# AIFI

ITALIAN PRIVATE EQUITY AND VENTURE CAPITAL ASSOCIATION

## AIFI REMARKS ON THE CESR MANDATE AND WORK PROGRAMME ON INVESTMENT MANAGEMENT (REF: CESR/04-160)

### "Par. 3.4 Common approach to non-harmonized funds"

The private equity and venture capital industry is highly international. Within Europe, the majority of funds invests in more than one European country and many individual investments are themselves cross-border by nature. At the fund investor level, while the bulk of capital for European venture capital and private equity funds is raised locally, international investors are also significant participants.
However, because not all European fund structures are recognised in all European countries, some complications arise for funds investing in several national markets, imposing a severe fiscal and regulatory burden and resulting in a need for complex and expensive structures.
Another problem is that each country has its own marketing and promoting rules so that offering private equity funds in different European countries can be complicated and expensive. It can even be difficult to know the details of these regulations.

To increase the amount of capital available within Europe for private companies and increase the incidence of trans-national investments in private equity and venture capital, two solutions could be followed:

1. **Create a common instrument for the private equity activity in the European countries (a pan-European fund structure)**. This structure should grant a good flexibility, not imposing undue restrictions on the type of investments which can be made, and should be based on the principle of tax transparency. That means that tax liability should pass directly to investors, with the fund itself paying no taxes on capital gains or income. Investors should also get any tax credits tied to dividend and interest, withholding tax should be minimised through the application of the double tax treaties of the investors, capital gains tax should only be paid at the investor level. Furthermore, the fund should not create a permanent establishment for itself, or for investors in the country in which the management team operate or in which they are investing. It is necessary to define a sort of "European establishment".

2. **Harmonizing in different European countries the requirements for marketing and promoting private equity funds reserved to professional investors.** If it was not possible create a flexible pan-European structure, the best solution could be to make homogenous and simplifying the offering procedure of closed-end funds. In particular, the focus should be on the funds reserved to professional investors, because these investors – either institutions or highly sophisticated – are risk oriented and do not require the same degree of protection which the regulatory system affords to smaller retail investors.

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To determine the proper ingredients of this standardization, one should consider certain recurring requirements of fund managers and investors involved in a fundraising process covering different EU jurisdictions that can be better satisfied if EU legislations have some level of harmonisation.
A private equity fund is typically marketed to investors in the home country of the fund managers and in other jurisdictions by using an English language private placement memorandum (PPM) the contents of which are fairly standard in the market practice. To protect fund managers against the risk that the marketing process is not classified as a private placement in the jurisdictions where the fund is marketed or otherwise breaches the securities laws of such jurisdictions, the PPM normally contains a section on selling restrictions which indicates how the fund is classified under the securities laws of the jurisdiction concerned, the type of investors which may lawfully acquire interests therein and the relevant conditions. In addition, legal advise concerning the securities laws of certain jurisdictions is normally sought by fund managers to prevent breaches of such laws. This pragmatic approach is far from being satisfactory for EU jurisdictions because the legal enquiries relating to such jurisdictions are normally expensive and not very detailed.
The more reasonable solution, in this case, is a system similar to the one of United Kingdom, where investment funds are not regulated as such, but their managers, operators and investment advisers are regulated. Broadly speaking, private equity funds are regarded as specialist investment vehicles, for promotion to institutional and sophisticated investors only. Following on from these principles, it is necessary:

- giving an homogenous definition of the category of “professional investors”;
- fixing minimum requirements for closed-end funds promoted to professional investors, in terms of investments limits, asset management rules and borrowing or other powers. The aim is to leave flexibility in realising the investment strategies and to grant freedom in the bargaining between managers and subscribers;
- establishing a common procedure to offer private equity vehicles in different European countries.

In short, harmonising the rules of EU legislations dealing with private placement of private equity funds (e.g. by providing a EU-wide definition of professional investors and by creating a common legal environment for placement of private equity funds to such investors) may only be beneficial for the European private equity industry.
In this way, two important goals for the development of a single European market could be reached: on the one hand, to grant the flexibility requested by the private equity players in their activity and, on the other hand, to preserve regulation and controls on the intermediaries of financial markets, that will continue to be regulated and supervised in their home countries.

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