examples of unrealised or delayed fund raising opportunities, as well as in underlying investments in European growth companies caused by significant administrative, legal and fiscal barriers, which are not faced by ‘harmonised’ assets or funds.

EVCA would also like to draw the Commission’s attention to the fact that any consolidation or changes to existing (or ultimately new) legislation - that are largely focused on retail financial services - should not have an indirect, unintended negative impact on private equity and venture capital, which draws the vast majority of its funds from non-retail sources (such as institutional investors; see comments in Section 4).

**Section 4- Possible, targeted new initiatives**

In terms of possible, targeted new initiatives, analysing the current situation of tax and legal impediments to a truly competitive private equity and venture capital market in Europe leads EVCA and the European industry to look for a pan-European investment structure with a specific regime and for the emergence of efficient integrated pan-European trading platforms and quoted markets for European high-potential companies (including SMEs).

However, given the specific characteristics and nature of the private equity and venture capital business model and its potential to further positively impact the growth of the European economy, it must also be noted that any new policy initiatives as outlined in the Green Paper on ‘non-harmonised’ assets must be carefully assessed and addressed.
In this respect, from the outset, it is important to note that these specificities imply specific measures for eligible (non-retail) investors, mainly institutional investors such as banks, insurance companies and pension funds, with long-term investment perspectives, enabling cross-border fund raising, investment and competition (further to Section 3.3 above).

To that extent, potential European supervisory functions or developments should minimise the regulatory burden for firms, systems and markets, remain appropriate and balanced in their nature and scope, and must also recognise the special relationship created between the investor, the manager of the portfolio of active investments in underlying companies, and the entrepreneur.

Furthermore, if retail investors should be regarded as potential investors in private equity and venture capital, then only dedicated vehicles should be open to them and current rules of investors’ protection, as is already the case for harmonised funds should apply.

Therefore the “three-step evolutionary approach” proposed by the Commission and as referred to in Section One fits perfectly well with the specificities of the private equity and venture capital business model, and as a process to address these issues.

As per Step 1 of the Commission’s approach, private equity and venture capital investments can help to stimulate and enhance the EU Lisbon process, support new companies, encourage sustainable growth and reinvigoration of the EU economy.

**Regarding a pan-European investment structure for private equity and venture capital**

Step 2 of maximising the current framework, identifying gaps and developing existing tools, could be achieved by reviewing current investment structures in order to coordinate research and analysis of existing divergences and to achieve mutual recognition of the most widely used market tools. This process of “mutual recognition” does not imply that existing national structures will be ‘deleted’: it simply means that cross-border fund raising and investment opportunities will be enhanced for interested parties.

Tools such as ‘Memorandums of Understanding (MOU)’ or indeed the use of the ‘Open Method’ of coordination could be used to help facilitate this process, and increase awareness and transparency as to the issues faced by the industry as well as enhancing administrative and policy dialogue.

Step 3 of the Commission’s approach, that is to say developing new structures, such as a common structure for pan-European private equity and venture capital investments, will be deployed if cooperation between EU Member States has not fulfilled the goal of creating an open, competitive single financial market. There could then be a business case for developing a 26th regime, leaving the 25 sets of national rules untouched.

These steps would also be supported by pan-European definitions of private placement rules adapted to the private equity and venture capital industry, recognition of specific investment rules for the management company, and definition of eligible investors, who are able to deal with the far greater levels of complexity involved in investments in the asset class.
Regarding efficient integrated pan-European trading platforms and quoted markets for European high-potential companies (including SMEs)

Another key feature for further European economic development and growth are efficient and well functioning integrated stock markets for high potential companies. These are paramount to realising the benefits that the private equity and venture capital industry provides. They are part of the ‘entrepreneurial and technological eco-system’ as they fulfil the needs of high-potential companies in enabling them to raise further new funds in the open market, and the private equity and venture capital industry to realise returns on existing investments.

In turn, this will allow the industry to return the proceeds to investors and thus to ultimate beneficiaries such as pensioners, and allocate capital to new opportunities through another financing cycle, which will have a positive impact on the wider EU economy and its global competitive position. For example, the vital role of this eco-system and its process is clearly regarded as forming part of the fundamental base of American economic success.

In respect of ‘Step 2’ of the Commission’s approach, specific conditions are required to ensure successful outcomes which the different regulators should address: a good pool of liquidity, good equity research to support flotation and on-going trading, investor groups committed to a long-term presence in the market, and an efficient stock market clearing and settlement system working on a ‘real-time’ basis.

Furthermore, Step 3 could be achieved on the basis of a form of mutual recognition or a shared common technology platform, to enable consistency and cohesion between exchanges.

Conclusion

Whilst broadly supporting the Commissions Green paper, EVCA also notes that building on the results achieved so far in the wider financial markets also requires a renewed political commitment from all EU actors. In this respect, whilst finalising existing initiatives, stakeholders and policymakers must also pursue a policy which not only encourages investment, growth, jobs and innovation in companies, but also innovation in financial products so that protection fits and suits the type of investor and the business models of asset classes. This is particularly true given the longer-term structural and demographic needs of the European economy.

EVCA remains at the disposal of the European Commission and other stakeholders for further discussions on the issues noted above, and can provide additional material and economic rationale it has developed in support of the above comments. EVCA can be contacted via the address below:

EVCA
Minervastraat 4
B-1930 Zaventem
Belgium
Tel: +32 2 715 00 20
Fax: +32 2 725 07 04
Email: info@evca.com
http://www.evca.com