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Introduction

Amidst all of the discussions, publications and anxieties regarding EU Directive 2011/61/EU on Alternative Investment Fund Managers ("AIFMD") and its implications for both EU and Non-EU AIFMs, it can sometimes be overlooked that, on the same date that AIFMD goes live, July 22, 2013, a somewhat related EU regime for EU social entrepreneurship funds also comes into force under EU Regulation 346/2013 on European Social Entrepreneurship Funds (the "EuSEF Regulation").

The EU Commission has decided that creating European Social Entrepreneurship Funds ("EuSEFs") could provide the means by which investment management products could intermediate capital from investors to social businesses.

This regime is of note because it allows EU <u>registered</u> AIFMs manage certain types of qualifying social entrepreneurship funds domiciled in the EU, known as EuSEFs, and to market those EuSEFs to professional (and certain other) investors throughout the European Union.

This represents, in effect, a relaxation of the AIFMD rule that a registered AIFM cannot benefit from any of the rights under AIFMD (e.g. right to manage or market cross-border).

As a result a registered AIFM can manage an EuSEF domiciled anywhere in the EU and can market it anywhere in the EU to professional (and certain other) investors. The Regulation does not extend to Non-EU AIFMs nor to Non-EU funds.

The EuSEF Regulation will be directly applicable from July 22, 2013.

Asset Management and Investment Funds Group Dillon Eustace
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■ Who does the EuSEF Regulation apply to?

In summary, they apply to sub-threshold (i.e. registered) AIFM who meet the following criteria:

- (i) manage portfolios of EuSEFs;
- (ii) are established in the EU;
- (iii) whose assets under management in total do not exceed the threshold referred to in point (b) of Article 3(2) of AIFMD (i.e. a total AUM of less than EUR 500million comprised of closed ended and unleveraged funds); and
- (iv) are registered with the competent authorities of their home Member State in accordance with point (a) of Article 3(3) of AIFMD.;

For more information AIFMD, please refer to Dillon Eustace's "Guide to AIFMD", which can be found here.

When does the EuSEF Regulation apply?

The EuSEF Regulation come into force on July 22, 2013.

Key Concepts

What is an EuSEF?

An EuSEF is a fund that:

- (i) is a collective investment undertaking;
- (ii) intends to invest at least 70% of its aggregate capital contributions and uncalled committed capital in assets that are qualifying investments;
- (iii) does not use more than 30% of its aggregate capital contributions and uncalled committed capital to acquire non-qualifying investments; and

(iv) is established in the European Union;

A "collective investment undertaking" means an AIF as defined in point (a) of Article 4(1) of AIFMD i.e. a fund which (i) raises capital from a number of investors, with a view to investing it in accordance with a defined investment policy for the benefit of those investors; and (ii) does not require authorisation under the UCITS Directive;

"Qualifying investments" are equity, or quasi-equity instruments; secured or unsecured loans granted by the qualifying venture capital fund to a qualifying portfolio undertaking; shares of a qualifying portfolio undertaking; and units or shares in other qualifying venture capital funds, provided (in each case) that certain tests are met; and

"Qualifying portfolio undertaking" means an undertaking that:

- (i) is not admitted to trading on a regulated market or multilateral trading facility;
- (ii) has the achievement of measurable, positive social impacts as its primary objective in accordance with its articles of association or other rules;
- (iii) provides services or goods to vulnerable, marginalised, disadvantaged or excluded persons, or employs a method of production of goods or services that embodies its social objective or provides financial support exclusively to social undertakings;
- (iv) uses its profits primarily to achieve its social objectives;
- is managed in an accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities;

Managers of a qualifying social entrepreneurship funds shall employ, for each qualifying social entrepreneurship fund that they manage, 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.

Managers must also ensure that these procedures are clear and transparent and include indicators that may, depending on the social objective and nature of the qualifying portfolio undertaking, include subjects such as: employment and labour markets; standards and rights related to job quality; social inclusion and protection of particular groups; equal



treatment, equal opportunities and non-discrimination; public health and safety; and access to social protection and health and educational systems.

Who is or can be the manager of an EuSEF?

The EuSEF Regulation provides that the manager can manage portfolios of EuSEFs whose assets under management, in total do not exceed the threshold referred to in point (b) of Article 3(2) of AIFMD (i.e. a total AUM of less than EUR 500million comprised of closed ended and unleveraged funds)

Registered managers of EuSEFs are subject to a lighter regulatory regime than AIFM with a full authorisation under AIFMD. Once they comply with the AIFMD requirements in relation to organisational requirements, liquidity management, valuation, certain of the transparency obligations and certain of the requirements set out in the European Commission's Delegated Regulation (EU) 231/2013 (the "Level 2 Regulation"), they will be able to benefit from the marketing passport offered by the EuSEF Regulation.

For more information on the requirements applicable to registered managers, please refer to Dillon Eustace's "Guide to AIFMD", which can be found here.

The EuSEF Regulation also provides that the manager shall be either:

- an external manager, which is the legal person appointed by the EuSEF or on behalf of the EuSEF and which, through this appointment, is responsible for managing the EuSEF (external AIFM); or
- the EuSEF itself, which shall then be registered as manager, where the legal form of the EuSEF permits an internal management and where the AIF's governing body chooses not to appoint an external manager.

An internally managed EuSEF cannot be appointed as the external manager or another EuSEF.

Who can invest?

EuSEFs may only be marketed to investors who have the experience, knowledge and expertise to make their own investment decisions and properly assess the risks associated with such investments.



Therefore EuSEFs may only be sold to investors who:

- (i) are <u>or elect to be treated as</u> professional clients;
- (ii) are willing to invest at least €100,000: and
- (iii) have confirmed in writing that they are aware of the risks associated with their investment;

These restrictions do not apply to investments made by executives, directors or employees involved in the management of a manager of an EuSEF when they are investing in an EuSEF that they manage.

A "professional investor" is any investor which is considered to be a professional client or may be treated as a professional client on request within the meaning of Annex II of Directive 2004/39/EC. A list of investors categorised as professional investors can be found in Dillon Eustace's "Guide to AIFMD", which can be found here.

Limited use of Leverage

In order to ensure that EuSEFs do not contribute to the development of systemic risks, and that such funds concentrate, in their investment activities, on supporting qualifying portfolio undertakings, the use of leverage at the level of the fund is limited.

Managers of EuSEFs may not:

- (i) leverage the EuSEF using any method by which the exposure of the fund will be increased beyond the level of its committed capital, whether through borrowing of cash or securities, the engagement into derivative positions or by any other means.
- (ii) borrow, issue debt obligations or provide guarantees at the level of EuSEF where such borrowings, debt obligations or guarantees are covered by uncalled commitments.

Conduct of business rules

Managers of EuSEF must meet the following criteria in relation to the conduct of business and the relationship of those managers with their investors. They must:

- (i) act honestly, fairly and with due skill, care and diligence;
- (ii) have appropriate systems and controls in place to prevent malpractice that can reasonably be expected to affect the interests of investors;
- (iii) conduct their business activities in a way that promotes the best interests of the funds they manage, their investors and the integrity of the market;
- (iv) have adequate knowledge and understanding of the undertakings in which they invest;
- (v) treat their investors fairly;
- (vi) ensure that no investor obtains preferential treatment, unless that treatment is disclosed in the rules or instruments of incorporation of the fund;
- (vii) not delegate functions to third parties to such an extent that it becomes a mere "letter-box" entity;
- (viii) identify and, wherever possible, avoid conflicts of interest. Where this is not possible, the manager must manage, monitor and disclose conflicts of interest appropriately to prevent them adversely affecting the fund and investors' interests;
- (ix) have sufficient own funds, and use adequate and appropriate technical and human resources as necessary for the proper management of the funds it manages; and
- (x) give their regulators and investors prescribed information at regular intervals.
- Is registration obligatory and what are the benefits of registration as manager of an EuSEF?

If a manager and its funds are registered the manager will be entitled to use the 'EuSEF' label for its EuSEFs. This label will entitle the manager to sell such funds across the EU by way of a marketing passport, thereby avoiding the 'patchwork of uncertainty' of private placement regimes across the EU.

Registration as manager of an EuSEF is <u>an entitlement but is not an obligation</u>. If you are a sub-threshold manager, marketing your funds in the EU and the investment policy of your funds is compatible with the requirements of the EuSEF Regulation then you will be missing out on an opportunity to greatly simplify the distribution of your funds while also remaining subject to the registration criteria under AIFMD. For more information on registration and AIFMD, please refer to Dillon Eustace's "Guide to AIFMD", which can be found here.

Overall assessment of the practicalities of registration as manager of an EuSEF?

If a manager manages funds that invest in qualifying portfolio undertakings (as defined in the EuSEF Regulation) and meets the requirement of Article 3(2) of AIFMD (i.e. a total AUM of less than EUR 500million comprised of closed ended and unleveraged funds), then the opportunity to avail of a marketing passport will be very attractive as it will not add appreciably to the light touch regulatory burden already imposed on that manager, who would in any case, be a registered manager under AIFMD.

CONTACT US

Our Offices

Dublin

33 Sir John Rogerson's Quay Dublin 2 Ireland

Tel: +353 1 667 0022 Fax: +353 1 667 0042

Cayman Islands

Landmark Square West Bay Road, PO Box 775 Grand Cayman KY1-9006 Cayman Islands

Tel: +1 345 949 0022 Fax: +1 345 945 0042

Hong Kong

604, 6/F, Printing House 6 Duddell Street Central Hong Kong Tel: +852 35210352

New York

245 Park Avenue 39th Floor New York, NY 10167 United States

Tel: +1 212 792 4166 Fax: +1 212 792 4167

Tokyo

12th Floor, Yurakucho Itocia Building 2-7-1 Yurakucho, Chiyoda-ku Tokyo 100-0006, Japan Tel: +813 6860 4885 Fax: +813 6860 4501

e-mail: enquiries@dilloneustace.ie
website: www.dilloneustace.ie

Contact Points

For more details on how we can help you, to request copies of most recent newsletters, briefings or articles, or simply to be included on our mailing list going forward, please contact any of the team members below.

Trevor Dolan

E-mail: trevor.dolan@dilloneustace.ie

Tel: + 353 1 673 1850 Fax: + 353 1 667 0042

Donnacha O'Connor

E-mail:

donnacha.oconnor@dilloneustace.ie

Tel: + 353 1 673 1729 Fax: + 353 1 667 0042

Brian Dillon

E-mail: brian.dillon@dilloneustace.ie

Tel: + 353 1 673 1713 Fax: + 353 1 667 0042

Brian Higgins

E-mail: brian.higgins@dilloneustace.ie

Tel: + 353 1 673 1891 Fax: + 353 1 667 0042

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