

Ministerstvo financí České republiky
Ministry of Finance of the Czech Republic

Prague, 10 August 2011

Please find below our responses to the questions included in the the Consultation paper on the new European regime for Venture Capital. These comments are only an indication of the possible approach by the Ministry of Finance of the Czech Republic and they are not meant as our final official policy position.

General comments:

The cross border investment and marketing of units of the venture capital (VC) funds within the Member States is possible, as it is an integral part of the fundamental EU Treaty freedoms. Hence, the proposed "passport" framework, if it is going to be introduced, should not in any way distort or alter the level of free movement of capital already achieved throughout the EU. We believe it is crucial to outline the proposed regulatory framework as voluntary. It should merely make easier already existing business operations.

In this respect we welcome the initiative as an attempt to support the cross border fundraising activities of VC funds, or their managers, investing mainly in SMEs, its most important goal being to save compliance costs of such VC managers voluntarily possessing the "passport" as they fundraise in other MS than their own.

We are further of the opinion that there is an important question of subjects who would be eventually eligible to apply for the "passport". Considering the various way of operation of many "small" VC managers, it is not only the question of "VC fund" or "VC manager" definition. The "promoter of the VC investment" typically ascertains whether institutions/wealthy individuals are interested in particular venture, without necessarily knowing what their reaction would be and whether the actual vehicle for that venture would be established. Introducing a passport regime in this matter, therefore, seems to an inappropriate means to do so. The exact shape of the venture, its vehicle and its investors emerges in the process of fundraising.

Box 1

a) Do you think that encouraging Member States to a process of mutual recognition of venture capital funds, based on the direct enforcement of the Treaty freedoms, could facilitate the cross-border activity of these funds?

b) Do you believe that the main impediment preventing cross-border venture capital fundraising and investments is

- the absence of a passport for activities under the AIFMD thresholds;

- or the fact that the AIFMD is not tailored to venture capital in general?

c) Is a targeted modification of AIFMD rules for venture capital or a standalone initiative in this area the more appropriate tool to increase venture capital activities? Please specify.

- d) From your experience, could you provide concrete examples where you encounter additional administrative or regulatory hurdles when raising or investing funds across the EU?
- e) Do you believe that an initiative on cross-border operations of venture capital could contribute to eliminating the cross-border tax problems encountered and if so, how?
- f) How could a possible passport for venture capital operators facilitate targeted tax incentives in favour of cross-border venture capital investments?

The Treaty freedoms in regard to the process of mutual recognition of VC investment vehicles should be supported. Generally, we do regard VC as an “investment policy” of an investment fund/vehicle rather than as a distinctive legal structure of that fund or vehicle. Since also the AIFMD aims primarily on the inner workings of “alternative investment managers” and deliberately does not cover their investment policies, we would welcome rather the “stand alone” initiative addressing the issue as the way forward.

We believe that the solution of the double taxation is not a question which could be properly addressed by this initiative.

Box 2

- a) Do you agree with this approach? If not, what alternative approach would you suggest? Could you then briefly outline the pros and cons of such an alternative?
- b) Do you consider such a voluntary regime to have any major cost implications for the key stakeholders? (Investors, competent authorities, venture capital business). Please specify.
- c) Based on your experience, could you provide qualitative and/or quantitative assessment of potential cost savings that the European 'Passport' would bring about?
- d) What information should the manager provide to the competent authority?
- e) What option would you favour: registration with the national authority or with ESMA? Alternatively, ESMA could hold a European register of venture capital managers and funds with the information provided by national authorities. Would you favour this solution?

We generally agree with the stated approach. The most important challenge for the discussed regulation, if it ever should be enacted, is not to burden the investment managers with unnecessary and costly regulation they would need to comply with. As a basic principle, any structure or framework supporting the VC investment should aim on broadening the business chances for the market participants on a voluntary basis.

We believe that the “passport” should be applied for at the national authorities, possibly through the standardized procedure. The register of the venture capital managers run by ESMA would be useful if it represented an informative list mirroring the registrations with the national authorities.

Box 3

- a) Do you agree with this approach? If not, what alternative approach would you suggest?

b) What should be the content and timeframe of the notification? Should the notification cover both, the places where the manager intends to invest in SMEs and the places where it intends to raise funds?

c) Do you consider such a procedure to have any major cost implications for the key stakeholders? (Investors, competent authorities, venture capital business). Please specify

The notification procedure should be as simple as possible. We believe that it is not necessary to go any further than providing basic information about the manager and particular investment venture, if it is known at the time of the notification. If the "passport" should really help the industry to operate on the cross-border basis, we believe there is no need to cover the places of investment or fundraising in the registration process. Such information, if needed, should be obtained directly from the manager or from the funds prospectus.

Box 4

a) Do you agree with this approach? If not, and in case you believe venture capital should be accessible to retail investors, what kind of measures would you recommend to ensure their protection?

b) What are the restrictions (if any) on participation of retail investors in your country within the fund structures used for venture capital investments?

We agree that the restriction for the retail investors should be kept, but the scope of eligible investors should be broader than just professional investors under MiFID. In our opinion, an investment of individuals investing at least a predefined minimum amount could be allowed.

Box 5

a) Do you agree with this approach? If not, what alternative approach would you suggest?

b) Do you agree with the need to require an annual report for each fund?

c) Do you agree that the annual report should reflect the annual financial accounts and a report of the activities of the financial year?

d) Do you agree with the obligation to audit the financial information of the annual report?

e) What reporting requirements/obligations exist within the fund structures used in your country for the purpose of venture capital investments? Would you consider that the proposed information requirements would constitute a significant administrative burden? Please specify.

f) Do you think that more information requirements should be imposed on venture capital managers? If so, please specify.

We are of the opinion that all VC vehicles within the EU, even in the form of a simple business company have a certain level of general reporting obligation, such as annual report with auditing obligation. We don't call for specific reporting requirements/obligations.

Box 6

• Do you think there is a need to specify any operating condition for venture capital entities? If yes, what would you consider as sufficient EU level framework

for venture capital managers in this area and what level of compliance cost would this entail?

- Do you think that it should be specified that venture capital entities should comply with rules of conduct when dealing with their investors? If yes, to what extent?
- Do you think that it should be specified that venture capital entities should comply with specific organisational requirements? If yes, to what extent?
- Do you think that it should be specified that the persons effectively conducting the business should have good repute and experience? If yes, to what extent?
- Do you think that it should be specified that the significant shareholders should be suitable? If yes, to what extent?

As stated above, we believe that VC investment is more distinctive as an investment strategy than as a legal structure. We believe that the regulation requirements in all MS meet certain standards for this type of investment already. We believe that since the VC investment aims exclusively on institutional/professional investors, these investors can decide for themselves if a particular VC investment manager/investment vehicle is reliable and established under trustworthy legal regime.

Box 7

- a) Do you agree with this approach? If not, what alternative approach would you suggest?
- b) Is it convenient to specify in the legislative proposal the legal forms that the venture capital funds might adopt?
- c) Is there any other aspect relating to the legal form of the venture capital entities that the proposal should take into account?

We agree with the stated approach. The legal forms that the VC funds can adopt should be left to the national regulation.

Box 8

- a) What, if any, investment criteria determine your existing national fund structures used for purposes of venture capital investments?
- b) Do you think it is worth specifying any investment rules for venture capital funds? If yes:
- c) Do you think there is a need to define a compulsory investment percentage of assets that the venture capital fund should invest in SMEs? If yes, what compulsory investment percentage would you propose and how should it be calculated?
- d) Do you agree with the need to envisage a flexible application of the principle described?

Setting a compulsory investment percentage could be a practical way how to define the subjects eligible for the "passport". For example if there is a set mandatory minimum percentage of the funds assets as an investment to the European SMEs, the rest being an investment in other liquid assets, it would be similar to the master-feeder structure under UCITS IV and a distinct measure determining that the subject is eligible to obtain the "passport". The actual percentage ratio should be naturally a matter of further discussion. This can also

be an appropriate measure how to direct the benefits of the "passport" scheme towards the SMEs.

Box 9

- a) *How do your national rules capture (if at all) the definition of venture capital funds?*
- b) *Should the temporary nature of the venture capital investment activity in SMEs constitute a criterion that should be reflected?*
- c) *Do you think it should be specified any temporal limit (minimum and maximum) to the participation of the venture capital fund in the capital of the SME (i.e., from at least 2 to 10 years)?*
- d) *Are there any other means of finance that venture capital funds provide to SMEs that should be reflected (e.g. loans)?*
- e) *Do you think that there is a need to specify that the manager should be actively involved in the development, growth and success of the SME? Or should the passive investment in an SME also be considered by the proposal as venture capital investment?*
- f) *What other criteria would you consider appropriate to capture the venture capital activity?*

Box 10

- a) *To what extent does your national regime capture the above definitions of typical venture capital strategies?*
- b) *Do you agree that the special rules on venture capital should only apply when funds invest in the seed, start-up and expansion stages of SMEs? If not, do you believe that SMEs in a restructuring phase should also benefit from venture capital? What other alternative approaches would you suggest?*
- c) *Would you propose other definitions to define the permitted portfolio of venture capital funds?*
- d) *Do you agree that venture capital funds do not/should not use leverage?*

There is not a definition of VC investment under the current Czech regulation. The regulation of the non-UCITS investment vehicles leads to the effect that the venture capital could be invested through the qualified investor funds (QIFs) or through the non regulated subjects on the strictly private equity basis.

Box 11

- a) *Do you agree with the list of entities described as not being proper investment targets for venture capital funds?*
- b) *If not, what types of companies would you specify as eligible investment targets?*
- c) *Do you think that the EU should draw inspiration from the criteria set by the SEC to define the target companies of the venture capital funds?*

See opinion to the Box 8.

Box 12

What could be an appropriate regime for third country venture capital funds?

We have no preferences in this regard. But, in general, the scheme should be allowed for the funds to participate irrespective of their jurisdiction.

Box 13

- a) Do you agree with this approach?*
- b) Would you support the first (exemption for entities below the AIFMD threshold) or the second option (exemption independently from the threshold)? Would you suggest an alternative approach?*
- c) Are there any particular elements from the AIFMD that in your view should also apply to the venture capital managers?*

We would prefer the first option. The relationship to the AIFMD should be cleared in the way that the VC scheme would apply, unless the investment manager would fall under the full requirements of AIFMD, be it on the grounds it exceeds the limits set in the Article 3(2) AIFMD or as a result of an opt-in.

Box 14

- a) Do you agree with this approach? If no, what alternative approach would you suggest?*
- b) What supervisory powers should be granted to the competent authorities for the supervision of venture capital funds and managers?*
- c) What type of sanctions should be envisaged?*

We generally agree with the stated approach. However, the powers granted to the competent authorities should stem from national law, according the needs of local legal regime.