

POLICY BRIEF

How EuSEF's Recent Reform can Impact the VP/SI Sector

1. WHAT IS EuSEF AND WHY WAS IT CREATED?

The [European Social Entrepreneurship Funds](#) (EuSEF) Regulation¹ was adopted together with the [European Venture Capital Funds](#) (EuVECA) Regulation on 17 April 2013 and came into force on 22 July 2013. Both Regulations were designed to establish a framework for investment funds to channel money from private investors into SMEs to boost jobs and growth. The difference between the two is that EuSEF focuses on [social enterprises](#), i.e. companies whose main objective is tackling societal challenges rather than only maximising profit.

While social enterprises sometimes receive public support, private investments via social investments funds still remain vital to their growth. The EuSEF Regulation sets out a voluntary label for “European Social Entrepreneurship Funds”, allowing investors and social enterprises to better identify funds investing in social businesses across the EU.

The **EuSEF** label was therefore created to achieve the following goals:

- 1. Facilitating social investment funds' fundraising activities:** i.e., overcoming the fragmentation of national legal frameworks for such funds across national borders;
- 2. Facilitating investing in social investment fund:** making it easier for investors to identify and invest in funds specialised in social enterprises;
- 3. Facilitating access to funding for social entrepreneurs:** ensuring that no barriers hinder the efficient channelling of investments to social businesses.

2. HOW DOES EuSEF WORK IN PRACTICE?

The EuSEF works as follows: a fund manager established in the EU can apply to the [National Competent Authority](#)

¹ Regulation (EU) No 346/2013 of the European Parliament and of the Council of 17 April 2013 on European social entrepreneurship funds: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32013R0346>

(NCA) of her/his Member State to run a social entrepreneurship fund and obtain the EuSEF designation. Provided the requirements defined in the Regulation are met, the fund manager is then registered with the NCA and can use the EuSEF label to market the fund across the EU. The NCA is then responsible to communicate to the [European Securities and Markets Authority](#) (ESMA) the list of managers and funds that have been registered. ESMA maintains a central [database](#), publicly accessible on the internet, listing all funds that obtained the EuSEF designation.

Funds complying with the Regulation receive a marketing passport which allows them to collect capital from investors across the EU, with a minimum commitment of at least €100,000. In return, EuSEF funds have to direct at least 70% of their investments to social businesses.

However, as of April 2016 only 5 EuSEF funds were notified to ESMA, while 70 funds were registered under EuVECA. These figures indicate that the overall design of the EuSEF needed reform.

3. THE REFORM

With a view to improve the EuSEF Regulation, in 2015 the European Commission launched a [public consultation](#) aiming at gathering feedback from citizens and interested organisations on the matter. [EVPA contributed](#) to the process and made key recommendations. In particular, EVPA advocated for:

- A wider definition of a social enterprise, as the wording of the former Art. 3 (1)(d)(ii) (“to vulnerable or marginalised, disadvantaged or excluded persons”) was too vague;
- The extension of undertakings' services and goods to society at large and not only to vulnerable groups;
- The primacy of the social purpose in the definition of social enterprises not to be bypassed by financial considerations;
- More tools to better help EuSEF managers implement the Regulation.

In addition to the public consultation, as part of its [2016 REFIT work programme](#)², the European Commission started a legislative review of the EUSEF Regulation through an impact assessment. The review identified a number of factors holding back the development of the EuSEF funds, namely: i) the rules that governed the assets funds can invest into, ii) the way the managers ran the funds, iii) how the Regulation interacted with other existing investment fund laws.

As a consequence, the Commission proposed a reform of the Regulation. On June 2017, the EU Commission, the EU Parliament and the EU Council reached a political agreement in [trilogue](#)³. The following amendments were proposed:

- Alternative Investment Fund Managers (AIFM)⁴ were entitled to run EuSEF funds;
- the initial capital for fund managers was set at €50,000;
- the definition of positive social impact was broadened;
- the registration process was simplified by including a guaranteed turnaround time of two months for new manager registrations;
- the costs associated with cross-border marketing were decreased through simplifying registration. Moreover, no fees could be charged for marketing where there was no supervisory action;
- EuSEF funds could be used to promote risk capital

2 REFIT is part of the Commission's better regulation agenda. It makes sure that EU laws deliver their intended benefits for citizens, businesses and society. It does so by ensuring that EU law is simple and easy to understand whilst removing unnecessary burdens.

3 Negotiations between the institutions on legislative proposals generally take the form of tripartite meetings ('trilogues') between Parliament, the Council and the Commission. For a given file, each institution designates its negotiators and defines its negotiating mandate. Trilogues may be organised at any stage of the legislative procedure (first, second or third reading). Any provisional agreement reached in trilogues is informal and has therefore to be approved by the formal procedures applicable within each of the EU Institutions.

4 Pursuant to article 3 of the Directive 2011/61/EU (known as the Alternative Investment Fund Managers Directive - [AIFMD](#)), Alternative Investment Fund Manager (AIFM) are defined as 'collective investment undertaking, including investment compartments which raise 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'. The AIFMD aims at monitoring and regulating the activities of hedge funds, private equity and any other alternative investment firms. The AIFM Directive obliges all covered AIFMs to obtain authorisation, and make various disclosures in order to operate on the market.

investments through, for example, more favourable treatment of private investors than of public investors, provided such aid is compatible with State aid rules;

- ESMA's database was set to include information concerning all EuSEF managers and their funds.

The text of the new Regulation was adopted by the EU Parliament on 14 September 2017 and by the EU Council on 9 October 2017. The final act (Regulation 2017/1991 'Amending Regulation') was published in the [Official Journal on 10 November 2017](#). The EuSEF reform came into force on 1 March 2018.

4. HOW THE EUSEF'S RECENT REFORM CAN IMPACT THE VP/SI ECOSYSTEM?

Although it is early to witness the consequences of the reform, some aspects are worth of reflection:

I) INCREASED ACCESSIBILITY - MORE SOCIAL FUNDS

The reform simplifies the registration process and explicitly prohibits fees imposed by competent authorities of host Member States where no supervisory activity is performed. These new rules are expected to incentivise more managers in applying for obtaining the EuSEF designation.

II) MORE MANAGERS - MORE SOCIAL CAPITAL

The reform expands the number of managers entitled to apply. In fact, as of 1 March 2018, fund managers authorised under the AIFM Directive will be able to register as EuSEF managers. This means EuSEF funds will have access to a broader range of eligible investors and consequently more capital is expected to be channelled into the market to achieve social objectives.

III) NEW DEFINITION - NEW OPPORTUNITIES

The definition of positive social impact has been expanded in order to increase the range of eligible undertakings in which social funds can invest⁵. This extension is also set to reduce the discrepancies between definitions of

5 See Article 2 of the Regulation (EU) 2017/1991 of the European Parliament and of the Council of 25 October 2017 amending Regulation (EU) No 345/2013 on European venture capital funds and Regulation (EU) No 346/2013 on European social entrepreneurship funds: <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32017R1991>

positive social impact across Europe. The amendment in question is relevant insofar it harmonises the EU regulatory framework and facilitates the participation of investors in social funds.

IV) MORE INFORMATION - MORE SOCIAL IMPACT

ESMA's central database will now include information concerning all EuSEF managers and their funds, offering helpful information for those interested in applying. Moreover, this amendment is expected to help EuSEF managers to further collect capital from investors across the EU, thus multiplying their possibilities to achieve social impact.

V) MORE HARMONISATION - MORE CERTAINTY

The reform specifies the minimum capital necessary to become a manager, which is set at €50,000. This aspect will enhance certainty in the EU markets, as previously this was a matter for local regulators to set.

5. THE WAY FORWARD

The reform improves several aspects of the original Regulation and is expected to foster positive social impact across Europe, notably by increasing the number of managers who can run EuSEF funds and thus multiplying funding available for social enterprises. Yet, there are three main barriers that might hinder the Regulation achieving its full potential.

First, the EU Commission should better advertise the (reformed) Regulation and how it works. On the one hand, national regulators are often not trained and therefore not able to properly communicate technical aspects of the Regulation to interested managers. On the other hand, small managers are often not aware of the Regulation, and, if they are, they do not have the skills and resources to understand how to run a EuSEF fund and are thus not able to make the most out of the Regulation. This aspect represents a missed opportunity for both social managers and social enterprises that wish to generate social impact in Europe. To overcome this barrier, EMSA should be used as a platform for national regulators to exchange ideas and useful information.

Second, the EuSEF Regulation works well for managers that are interesting in marketing their funds across the EU, but it does not represent an added value for managers that are interested in running these funds only

in their own country. These latter managers can in fact use other tools to achieve their purposes. To this end, the EU Commission should make the EuSEF instrument appealing also to managers whose only market is their country of origin.

Third, the provisions of social impact measurement and reporting under the EuSEF framework are often considered too strict by fund managers. To overcome this additional hurdle certain fund managers have opted for the EuVECA framework whilst retaining a social impact focus. Opting for the EuVECA framework has also the additional perk of giving access to a wider range of investees, as it allows fund managers to invest in both for profit companies and social enterprises.

While the changes enacted by the reform should be all welcomed, only time will tell whether the reformed EuSEF Regulation can create a larger space for social impact in Europe, effectively address the issues outlined above and thus positively impact the VP/SI sector.

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