



European Securities and
Markets Authority

Final Report

ESMA's technical advice to the European Commission on the delegated acts of the Regulations on European Social Entrepreneurship Funds and European Venture Capital Funds

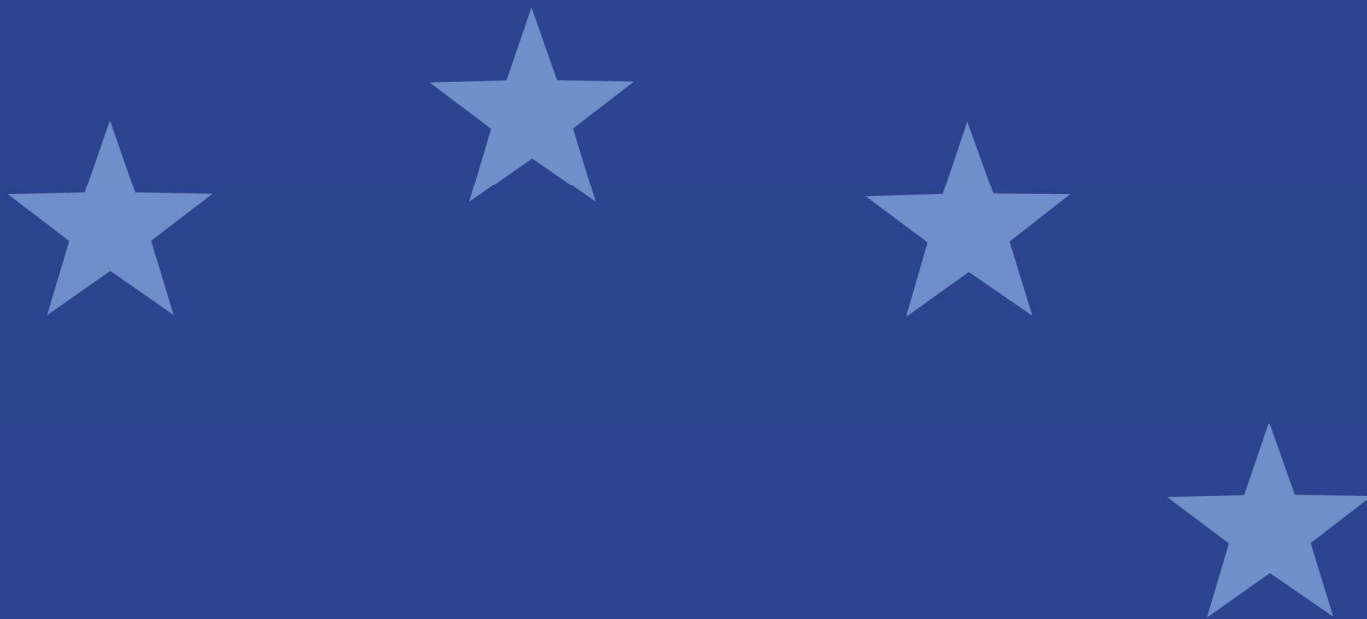




Table of Contents

I. Executive Summary	4
II. Purpose and background	5
III. Elements of the advice to the European Commission	7
Annex I – Commission mandate to provide technical advice	40
Annex II – Cost-benefit analysis	48
Annex III – Technical advice	61
Annex IV – Opinion of ESMA's Securities and Markets Stakeholder Group	71
Annex V – Feedback statement	76



Acronyms used

AIF	Alternative Investment Fund
AIFM	Alternative Investment Fund Manager
AIFMD	Alternative Investment Fund Managers Directive
ESMA	European Securities and Markets Authority
EuSEF	European Social Entrepreneurship Fund
EuVECA	European Venture Capital Fund
GECES	Group d'experts de la Commission sur l'entrepreneuriat social
MiFID	Markets in Financial Instruments Directive
OECD	Organisation for Economic Co-operation and Development

I. Executive Summary

Reasons for publication

This paper sets out the technical advice that ESMA should provide to the European Commission by 30 April 2015 on the delegated acts of Regulations 346/2013 on European Social Entrepreneurship Funds (EuSEF) and 345/2013 on European Venture Capital Funds (EuVECA).

Contents

The Report is divided in five parts. The first deals with the advice on the types of goods and services, methods of production for goods and services and financial support embodying a social objective. The second and third parts deal with the advice on the conflicts of interest of EuSEF and EuVECA managers, respectively. The fourth part deals with the advice on the methods for the measurement of the social impact. The fifth part deals with the advice on the information that EuSEF managers should provide to investors. Each of these parts is divided in four sections: the first sets out the applicable legal framework; the second describes the mandate and indications from the European Commission; the third explains the proposed policy approach; finally, the fourth sets out the advice to the Commission.

A number of annexes facilitate the reading of this document with supplementary information. Annex I reproduces the text of the Commission's mandate for technical advice. Annex II sets out a cost benefit analysis of the different policy options considered. Annex III reproduces the text of the advice to the Commission. Finally, Annex IV sets out the opinion of the Securities and Markets Stakeholder Group of ESMA.

Next steps

ESMA will provide input to the Commission as necessary on the development of the delegated acts to be prepared on the basis of ESMA's technical advice.

II. Purpose and background

1.1 EuVECA and EuSEF Regulations

1. On 22 July 2013 the Regulations 345/2013 on European Venture Capital Funds (EuVECA) and 346/2013 on European Social Entrepreneurship Funds (EuSEF) became applicable.
2. Both Regulations were proposed as key actions of the Single Market Act (SMA)¹. The EuSEF Regulation forms part of the Social Business Initiative of the Commission², in the context of the Europe 2020 strategy for delivering smart, sustainable and inclusive growth. The aim of the EuSEF Regulation is to support the provision of finance to social business in the EU by facilitating fundraising activity by funds that are specialised in this type of business. The Regulation promotes social funds in two ways: first, these funds may benefit from a marketing passport and, secondly, the Regulation creates an exclusive pan-European fund label that identifies these funds as “social” (EuSEF). Social businesses are described as undertakings whose primary objective is to achieve social impacts rather than generate profits for shareholders.
3. One of the objectives of the SMA is to improve access to finance for SMEs, in particular through venture capital. The Commission considers that venture capital has a positive impact in terms of economic growth, innovation and job creation. The aim of the EuVECA Regulation is to support venture capital by facilitating cross-border fundraising in the EU. The final goal is to increase the amount of funds available in the EU for venture capital. The Regulation should help European venture capital funds to reach the critical mass they need to develop sectoral specialisation, which is key for their success.
4. The rules of these Regulations are very similar. The Regulations devise a voluntary passport mechanism as a means to overcome the fragmentation of the legal framework for venture capital and social funds in the EU along national borders. The managers of EuVECA and EuSEF that are registered with the competent authorities benefit from the EU passport provided they comply with a number of conditions on conduct of business, conflicts of interest, organisational requirements and transparency. The range of eligible investors is restricted to MiFID professional clients and high-net worth individuals. The regulations apply to managers that are below the €500 million threshold of the AIFMD³.

1.2 Delegated acts

¹ Communication from the Commission: [Single Market Act. Twelve levers to boost growth and strengthen confidence. "Working together to create new growth"](#). 13 April 2011. The SMA, whose objective is to revive the Single Market by 2012, presents 12 key areas that are drivers for growth, competitiveness and social progress in the EU. Other areas of priority of the SMA are access to finance for SMEs, recognition of professional qualifications, intellectual property rights, digital single market, energy and transport infrastructure, taxation, public procurement, social cohesion and social entrepreneurship.

² Communication from the Commission: [Social Business Initiative "Creating a favourable climate for social enterprises, key stakeholders in the social economy and innovation"](#) 25 October 2010. The SBI outlines a number of measures to promote more responsible businesses in the EU by encouraging more responsible business, facilitating social entrepreneurship and cutting red tape for SMEs.

³ ESMA has issued a [Q&A](#) which addresses the issue of whether above-threshold AIFMs may use the EuSEF and EuVECA labels.

5. A number of provisions in the EuSEF and EuVECA Regulations empower the Commission to adopt delegated acts. The EuSEF Regulation provides for delegated acts specifying:
 - a) the types of goods and services or methods of production for goods and services embodying a social objective (Article 3(2)), taking into account the different kinds of qualifying portfolio undertakings (Article 3(1)(d)(ii) and those circumstances in which profits may be distributed to owners and investors (Article 3(2)), to ensure that any such distribution of profits does not undermine its primary objective (Article 3(1)(d)(iii));
 - b) the types of conflicts of interest managers of qualifying social entrepreneurship funds need to avoid and the steps to be taken in that respect (Article 9(5));
 - c) the details of the procedures to measure the social impacts to be achieved by the qualifying portfolio undertakings (Article 10(2)); and
 - d) the content and procedure for provision of information for investors (Article 14(4)).
6. The EuVECA Regulation provides for delegated acts specifying the types of conflicts of interest that managers of qualifying venture capital funds need to avoid and the steps to be taken in that respect (Article 9(5)).
7. ESMA has already contributed to the implementation of these Regulations. On 13 February 2014, ESMA submitted to the Commission the draft implementing technical standards to determine the format of the notification envisaged in Articles 16(1) of the EuVECA and 17 of the EuSEF Regulations⁴. In addition, since December 2013 ESMA's website hosts the Central Databases of registered EuVECA and EuSEF managers, as required in Articles 17 of the EuVECA Regulation and 18 of the EuSEF Regulation⁵.

1.3 Request for advice

8. The Commission requested the advice of ESMA on the preparation of the delegated acts foreseen in the Regulations (see Annex II). ESMA received the request on 27 May 2014. While the request for advice initially refers to 31 January 2015 as the deadline by which the Commission expected ESMA to deliver the advice, after further consultation with ESMA, the Commission decided to extend the deadline to 30 April 2015.
9. The Commission invites ESMA to take into account, for the advice on EuSEF, the work carried out by the Commission's expert group on social business (GECES)⁶ and, in particular, the report from the GECES sub-group on social impact measurement⁷ adopted

⁴ In order to make operative the passport for the managers, Articles 16 (1) of the EuVECA and 17 of the EuSEF Regulations imposes to the authority of the home Member State the obligation to notify certain events related to the passport. Articles 17(3) EuSEF and 16(3) EuVECA Regulations entrust ESMA with the obligation to develop draft implementing technical standards to determine the format of the notification.

⁵ <http://www.esma.europa.eu/page/Venture-Capital-and-Social-Entrepreneurship-Funds>

⁶ http://ec.europa.eu/internal_market/social_business/expert-group/index_en.htm

⁷ http://ec.europa.eu/internal_market/social_business/docs/expert-group/social_impact/140605-sub-group-report_en.pdf

in Heraklion in June 2014, as well as other sources of relevant information from organisations such as the OECD and the Impact Measurement Working Group of the G7 Social Impact Investment Taskforce⁸. The Commission asks ESMA to justify its advice by identifying a range of policy options with an assessment of the costs and benefits of each. The cost benefit analysis of the options can be found in Annex III of this final report.

10. During the development of the advice ESMA staff contacted and met a number of social entrepreneurs, impact investors, fund managers and other stakeholders of different EU Member States, with the aim of having a better understanding of the social entrepreneurship environment in the EU. These meetings proved very helpful for the development of the advice.
11. The final advice takes into account the views expressed by stakeholders during the public consultation that ran from 26 September until 10 December 2014, the open hearing with experts organised by ESMA on 10 November 2014 and the opinion of the Securities and Markets Stakeholder Group of ESMA (reproduced in Annex IV).

III. Elements of the advice to the European Commission

1 Level 2 advice on the types of goods and services or methods of production for goods and services embodying a social objective

12. The definition of the companies in which EuSEF can invest (“qualified portfolio undertakings”, also known as social enterprises) is a key element of the EuSEF framework because it determines the scope of the investment of a EuSEF. During the consultation, stakeholders stressed that there are many types of social enterprise, with activities covering a wide range of areas, often with innovative strategies. The reference to social enterprises in this document should be taken in the broad sense i.e. encompassing not only traditional companies with capital, but also other organisations and entities like associations, cooperatives, foundations, NGO and others (as well as individual projects launched by any of these entities).
13. The cost benefit analysis in Annex III provides some illustrative figures about the sector and a number of examples of social enterprises.

1.1 Legal framework

14. Article 3(1)(d) of the EuSEF Regulation lists the criteria that define a qualifying portfolio undertaking. A qualifying portfolio undertaking is an undertaking that:
 - a) *At the time of an investment by the qualifying social entrepreneurship fund is not admitted to trading on a regulated market or on a multilateral trading facility (MTF) as defined in point (14) and point (15) of Article 4(1) of Directive 2004/39/EC;*

⁸ <http://www.socialimpactinvestment.org/reports/Impact%20Investment%20Report%20FINAL%5B3%5D.pdf>

- b) *Has the achievement of measurable, positive social impacts as its primary objective in accordance with its articles of association, statutes or any other rules or instruments of incorporation establishing the business, where the undertaking:*
- provides services or goods to vulnerable or marginalised, disadvantaged or excluded persons,*
 - employs a method of production of goods or services that embodies its social objective, or*
 - provides financial support exclusively to social undertakings as defined in the first two indents;*
- c) *Uses its profits primarily to achieve its primary social objective in accordance with its articles of association, statutes or any other rules or instruments of incorporation establishing the business and with the predefined procedures and rules therein, which determine the circumstances in which profits are distributed to shareholders and owners to ensure that any such distribution of profits does not undermine its primary objective;*
- d) *Is managed in an accountable and transparent way, in particular by involving workers, customers and stakeholders affected by its business activities;*
- e) *Is established within the territory of a Member State, or in a third country provided that the third country:*
- is not listed as a Non-Cooperative Country and Territory by the Financial Action Task Force on Anti-Money Laundering and Terrorist Financing,*
 - has signed an agreement with the home Member State of the manager of a qualifying social entrepreneurship fund and with each other Member State in which the units or shares of the qualifying social entrepreneurship fund are intended to be marketed to ensure that the third country fully complies with the standards laid down in Article 26 of the OECD Model Tax Convention on Income and on Capital and ensures an effective exchange of information in tax matters, including any multilateral tax agreements;*
15. Article 3(2) empowers the Commission to adopt delegated acts specifying the types of services or goods and the methods of production of services or goods that embody a social objective referred to in point (ii) of point (d) of paragraph 1 of Article 3, taking into account the different kinds of qualifying portfolio undertakings and those circumstances in which profits can be distributed to owners and investors.

1.2 Indications from the Commission

16. The Commission asked ESMA to provide advice in relation to:

- a) Goods and services to vulnerable or marginalised, disadvantaged or excluded persons.
 - b) Methods of production that embody a social objective.
 - c) Financial support for the above two issues.
17. The Commission highlights that ESMA should consider the difference between intending to achieve these impacts as the primary goal of a qualifying portfolio undertaking compared with the incidental emergence of such an outcome. Similarly, a distinction must be made between an intended social impact and adherence to a plan for Corporate Social Responsibility implemented by undertakings that do not have social impact as their primary goal.
18. The Commission asks ESMA to take into account the work carried out by the Commission's expert group on social business (GECES) and, in particular, the report by the GECES sub-group on social impact measurement. ESMA should also take into account other sources of relevant information from organisations such as the OECD and the Impact Measurement Working Group of the G8 Social Impact Investment Taskforce.
19. The mandate of the Commission recalls that EuSEF qualifying portfolio undertakings are likely to be small in scale and therefore have limited resources. As a consequence, the advice should take into account proportionality and should avoid being burdensome for both the underlying qualifying portfolio undertakings as well as for the EuSEF managers themselves.

1.3 Advice

20. The report from the GECES refers to the definition of social enterprise comprised in the Social Business Initiative of the Commission.

“A social enterprise is an operator in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders. It operates by providing goods and services for the market in an entrepreneurial and innovative fashion and uses its profits primarily to achieve social objectives. It is managed in an open and responsible manner and, in particular, involves employees, consumers and stakeholders affected by its commercial activities. The Commission uses the term 'social enterprise' to cover the following types of business:

- those for which the social objective of the common good is the reason for the commercial activity, often in the form of a high level of social innovation;
- those where profits are mainly reinvested with a view to achieving the social objective;

- and where the method of organisation or ownership system reflects their mission, using democratic or participatory principles or focusing on social justice” (Social Business Initiative, COM(2011) 682 final, pp. 2-3).

(GECES Report on Social Impact Measurement, p. vii)

21. The following preliminary conclusions can be extracted from the definition provided in the GECES report:
 - a) There is no limitation as to the legal form of the social enterprise. A social enterprise (“qualifying portfolio undertaking”, in the language of the EuSEF Regulation) could take the form of a traditional company with equity, a cooperative, a foundation, an association, an NGO, etc.
 - b) The key element that distinguishes a social enterprise from other types of undertaking is the purpose of the enterprise. When the primary objective of the organisation is the achievement of a social impact (i.e. the solution of a social or environmental problem) the enterprise can be labelled as social. Having social impact as the primary goal makes the difference between social enterprises and companies that achieve a positive social impact incidentally, or that have a plan for Corporate Social Responsibility, but whose primary objective is different (i.e. the achievement of economic profit).
 - c) The fact that the main objective of the social enterprise is to achieve a social impact does not exclude the possibility of producing economic profits. The profit will be mainly reinvested with a view to ensuring the achievement of the social objective.
22. From the policy options identified (see cost benefit analysis in [Annex II](#)), ESMA proposed in the consultation that the most appropriate approach would be to develop a number of high-level principles that EuSEF managers could apply in order to assess whether the undertaking in which it intends to invest falls under the definition of qualifying portfolio undertaking i.e. whether the goods and services it provides, the methods of production that it applies or the financial support it provides, embed a social objective.
23. In addition, in order to provide for higher level of legal certainty, ESMA suggested in the consultation an indicative list of goods and services provided by the social enterprises, methods of production employed and financial support provided by the social enterprises. This would be an open-ended list that would not necessarily exclude from the scope of the Regulation goods, services, methods of production and financial support activities other than those reflected in the list.
24. The majority of respondents to the consultation agreed with the policy option chosen by ESMA, but favoured an approach more based on the principles, rather than on the list. A

number of stakeholders stressed the importance of following the definition of social enterprise provided by the Commission in the Social Business Initiative. In particular, it was pointed out that the social mission should be embedded in the articles of association or instruments of incorporation of the social enterprise and that the distribution of profits should not undermine the achievement of the social purpose of the enterprise.

25. Some stakeholders pointed out that there are different types of social enterprise and there are cases where their services or activities may not necessarily be directed exclusively to persons in situation of exclusion, disadvantage, marginalisation or that are vulnerable, but could also incorporate services or activities addressed to the community in general, provided that the primary purpose of the undertaking is social. This would include, for instance, companies providing goods or services having a pre-emptive purpose i.e. services addressed to the population as a whole (not only vulnerable groups) that intend to prevent a particular damage, rather than focusing on the curative process, after the damage has appeared.⁹
26. As to the examples of goods and services provided, some stakeholders indicated that the open-ended list was useful, but it should be clear that competent authorities should be flexible in the interpretation, considering it as merely indicative, so that new and innovative forms of social enterprises that may arise in the future are not excluded from the EuSEF scope of investment. Some stakeholders proposed adding the list in an annex of the advice, stressing that the list of examples is non-exhaustive.
27. The principles could be the following (these principles are accompanied by the indicative list of goods and services provided by the social enterprises, methods of production employed and financial support provided by the social enterprises):
 - 1) The primary purpose of the enterprise must be to address a social or environmental problem. Therefore, in order for it to be considered a social enterprise it would not suffice that an ordinary company respects the environment, implements a plan for Corporate Social Responsibility or applies high social or labour standards and principles of good governance. There is no doubt that these attitudes are positive from a social point of view; however, the social impact that these companies produce is incidental i.e. it is not the main purpose for which the company was created.
 - 2) The goods or services produced should be primarily addressed to persons in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable. This could potentially encompass a wide array of situations and persons: economically disadvantaged persons or communities, the homeless, persons with disabilities, the long-term unemployed, ex-convicts, convicts, non-integrated

⁹ EVPA provides the example of a Swedish social enterprise that develops computer games aimed at strengthening children's emotional intelligence in order to avoid or reduce bullying. This kind of social good is not primarily addressed to "*vulnerable or marginalised, disadvantaged or excluded persons*" but well to all children as this social enterprise' objective is precisely to pre-empt bad behaviours.

immigrant population, people or communities discriminated against due to racial, political, religious, cultural or gender reasons, minorities, children, the elderly, sick persons, isolated communities, persons with addiction problems, underqualified persons, etc. Taking into account the nature and variety of the situations that could be potentially covered, ESMA considers that the advice should not attempt to define any of these situations. The EuSEF manager should assess on a case by case basis whether the addressees of the goods or services provided by the social enterprise in which it intends to invest can be identified as being in a situation of exclusion, disadvantage, marginalisation or as being vulnerable, in view of the general understanding of what these situations are. The goods or services could also be very different but include:¹⁰

- access to clean water, education, energy, financial services or information
- active inclusion (including through cultural activities and language courses)
- affordable housing
- programmes for people with learning or physical disabilities
- agricultural productivity
- capacity-building
- community development
- conflict resolution
- disease-specific prevention and mitigation
- early child education and care
- employability
- employment generation
- equality and empowerment
- food banks
- food security
- generate funds for charitable giving

¹⁰ From the social impact objectives of the IRIS methodology: <http://iris.thegiin.org/metrics/list?filters=iris-reporting-info>

- health improvement
- human capital (skills update/re-orientation/upgrade)
- human rights protection or expansion
- medicine banks
- migrants' integration
- palliative care

3) Even if the goods or services produced are not addressed to persons in situation of exclusion, disadvantage, marginalisation or that are vulnerable, the enterprise can be considered social if its methods of production embody the social aim where:

- the main purpose of the enterprise is to provide the people that are in a situation of exclusion, disadvantage, marginalisation or that are vulnerable, as described in the previous point, with a job, or to integrate these persons in any form in the labour force. As mentioned before, this should not occur incidentally; it should be the main purpose of the enterprise.
- the enterprise provides goods or services directed at total populations having a pre-emptive purpose that aims at reducing the possibility of the appearance of damage in the future. These would be enterprises active in the field of early childhood education and care, active employment, health education and disease prevention and life-long learning.
- the enterprise develops activities of environmental protection with a societal impact.

4) The nature of the entities providing financial support to social enterprises is not defined in the EuSEF Regulation. These could be credit institutions, funds, specialised companies, crowdfunding platforms, micro-finance institutions, social investment finance intermediaries and community development finance institutions. However, the key element that qualifies these entities as social enterprises is that their financial activity should solely aim to support social enterprises.

28. The proposed approach would encompass the widest possible population of social enterprises, including those with innovative and creative strategies. At the same time this option provides for a clear framework capable of differentiating a social enterprise from an enterprise that it is not. It would be for each EuSEF (and, where needed, its competent authority) to assess whether the undertakings meet the principles set out above.

1.4 Advice to the Commission on the delegated acts concerning the specification of the definition of qualifying portfolio undertaking

1. The EuSEF manager shall take into account the conditions established in the following paragraphs in order to consider that an enterprise qualifies as a portfolio undertaking, as defined in Article 3(1)(d) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.
2. The primary purpose of the enterprise, irrespective of the legal form it adopts, shall be to address a social problem. The social mission of the enterprise should be the basis of its activities and it should be secured in its articles of association, statutes, or any other rules or instruments of incorporation establishing the business.
3. The enterprise shall use its profits primarily to achieve its social objective. The articles of association, statutes, or any other rules or instruments of incorporation establishing the business shall determine the circumstances in which profits are distributed to shareholders and owners to ensure that any such distribution does not undermine its primary purpose.
4. Ordinary companies having a positive social or environmental impact, including a corporate social responsibility plan, that is nevertheless incidental to their commercial activities shall not be accepted as qualifying portfolio undertakings.
5. The goods or services produced shall be addressed primarily to persons that are in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable. The EuSEF manager shall assess on a case by case basis whether the addressees of the goods or services provided by the qualifying portfolio undertaking can be identified as being in a situation of exclusion, disadvantage or marginalisation, or as being vulnerable, in accordance with the general meaning of these situations.
6. The qualifying portfolio undertaking may produce goods or services that are not necessarily addressed to persons in situation of exclusion, disadvantage, marginalisation or that are vulnerable, as defined in paragraph 3, insofar as the primary purpose of the enterprise is to produce a positive social impact by other means. In particular, the qualifying portfolio undertaking may apply methods of production that embody a social objective. These could be the case in the following, non-exhaustive circumstances:
 - a. Where the main purpose of the enterprise is to provide the persons that are in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable, as described in paragraph 5, with a job, or to integrate these persons in whatever way with the labour force. Where this happens incidentally, but not as the main purpose of the enterprise, the enterprise shall not be deemed as a qualifying portfolio undertaking.

- b. Where the enterprise provides goods or services directed at total populations having a pre-emptive purpose, i.e., aiming at reducing the possibility of the appearance of damage in the future. These could include, but are not limited to, the following: early childhood education and care, active employment, health education and disease prevention and life-long learning.
- c. The activity of the enterprise concerns environmental protection with societal impact.
- d. The enterprise provides financial support solely to other qualifying portfolio undertakings. This includes, but is not limited to, the following entities: credit institutions, investment funds, special purpose vehicles, crowdfunding platforms, micro-finance institutions, social investment finance intermediaries and community development finance institutions.

Indicative list of examples

The following examples are merely indicative. Social enterprises may address new or emerging categories of people at risk of exclusion or could develop innovative products, services and organisational models that are not included in these lists. Therefore, the examples are non-exhaustive.

Indicative examples of persons that are in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable:

These include, but are not limited to, the following persons: economically disadvantaged persons or communities, the homeless, persons with disabilities, the long-term unemployed, convicts, ex-convicts, non-integrated immigrant populations, people or communities that are discriminated against for racial, political, religious, cultural or gender reasons, minorities, children, the elderly and sick persons, isolated communities, persons with addiction problems, underqualified persons, etc.

Indicative examples of goods or services provided by the qualifying portfolio undertaking:

These may include, but are not limited to, the following: access to clean water, education, energy, financial services or information; active inclusion (including through cultural activities and language courses); affordable housing; programmes for people with learning or physical disabilities; agricultural productivity; active inclusion; capacity-building; community development; conflict resolution; disease-specific prevention and mitigation; early child education and care; employability; employment generation; equality and empowerment; food banks; food security; generate funds for charitable giving; health improvement; human capital (skills update/re-orientation/upgrade); human rights protection or expansion; medicine banks; migrants' integration and palliative care.

2 Delegated acts on conflicts of interest of EuSEF managers

2.1 Legal framework

29. Article 9 of the EuSEF Regulation establishes the following:

1. *Managers of qualifying social entrepreneurship funds shall identify and avoid conflicts of interest and, where they cannot be avoided, manage and monitor and, in accordance with paragraph 4, disclose those conflicts of interest promptly in order to prevent them from adversely affecting the interests of the qualifying social entrepreneurship funds and the investors therein and to ensure that the qualifying social entrepreneurship funds that they manage are fairly treated.*
2. *Managers of qualifying social entrepreneurship funds shall identify in particular those conflicts of interest that may arise between:*
 - a) *managers of qualifying social entrepreneurship funds, persons who effectively conduct the business of those managers, employees of, or any person who directly or indirectly controls or is controlled by, those managers, and the qualifying social entrepreneurship fund managed by those managers, or the investors therein;*
 - b) *a qualifying social entrepreneurship fund or the investors therein, and another qualifying social entrepreneurship fund managed by the same manager, or the investors therein;*
 - c) *the qualifying social entrepreneurship fund or the investors therein, and a collective investment undertaking or UCITS managed by the same manager, or the investors therein.*
3. *Managers of qualifying social entrepreneurship funds shall maintain and operate effective organisational and administrative arrangements in order to comply with the requirements laid down in paragraphs 1 and 2.*
4. *Disclosures of conflicts of interest as referred to in paragraph 1 shall be provided, where organisational arrangements made by a manager of a qualifying social entrepreneurship fund to identify, prevent, manage and monitor conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to investors' interests will be prevented. A manager of a qualifying social entrepreneurship fund shall disclose in clear terms the general nature or sources of conflicts of interest to the investors before undertaking business on their behalf.*

30. Article 9(5) of the EuSEF Regulation empowers the Commission to adopt delegated acts specifying:

- 1) the types of conflicts of interest referred to in Article 9(2);

- 2) the steps that managers of a qualifying social entrepreneurship fund must take, in terms of structures and organisational and administrative procedures, in order to identify, prevent, manage, monitor and disclose conflicts of interest.

2.2 Indications from the Commission

31. The mandate of the Commission noted that EuSEF are managed by entities below the threshold in Article 3(2) of the AIFMD, and are therefore simpler structures with less opportunity for confronting many of the conflicts of interest foreseen in Article 14 of the AIFMD and Articles 30 to 37 of the AIFMD Level 2 Regulation. Recognising that the EuSEF qualifying portfolio undertakings are likely to be small in scale and therefore have limited resources, the Commission invites ESMA to take into account the principle of proportionality in the advice, and avoid being burdensome for both the qualifying portfolio undertakings and the EuSEF managers.
32. The Commission invited ESMA to take into account the report of the GECES sub-group on social impact measurement and other organisations such as the OECD and the Impact Measurement Working Group of the G8 Social Impact Investment Taskforce.
33. From the policy options identified (see Annex III), it seems that the most appropriate approach would be to advise the Commission to adopt proportionate rules on conflicts of interest that are tailored to the specific circumstances of the EuSEF managers and which would create no or very low cost to EuSEF managers, having relatively simple requirements in terms of organisation and administrative procedures.
34. In terms of identification of the conflicts of interest, the EuSEF manager should assess the situation of the persons or entities referred to in Article 9(2) of the EuSEF Regulation: manager, person who effectively conduct the business, employees of, or any person who directly or indirectly controls or is controlled by the EuSEF manager (“relevant person”).
35. The conflicts of interest could be of different types, depending on whether a relevant person:
 - 1) is likely to make a financial gain, or avoid a financial loss, at the expense of the EuSEF or its investors;
 - 2) has an interest in the outcome of a service or an activity provided to the EuSEF or its investors or to a client or of a transaction carried out on behalf of the EuSEF or a client, which is distinct from the EuSEF’s interest in that outcome;
 - 3) has a financial or other incentive to favour:
 - the interest of a client or group of clients or another AIF or a UCITS over the interest of the EuSEF,

- the interest of one investor over the interest of another investor or group of investors in the same EuSEF;
 - 4) carries out the same activities for the EuSEF and for another AIF, UCITS or client; or
 - 5) receives or will receive from a person other than the EuSEF or its investors an inducement in relation to collective portfolio management activities provided to the EuSEF, in the form of monies, goods or services other than the standard commission or fee for that service.
36. As to the steps that the managers should adopt in order to identify, prevent, manage, monitor and disclose the conflicts of interest on an ongoing basis, ESMA advises the Commission to adopt the following standards:
- 1) The EuSEF manager should establish a conflicts of interest policy in writing. The policy should be appropriate to the size and organisation of the EuSEF manager and the nature, scale and complexity of its business. The policy should identify the circumstances that may give rise to a conflict of interest and should include procedures and measures to be adopted in order to prevent, manage and monitor such conflicts.
 - 2) These procedures and measures should be appropriate in the view of the EuSEF manager and could include one or more of the following, as appropriate:
 - (i) preventing the exchange of information between relevant persons where needed;
 - (ii) separating the supervision of relevant persons whose interest may conflict;
 - (iii) removing links in the remuneration of relevant persons engaged in different activities where a conflict may arise;
 - (iv) measures to prevent a relevant person from exercising inappropriate influence over the management of the EuSEF;
 - (v) measures to prevent or control the involvement of a relevant person in different activities where a conflict of interest may arise;
 - (vi) other alternative measures, where appropriate.
 - 3) Where these measures are not sufficient to ensure in a reasonable manner the prevention of the damage caused by conflicts of interest, the senior management of the EuSEF should be informed and take the necessary action to ensure that the EuSEF manager acts in the best interest of the EuSEF or the investors.

37. If, notwithstanding the existence of conflicts of interest that cannot be avoided, the senior management of the EuSEF takes the decision to carry on with the business, the EuSEF manager shall disclose these conflicts promptly to investors prior to undertaking the business on behalf of the fund. In every case, the EuSEF manager shall disclose the general nature or sources of conflicts of interest to investors before undertaking business on their behalf and shall decide whether to include this disclosure in the information that the EuSEF manager has to provide to the investors in accordance with the Article 14 of the EuSEF Regulation.

2.3 Advice on the delegated acts on conflicts of interest of EuSEF managers

Advice on types of conflicts of interest

For the purpose of identifying the types of conflicts of interest that arise in the course of managing a EuSEF, the EuSEF manager shall take into account, in particular, whether any of the relevant persons mentioned in Article 9(2) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds:

- a) is likely to make a financial gain, or avoid a financial loss, at the expense of the EuSEF or its investors;
- b) has an interest in the outcome of a service or an activity provided to the EuSEF or its investors or to a client or of a transaction carried out on behalf of the EuSEF or a client, which is distinct from the EuSEF's interest in that outcome;
- c) has a financial or other incentive to favour:
 - (i) the interest of a client or group of clients or another AIF or a UCITS over the interest of the EuSEF,
 - (ii) the interest of one investor over the interest of another investor or group of investors in the same EuSEF;
- d) carries out the same activities for the EuSEF and for another AIF, UCITS or client;
- e) receives or will receive from a person other than the EuSEF or its investors an inducement in relation to collective portfolio management activities provided to the EuSEF, in the form of monies, goods or services other than the standard commission or fee for that service; or
- f) may be in a position, by virtue of personal interests, to dominate the development of the qualifying portfolio undertaking to the disadvantage of the EuSEF or its investors or at the expense of the achievement of the EuSEF's

social objective.

Advice on the steps to identify, prevent, manage, monitor and disclose the conflicts of interest

1. The EuSEF manager shall establish a conflicts of interest policy in writing.
2. The policy shall be appropriate to the size and organisation of the EuSEF manager and the nature, scale and complexity of its business.
3. The policy shall identify the circumstances that may give rise to a conflict of interest and shall include procedures and measures in order to prevent, manage and monitor such conflicts on an ongoing basis. These measures could include one or more of the following, as appropriate:
 - a) preventing the exchange of information between relevant persons where needed;
 - b) separating the supervision of relevant persons whose interest may conflict;
 - c) removing links in the remuneration of relevant persons engaged in different activities where a conflict may arise;
 - d) measures to prevent a relevant person from exercising inappropriate influence over the management of the EuSEF;
 - e) measures to prevent or control the involvement of a relevant person in different activities where a conflict of interest may arise;
 - f) other alternative measures, where appropriate.
4. Where the measures included in the conflicts of interest policy are not sufficient to ensure in a reasonable manner the prevention of the damages caused by conflicts of interest, the senior management of the EuSEF shall be informed and shall take the necessary action to ensure that the EuSEF manager acts in the best interest of the EuSEF or the investors.
5. If, notwithstanding the existence of conflicts of interest that cannot be avoided the senior management of the EuSEF takes the decision to carry on with the business, the EuSEF manager shall disclose these conflicts promptly to the investors prior to undertaking the business on their behalf. In every case, the EuSEF manager shall disclose the general nature or sources of conflicts of interest to the investors before undertaking business on their behalf.
6. The EuSEF manager may decide to include this disclosure in the information that it has to provide to investors in accordance with Article 14 of Regulation (EU) N. 346/2013, of

17 April 2013, on European Social Entrepreneurship Funds.

3 Delegated acts on conflicts of interest of EuVECA managers

3.1 Legal framework

38. The same rules apply on conflicts of interest for EuVECA managers and for EuSEF managers (Articles 9 of the EuVECA and of the EuSEF Regulations). Like in the case of EuSEF managers, the Commission is empowered to adopt Level 2 measures specifying types of conflicts of interest and the steps that EuVECA managers must take in order to identify, prevent, manage, monitor and disclose the conflicts of interest.

3.2 Indications from the Commission

39. Similarly to the case of EuSEF, the mandate of the Commission notes that EuVECA managers are managed by entities below the threshold in Article 3(2) of the AIFMD, and are therefore simpler structures with less opportunity for confronting many of the conflicts of interest foreseen in Article 14 of the AIFMD and Articles 30 to 37 of the AIFMD Level 2 Regulation. Since the EuVECA qualifying portfolio undertakings are likely to be small in scale and therefore have limited resources, the Commission invites ESMA to take into account the principle of proportionality in the advice, and avoid being burdensome for both the qualifying portfolio undertakings and the EuVECA managers.

3.3 Proposed approach

40. The approach set out in the previous section for EuSEF managers is applicable to the conflicts of interest of EuVECA. However, taking into account that, as part of their business model, EuVECA managers are very active in the management of the companies in which the EuVECA is invested, the specific conflicts of interest arising from this situation should be taken into account. Therefore, the rules on the strategies for the exercise of the voting rights set out in Article 37 of the AIFMD Commission Regulation may be of relevance for the EuVECA managers.

41. In addition to those set out in the previous section, the following conditions could be imposed on EuVECA managers:

- a) First, the EuVECA managers should develop adequate and effective strategies for determining when and how any voting rights held in the EuVECA portfolio are to be exercised, to the exclusive benefit of the EuVECA concerned and its investors.
- b) Second, these strategies should determine measures and procedures for a) monitoring relevant corporate actions, b) ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant

EuVECA and c) preventing or managing any conflicts of interest arising from the exercise of voting rights.

- c) Thirdly, the EuVECA manager should make available to the investors a summary description of the strategies and details of the actions taken on the basis of those strategies.

3.4 Advice on the delegated acts on conflicts of interest of EuVECA managers

Advice on types of conflicts of interest

For the purpose of identifying the types of conflicts of interest that arise in the course of managing a EuVECA, the EuVECA manager shall take into account, in particular, whether any of the relevant persons mentioned in Article 9(2) of the Regulation (EU) N. 345/2013, of 17 April 2013, on European Venture Capital Funds:

- a) is likely to make a financial gain, or avoid a financial loss, at the expense of the EuVECA or its investors;
- b) has an interest in the outcome of a service or an activity provided to the EuVECA or its investors or to a client or of a transaction carried out on behalf of the EuVECA or a client, which is distinct from the EuVECA's interest in that outcome;
- c) has a financial or other incentive to favour:
 - (i) the interest of a client or group of clients or another AIF or a UCITS over the interest of the EuVECA,
 - (ii) the interest of one investor over the interest of another investor or group of investors in the same EuVECA;
- d) carries out the same activities for the EuVECA and for another AIF, UCITS or client; or
- e) receives or will receive from a person other than the EuVECA or its investors an inducement in relation to collective portfolio management activities provided to the EuVECA, in the form of monies, goods or services other than the standard commission or fee for that service

Advice on the steps to identify, prevent, manage, monitor and disclose the conflicts of interest

1. The EuVECA manager shall establish a conflicts of interest policy in writing.
2. The policy shall be appropriate to the size and organisation of the EuVECA manager and

the nature, scale and complexity of its business.

3. The policy shall identify the circumstances that may give rise to a conflict of interest and shall include procedures and measures in order to prevent, manage and monitor such conflicts on an ongoing basis. These measures could include one or more of the following, as appropriate:
 - a) preventing the exchange of information between relevant persons where needed;
 - b) separating the supervision of relevant persons whose interest may conflict;
 - c) removing links in the remuneration of relevant persons engaged in different activities where a conflict may arise;
 - d) measures to prevent a relevant person from exercising inappropriate influence over the management of the EuVECA;
 - e) measures to prevent or control the involvement of a relevant person in different activities where a conflict of interest may arise;
 - f) other alternative measures, where appropriate.
4. Where the measures included in the conflicts of interest policy are not sufficient to ensure in a reasonable manner the prevention of the damage caused by conflicts of interest, the senior management of the EuVECA shall be informed and shall take the necessary action to ensure that the EuVECA manager acts in the best interest of the EuVECA or the investors.
5. If, notwithstanding the existence of conflicts of interest that cannot be avoided, the senior management of the EuVECA takes the decision to carry on with the business, the EuVECA manager shall disclose these promptly to the investors prior to undertaking it on their behalf. In any case, the EuVECA manager shall disclose the general nature or sources of conflicts of interest to investors before undertaking business on their behalf.
6. The EuVECA manager shall decide whether to include this disclosure in the information that it has to provide to investors in accordance with Article 13 of Regulation (EU) N. 345/2013, of 17 April 2013, on European Venture Capital Funds.
7. The EuVECA manager shall develop adequate and effective strategies for determining when and how any voting rights held in the EuVECA portfolio are to be exercised, to the exclusive benefit of the EuVECA concerned and its investors. These strategies should determine measures and procedures for:
 - a) monitoring relevant corporate actions,

- b) ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant EuVECA, and
- c) preventing or managing any conflicts of interest arising from the exercise of voting rights.

8. The EuVECA manager shall make available to the investors on demand a summary description of the strategies and details of the actions taken on the basis of the strategies referred to in paragraph 7.

4 Delegated acts on social impact measurement

4.1 Legal framework

42. Article 10 of the EuSEF Regulation establishes the following:

1. *Managers of a qualifying social entrepreneurship fund 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. The managers shall 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 one or more of the following subjects:*

- a) employment and labour markets;*
- b) standards and rights related to job quality;*
- c) social inclusion and protection of particular groups;*
- d) equal treatment, equal opportunities and non-discrimination;*
- e) public health and safety;*
- f) access to and effects on social protection and on health and educational systems.*

43. Article 10(2) of the EuSEF Regulation empowers the Commission to adopt delegated acts specifying the details of the procedures referred to in Article 10(1), in relation to different qualifying portfolio undertakings.

4.2 Indications from the Commission

44. The Commission indicates in the mandate that any assessment must relate to the stated objective of the qualifying portfolio undertaking invested in. The Commission invites ESMA

to take into account the work carried out by the GECES sub-group on social impact measurement, which received a mandate to develop by the end of 2013 a methodology for measuring the social impact of activities by social enterprises, and other organisations such as the OECD and the Impact Measurement Working Group of the G8 Social Impact Investment Taskforce, by considering the methodologies for measuring social impact set out in the relevant reports.

45. The Commission highlights that the methodologies have to be applied in a proportionate manner that takes account of the wide variety of social businesses and their often small scale and limited resources. The Commission indicates that EuSEF managers should not be required to put unnecessary procedural requirements in place for the qualifying portfolio undertakings they invest in. The Commission notes that the qualifying portfolio undertakings being invested in will be non-financial firms and therefore are unlikely to be familiar with the processes involved in financial regulation.

4.3 Proposed approach

46. There are a number of methods that are widely used for the measurement of the social impact produced by the action of an organisation. The most well known are the Social Return on Investment (SROI)¹¹ and the Impact Reporting and Investment Standards (IRIS)¹².
47. The SROI method, developed in 1997 by the Roberts Enterprise Development Foundation, provides a number of principles and a process for determining which indicators should be used to measure the impact of an organization. The steps of the process are the following:
 - a) Define the scope of the analysis: description of the objectives of the organisation, stakeholders impacted and relationship between the organisation inputs, activities and outcomes for each stakeholder.
 - b) Identify indicators, impact and attribution: set out the indicators to measure the inputs, activities and outcomes, and quantify the impact attributable to the organization.
 - c) Value: assign monetary values to the relevant outcomes where possible and calculate the SROI ratio (impacts divided by the inputs) for these outcomes.
 - d) Manage value: report the impact and develop systems to manage the value created.
48. The IRIS indicators, developed by the Rockefeller Foundation in 2009, provides for a comprehensive set of performance indicators with standardized definitions. The entity

¹¹ <http://www.thesroinetwork.org/>

¹² <http://iris.thegiin.org/>

measuring the impact should choose the most appropriate indicators in view of the activity performed by the social undertaking.

49. It is said that both methods do not compete, but are complementary. In addition, the report of the sub-group of GECES on social impact measurement also refers to those developed by the UK Big Society Capital¹³, the Universal Standards for Social Performance Management¹⁴, the Gamma Model¹⁵, the Implied Impact¹⁶ model, etc¹⁷. In addition, EVPA has developed a Practical Guide to Measuring and Managing Impact¹⁸.
50. The standard developed by GECES in the report involves five stages:¹⁹
- a) *Identify objectives: of the various parties in seeking measurement, and of the service being measured.*
 - b) *Identify stakeholders: who gains and who gives what and how?*
 - c) *Set relevant measurement: the social enterprise will plan its intervention, and how the activity achieves the outcomes and impacts most needed by its beneficiaries and stakeholders. This link from activity to impact is the social enterprise's theory of change. It will decide this, and establish measurement most appropriate to explaining that and the achieved impacts, and will then agree it with major stakeholders.*
 - d) *Measure, validate and value: assessing whether the targeted outcomes are actually achieved in practice, whether they are apparent to the stakeholder intended to benefit, and whether they are valuable to that stakeholder.*
 - e) *Report, learn and improve: as the services are delivered and the measurements of their effectiveness emerge, so these results are reported regularly and meaningfully to internal and external audiences.*
51. ESMA's advice should be consistent with the GECES report on social impact measurement. Therefore, in view of the policy options identified in the cost benefit analysis (see Annex III), ESMA advises the Commission to adopt Level 2 measures providing for a method on social impact measurement with the following steps and characteristics:
- a) In accordance with Article 10 of the EuSEF Regulation, the EuSEF manager should employ procedures to measure the extent to which the social undertakings achieve the social impact to which they are committed.

¹³ <http://www.thinknpc.org/publications/mapping-outcomes-for-social-investment/>

¹⁴ <http://www.sptf.info/spmstandards/universal-standards>

¹⁵ <http://www.iese.edu/en/files2/foc.pdf>

¹⁶ <http://impliedimpact.org/>

¹⁷ GECES report on social impact measurement, pp. 44 – 50

¹⁸ <http://evpa.eu.com/knowledge-centre/publications/evpa-publications/>

¹⁹ GECES report on social impact measurement, p. iii

- b) In accordance with the principle of proportionality, the methodology selected should be adapted to the size of the EuSEF manager and the complexity of its business and of the social undertakings in which the EuSEF invests. The measurements shall be conducted with a view to providing results which are clear, transparent and relevant having regard to the social impact objectives disclosed to the investors
- c) In accordance with Article 14(1)(e) of the EuSEF Regulation, the EuSEF manager has to inform the investors, prior to their investment decision, about the methodologies that will be used to measure social impacts. This could be done in summary form or by reference to a website
- d) Measuring the social impact is the responsibility of the EuSEF manager, but the manager should involve in the process of measurement the social undertakings in which it invests.
- e) The manager shall apply a methodology that follows a process composed by the following stages:
 - 1. The objectives sought should be clearly identified (target beneficiaries, outcomes and activities)
 - 2. The stakeholders (who gains and who gives what) should be identified
 - 3. The relevant measurement of the results should be set in terms of inputs, outputs and outcomes. The EuSEF manager should set relevant indicators of the outcomes achieved and should take into account the following:
 - (i) The *inputs* are the resources with which the social enterprise counts (human, financial, intellectual, buildings, equipment, etc). In the example cited in the GECES report that refers to the provision of home support to help people recover from a stroke²⁰, the inputs would be the funding required to provide therapists, the premises and tools, the time and expertise of the therapists, etc.
 - (ii) The *outputs* are the results of the activity, the tangible products from the activity of the social enterprise (number of people reached, items sold, etc.). In the example cited above, it would be the number of stroke victims seen, number of courses or sessions, number of carers that attended the sessions, etc.
 - (iii) Finally, the *outcomes* are the changes, benefits or effects resulting from the activity of the social enterprise on the target population. In

²⁰ GECES Report, page 17

the example, the outcome would be how the stroke victims are able to change their behaviours as a result of the activity in order to recover more quickly. This may lead to less burden on the State in providing financial support for their care or to some of them being able to re-join the workforce, or do so more quickly, etc.

4. The outcomes should be measured: the EuSEF manager should assess whether the targeted outcomes are actually achieved in practice. The evidence needs to be proportionate in terms of cost, accuracy and detail. In addition, where possible and appropriate, it should be assessed to which extent the outcomes are attributable to the specific activities delivered by the enterprise. The outcomes should be adjusted to remove what would have happened anyway, the effect of the involvement of others, and any reduction of the effect over time. In this way stakeholders can evaluate the contribution of the activities to achieve the identified outcomes, and for how long that effect may last.

The EuSEF manager should ensure that the measurement is based on sufficiently sound evidence. This could be achieved through an internal (or outsourced) process of validation with appropriate supporting evidence or as a result of a third party providing independent review or audit assurance.

5. The results of the impact measurement should be reported: as the services are delivered and the measurements of their effectiveness emerge, the results should be reported regularly, in a transparent and clear manner. The reporting enables, firstly, the social enterprise to learn and improve the services provided, secondly, the EuSEF manager to consider whether the investment objectives are being achieved and, thirdly, the investors to assess the outcome of their investment and, eventually, to reconsider it.
- f) Where the EuSEF manager decides to follow a generally accepted methodology, such as the IRIS, the SROI, or any other mentioned in the GECES report, it shall be deemed compliant with the Regulation provided that the methodology follows the steps described above.
 - g) The EuSEF documentation (including constitutional documents or subscription documents) shall provide information on the periodicity, content and format of the reporting. However, the manager should comply, at least, with the following disclosure obligations:
 - (i) First, where pertinent (i.e. in case the investment targets have been identified), the EuSEF manager has to inform the investors about the

positive social outcomes being targeted by the EuSEF, including, where relevant, information on past performance in this area.

- (ii) Second, in accordance with Article 13 of the EuSEF Regulation, the EuSEF manager has to provide an annual report to the authority and the investors. In this report, the EuSEF manager should include information on the overall social outcomes achieved by the investment policy and the method used to measure those outcomes (paragraph 2(a) of Article 13).

4.4 Advice on the Level 2 measures on social impact measurement

1. The EuSEF manager shall employ procedures to measure the extent to which the qualifying portfolio undertakings achieve the social impact to which they are committed.
2. According to the principle of proportionality, the methodology selected shall be adapted to the size of the EuSEF manager, and the complexity of its business and of the qualifying portfolio undertakings in which the EuSEF invests.
3. The measurement shall be performed by the EuSEF manager itself or by third parties, including the qualified portfolio undertakings themselves. The EuSEF manager shall ensure that the relevant stakeholders, in particular the qualifying portfolio undertakings, are involved in the measurement process, by agreeing with the qualifying portfolio undertaking the measurement to be applied.
4. The measurements shall be conducted with a view to providing results which are clear, transparent and relevant having regard to the social impact objectives disclosed to the investors.
5. The EuSEF manager shall inform investors, prior to their investment decision, about the methodologies that it uses to measure social impacts. This could be done in summary form or by reference to a website.
6. The manager shall ensure that the methodology chosen in order to measure the social impact of the qualified portfolio undertakings follows these steps:
 - a) The objectives sought shall be clearly identified (target beneficiaries, outcomes and activities)
 - b) The stakeholders shall be identified
 - c) The relevant measurement of the results shall be set in terms of inputs, outputs and outcomes. The EuSEF manager shall set relevant indicators of the outcomes achieved and should take into account the following:
 - (i) The *inputs* are the resources with which the qualifying portfolio

undertaking counts (human, financial, intellectual, buildings, equipment, etc)

(ii) The *outputs* are the results of the activity, the tangible products from the activity of the qualifying portfolio undertaking (number of people reached, items sold, etc)

(iii) Finally, the *outcomes* are the changes, benefits or effects resulting from the activity of the qualifying portfolio undertaking on the target population.

d) The outcomes shall be measured. For this purpose, the manager shall use reasonable efforts to, where possible and appropriate:

(i) assess to which extent the outcomes are attributable to the specific activities delivered by the enterprise;

(ii) adjust the outcomes to remove what would have happened anyway, the effect of the involvement of others, and any reduction of the effect over time; and

(iii) ensure that there is proportional evidence underpinning the assessment, either through an internal (or outsourced) process of validation with appropriate supporting evidence or as a result of a third party independent review or audit assurance.

e) The results of the impact measurement shall be reported in a transparent and clear manner.

7. Where the EuSEF manager decides to follow a generally accepted methodology it shall be deemed compliant with the requirement set out in Article 10 of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds, provided that the methodology follows the steps described in the paragraph above.

8. The EuSEF documentation (including constitutional documents or subscription documents) shall provide information on the periodicity, content and format of the reporting. The EuSEF manager shall:

a) where pertinent, such as in cases where the investment targets have been identified, inform the investors about the positive social outcomes being targeted by the EuSEF and about the past performance in this area, if available, in accordance with Article 14(1)(d) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.

b) include information on the overall social outcomes achieved by the investment policy

and the method used to measure those outcomes in the annual report produced in accordance with Article 13 of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.

5 Delegated acts on information to EuSEF investors

5.1 Legal framework

52. Article 14 of the EuSEF Regulation establishes the following:

1. Managers of qualifying social entrepreneurship funds shall, in relation to the qualifying social entrepreneurship funds that they manage, inform their investors, prior to the investment decision of the latter, in a clear and understandable manner, of the following:

- a) the identity of that manager and of any other service providers contracted by that manager in relation to their management, and a description of their duties;*
- b) the amount of own funds available to that manager, as well as a detailed statement as to why that manager considers that amount to be sufficient for maintaining the adequate human and technical resources necessary for the proper management of its qualifying social entrepreneurship funds;*
- c) a description of the investment strategy and objectives of the qualifying social entrepreneurship fund, including:
 - (i) the types of qualifying portfolio undertakings in which it intends to invest;*
 - (ii) any other qualifying social entrepreneurship fund in which it intends to invest;*
 - (iii) the types of qualifying portfolio undertakings in which any other qualifying social entrepreneurship fund, as referred to in point (ii), intends to invest;*
 - (iv) the non-qualifying investments which it intends to make;*
 - (v) the techniques that it intends to employ; and*
 - (vi) any applicable investment restrictions;**

- d) *the positive social impact being targeted by the investment policy of the qualifying social entrepreneurship fund, including, where relevant, projections of such outcomes as may be reasonable, and information on past performance in this area;*
- e) *the methodologies to be used to measure social impacts;*
- f) *a description of the assets other than qualifying portfolio undertakings and the process and the criteria which are used for selecting these assets unless they are cash or cash equivalents;*
- g) *a description of the risk profile of the qualifying social entrepreneurship fund and any risks associated with the assets in which the fund may invest or the investment techniques that may be employed;*
- h) *a description of the qualifying social entrepreneurship fund's valuation procedure and of the pricing methodology for valuing assets, including the methods used for valuing qualifying portfolio undertakings;*
- i) *a description of how the remuneration of the manager of a qualifying social entrepreneurship fund is calculated;*
- j) *a description of all relevant costs and of the maximum amounts thereof;*
- k) *where available, the historical financial performance of the qualifying social entrepreneurship fund;*
- l) *the business support services and the other support activities the manager of a qualifying social entrepreneurship fund is providing or arranging through third parties in order to facilitate the development, growth or in some other respect the ongoing operations of the qualifying portfolio undertakings in which the qualifying social entrepreneurship fund invests, or, where these services or activities are not provided, an explanation of that fact;*
- m) *a description of the procedures by which the qualifying social entrepreneurship fund may change its investment strategy or investment policy, or both.*

2. *All of the information referred to in paragraph 1 shall be fair, clear and not misleading. It shall be kept up-to-date and reviewed regularly where relevant.*

3. *Where the manager of a qualifying social entrepreneurship fund is required to publish a prospectus in accordance with Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading (1) or in accordance with national law in relation to the qualifying social entrepreneurship fund, the information referred to in paragraph 1 of this Article may be provided separately or as a part of the prospectus.*

53. Article 14(4) of the EuSEF empowers the Commission to adopt delegated acts specifying:
- a) the content of the information referred to in points (c) to (f) and (l) of paragraph 1 of Article 14;
 - b) how the information as referred to in points (c) to (f) and (l) of paragraph 1 of Article 14 can be presented in a uniform way in order to ensure the highest possible level of comparability.

5.2 Indications from the Commission

54. The Commission indicates that ESMA's advice should consider the level of detail required to ensure that potential investors have a clear and understandable description of the risks inherent in a particular EuSEF. The Commission points out that some of the methodologies used will be non-financial in nature and so may pose different challenges in their explanation. The Commission invites ESMA to consider whether it would be appropriate to use formulations for social impact measurement used in the work carried out by the GECES and, in particular, the report by the GECES sub-group on social impact measurement.
55. The Commission invites ESMA to take into account that, first, EuSEF are available to both institutional and high net worth investors and, second, where it is relevant, a Key Information Document will be provided pursuant to the PRIIPs Regulation.²¹

5.3 Proposed approach

56. ESMA must give advice on the content of the pre-contractual information that the EuSEF manager has to provide to investors in respect to the following aspects:
- a) Investment strategy and objectives(Article 14(1)(c)), including:
 - (i) types of qualifying portfolio undertakings that will be targeted;
 - (ii) other EuSEF it intends to invest in and the types of EuSEF invested in by that fund;
 - (iii) non-qualifying investments that the EuSEF intends to make;
 - (iv) the investment techniques it will use; and
 - (v) any investment restrictions it has in place.

²¹ It should be noted that a KID would be provided when advising or selling a EuSEF to a retail client (so in effect only for sales to the HNW individuals referred to in Article 6 of the EuSEF Regulation).

- b) The positive social impact targeted including, where relevant, projections of such outcome and information on past performance and description of the methodologies to be used to measure social impact (Article 14(1)(d) and (e)).
- c) The non-qualifying assets held by the EuSEF and the process and the criteria used for selecting these assets (unless these are cash or cash equivalents) (Article 14(1)(f)).
- d) The support that the EuSEF manager provides or facilitates for the development, growth or the on-going operations of the social enterprise in which the EuSEF has invested. The EuSEF manager should explain in case it does not provide these support services to the social enterprises (Article 14(1)(l)).

57. The advice is the following:

- a) Information on the investment strategy and objectives (Article 14(1)(c) of the EuSEF Regulation)
 - (i) With regard to the types of qualifying portfolio undertaking that will be targeted by the EuSEF (Article 14(1)(c)(i) of the EuSEF Regulation), the information provided by the manager should help the investor form a clear picture of the target companies, where possible. In particular, the EuSEF manager should indicate:
 - 1. The sector or sectors where the target enterprises are active
 - 2. The geographical area where the target enterprises carry out their activities
 - 3. The sector of the society to which the activity of the target companies is addressed
 - 4. Whether these enterprises have a specific legal form (public limited company, limited liability company, cooperatives, foundations, NGO, etc)
 - (ii) Where the EuSEF intends to invest in other EuSEF (Article 14(1)(c)(ii) of the EuSEF Regulation), the EuSEF manager shall describe the profile of the target EuSEF.
 - (iii) With regard to the non-qualifying investments that the EuSEF intends to make (Article 14(1)(c)(iv) of the EuSEF Regulation), the EuSEF manager should inform investors about the type of assets, investment techniques and any applicable investment restrictions.

- (iv) The EuSEF manager should inform in general terms about the investment techniques that the EuSEF intends to use (Article 14(1)(c)(v) of the EuSEF regulation), i.e. whether it intends to use equity instruments, quasi-equity instruments, securitised or unsecuritised debt instruments, secured or unsecured loans or any other type of participation in the qualifying portfolio enterprise. It should also provide information on whether the EuSEF investment strategy envisages any investment restriction (Article 14(1)(c)(vi) of the EuSEF Regulation), in terms of sectors, activities or geographical areas excluded, investment percentages, limits or any other restrictions.
- b) With regard to the information on the positive social impact targeted (Article 14(1)(d) of the EuSEF Regulation), the EuSEF manager should provide investors with information about the objectives pursued by the EuSEF manager in terms of social impact foreseen in a clear and understandable manner.
- c) Where the EuSEF offered to the investor has a recorded performance in terms of social impact (Article 14(1)(d) *in fine* of the EuSEF Regulation), the EuSEF manager should provide to the investors either a copy of the last annual report or a summary of the relevant information reported in the annual report in accordance with Article 13(2)(a) of the EuSEF Regulation.
- d) With regard to the methodologies for measuring the social impact (Article 14(1)(e) of the EuSEF Regulation), the EuSEF manager should inform the investors about the methodology applied, as discussed in the previous section of this consultation paper.
- e) With regard to the description of the non-qualifying assets other than cash or cash equivalents that it intends to hold and the process for selecting those non-qualifying assets (Article 14(1)(f)), the information should serve to reassure investors that the EuSEF manager selects the non-qualifying assets in a manner that is consistent with the general investment policy of the EuSEF. For this reason, the EuSEF manager should specify the following:
 - The types of financial instrument and other assets that it holds in the EuSEF portfolio, which could account for no more than 30% of the aggregate capital contributions and uncalled committed capital of the EuSEF, as set out in Article 3(1)(b)(ii) of the EuSEF Regulation. This should not include holdings in cash or cash equivalents;²²

²² It is proposed that the term “cash or cash equivalents” be defined in the advice in a manner that is consistent with Guidelines on reporting obligations under Articles 3(3)(d) and 24(1), (2) and (4) of the AIFMD i.e. include exposures to cash and cash-equivalent asset classes, such as certificates of deposit, banker’s acceptances and similar instruments held for investment purposes that do not provide a return greater than a 3-month high credit quality government bond (see page 36 of [ESMA/2013/1339 \(revised\)](#))

- The sector or sectors of activity of the companies to which the non-qualifying assets refer;
 - The geographical area where the companies to which the non-qualifying assets refer carry out their activities;
 - The process and criteria used for selecting the non-qualifying assets.
- f) With regard to the description of the support services (Article 14(1)(l)), the EuSEF manager should specify the following
- (i) Indication of the types of support services that the EuSEF manager intends to provide to the social enterprise:
 1. Advisory
 2. Resources
 3. Monitoring of the development and guidance
 4. Training
 5. Material support (hubs, enterprise incubators, accelerators)
 6. Networking
 7. Legal support
 8. Others (describe)
 - (ii) The EuSEF manager should inform investors if the support services are totally or partially provided by third parties.
 - (iii) In case the EuSEF manager does not provide these services to the social enterprises in which it the EuSEF invests, the manager should specify this to the investor and should explain the reasons behind this decision.

5.4 Advice on the delegated acts on information to EuSEF investors

1. The information that the EuSEF manager shall provide to the investors in accordance with Article 14 of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds, shall include the elements set out in the following paragraphs.
2. The information about the investment strategy and objectives, required under Article 14(1)(c), shall include:

- a) With regard to the types of qualifying portfolio undertakings in which the EuSEF intends to invest:
 - (i) The social sector or sectors where the qualifying portfolio undertakings are active
 - (ii) The geographical area where the qualifying portfolio undertakings carry out their activities
 - (iii) The sector of the society to which the activity of the qualifying portfolio undertakings is addressed
 - (iv) Whether the qualifying portfolio undertakings limit the investment targets to companies with specific legal forms (public limited company, limited liability company, cooperatives, foundations, NGO, other)
 - b) With regard to the other EuSEF in which the EuSEF intends to invest and the qualifying portfolio undertakings in which these are invested, the EuSEF manager shall describe the profile of the target EuSEF.
 - c) With regard to the non-qualifying investments that the EuSEF intends to make, the EuSEF manager shall provide information on the type of assets, investment techniques and any applicable investment restrictions.
 - d) With regard to the investment techniques that the EuSEF intends to employ, the EuSEF manager shall inform in general terms, whether it intends to use equity instruments, quasi-equity instruments, securitised or unsecuritised debt instruments, secured or unsecured loans or any other type of participation in the qualifying portfolio enterprise. It shall inform whether the EuSEF investment strategy envisages any investment restriction, in terms of sectors, activities or geographical areas excluded, investment percentages, limits or any other restrictions.
3. The information on the positive social impact targeted and the projections of such outcomes required under the Article 14(1)(d) shall be presented in a clear and understandable manner, and shall include:
- a) the objectives pursued by the EuSEF manager in terms of social impact foreseen;
 - b) the periodicity in which EuSEF manager will report about the social impact achieved by the qualified portfolio undertakings; and
 - c) where the EuSEF has a recorded performance in terms of social impact, a

copy of the last annual report or a summary of the relevant information reported in the annual report in accordance with the Article 13(2)(a) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.

4. The information on the methodologies for measuring the social impact required under the Article 14(1)(e) shall describe in a clear and understandable manner the methodology applied by the EuSEF manager.
5. The description of the non-qualifying assets other than cash or cash equivalents that the EuSEF manager intends to hold and the process for selecting those non-qualifying assets, required by the Article 14(1)(f), shall specify the following:
 - a) The types of financial instrument and other assets that are held in the EuSEF portfolio;
 - b) The sector or sectors of activity of the companies to which the non-qualifying assets refer;
 - c) The geographical area where the companies to which the non-qualifying assets refer carry out their activities;
 - d) The process and criteria used for selecting the non-qualifying assets.
6. The information about the business support services and other support activities required under the Article 14(1)(l), shall specify the following:
 - a) whether the EuSEF manager provides these services to the qualifying portfolio undertakings. In case the manager does not provide these support services, it shall explain the reasons behind the choice not to provide capacity building services.
 - b) Indication of the types of support services that the EuSEF manager intends to provide to the qualifying portfolio undertaking. These could be advisory services, consultancy, resources, development monitoring, guidance, training, material support (hubs, enterprise incubators, accelerators), networking, legal support, or others;
 - c) whether the support services are totally or partially provided by third parties.



6 Grandfathering provisions

58. Finally, it should be noted that, at the date of issuance of this advice, a number of EuVECA and EuSEF are already registered in different EU Member States. Therefore, the Commission may wish to consider the introduction of a grandfathering clause.

Annex I – Commission mandate to provide technical advice

Request to ESMA for Technical Advice on Possible Delegated Acts concerning the Regulation on European social entrepreneurship funds and the Regulation on European venture capital funds

I. Introduction

The services of the European Commission (hereafter, the Commission) request ESMA's advice on the content of the delegated acts to be adopted pursuant to Article 3(2), Article 9(5), Article 10(2) and Article 14(4) of Regulation (EU) No 346/2013 on European social entrepreneurship funds (EuSEF). The Commission also requests ESMA's advice on Article 9(5) of Regulation (EU) No 345 on European venture capital funds (EuVECA).

The Articles mentioned above do not have specific deadlines for the delivery of delegated acts. But it is important that harmonised standards for the operation of EuSEF and EuVECA are put in place as soon as possible. The Commission requests that ESMA delivers its advice by 31 January 2015.

The Commission invites ESMA, in relation to EuSEF, to take into account the work carried out by the Commission's expert group on social business and the report from its sub-group on social impact measurement.

In accordance with the principles of Better Regulation the Commission must provide an impact assessment to accompany delegated acts. ESMA is requested, in addition to the advice on the content of the delegated acts, to justify its advice. This should include an identification of the range of policy options with an assessment of the costs and benefits of each. The results of this assessment should be submitted at the same time as the advice.

In the interest of transparency, the Commission will publish this request for advice on the DG Internal Market and Services website once it has been sent to ESMA.

II. Request to ESMA for Technical Advice on Possible Delegated Acts concerning the Regulation on European social entrepreneurship funds

1. Article 3(2) EuSEF – goods and services and methods of production with social impacts

I. Background

ESMA is requested to provide advice on delegated acts defining the goods and services or methods of production of goods and services that embody a social objective. This supports the requirement that qualifying portfolio undertakings must have the achievement of a measurable social impact as their primary goals.

II. Scope of the Commission's delegated powers

Article 3(2): The Commission shall be empowered to adopt delegated acts, specifying the types of services or goods and the methods of production of services or goods that embody a social objective referred to in point (ii) of point (d) of paragraph 1 of Article 3 of EuSEF, taking into account the different kinds of qualifying portfolio undertakings and those circumstances in which profits can be distributed to owners and investors.

III. Excerpt from level 1 text

Article 3 (1) of EuSEF

[...]

(d) 'qualifying portfolio undertaking' means an undertaking that:

(ii) has the achievement of measurable, positive social impacts as its primary objective in accordance with its articles of association, statutes or any other rules or instruments of incorporation establishing the business, where the undertaking:

- provides services or goods to vulnerable or marginalised, disadvantaged or excluded persons,*
- employs a method of production of goods or services that embodies its social objective, or*
- provides financial support exclusively to social undertakings as defined in the first two indents;*

IV. Questions and issues to be addressed

EuSEF managers need clarity as to what constitutes goods and services or methods of production of them that meet this requirement. ESMA is requested to provide advice in relation to:

1. Goods and services to vulnerable or marginalised, disadvantaged or excluded persons.
2. Methods of production that embody a social objective.
3. Financial support for the above two issues.

In giving its advice ESMA will consider the difference between intending to achieve of these impacts as the primary goal of a qualifying portfolio undertaking compared with the incidental emergence of such an outcome. Similarly, a distinction must be made between an intended social impact and adherence to a plan for Corporate Social Responsibility implemented by undertakings that do not have social impact as their primary goal.

ESMA's advice should also take into account the work carried out by the Commission's expert group on social business (GECES) and in particular the report by the GECES sub-group on social impact measurement. ESMA should also take into account other sources of relevant information from organisations such as the OECD and the Impact Measurement Working Group of the G8 Social Impact Investment Taskforce.

ESMA should recognise the need for proportionality in its advice, in particular recognising that the qualifying portfolio undertakings are likely to be small in scale and therefore have limited resources.

Any advice should therefore avoid being burdensome in nature for both the underlying qualifying portfolio undertakings as well as for the EuSEF managers themselves.

2. Article 9(5) EuSEF– conflicts of interest

I. Background

ESMA is requested to provide advice on delegated acts to:

- a) specify in detail the nature and risks posed by the conflicts of interest listed in Article 9(2) of EuSEF; and
- b) set out requirements for the operation of the internal governance, operational and administrative systems needed for EuSEF managers to be able to identify, prevent, manage, monitor and disclose conflicts of interest.

II. Scope of the Commission's delegated powers

Article 9(5): The Commission shall be empowered to adopt delegated acts specifying:

- a) the types of conflicts of interest referred to in Article 9(2) of EuSEF;
- b) the steps that managers of a qualifying social entrepreneurship fund must take, in terms of structures and organisational and administrative procedures, in order to identify, prevent, manage, monitor and disclose conflicts of interest.

III. Excerpt from level 1 text:

Article 9 of EuSEF

1. Managers of qualifying social entrepreneurship funds shall identify and avoid conflicts of interest and, where they cannot be avoided, manage and monitor and, in accordance with paragraph 4, disclose those conflicts of interest promptly in order to prevent them from adversely affecting the interests of the qualifying social entrepreneurship funds and the investors therein and to ensure that the qualifying social entrepreneurship funds that they manage are fairly treated.

2. Managers of qualifying social entrepreneurship funds shall identify in particular those conflicts of interest that may arise between:

- a) *managers of qualifying social entrepreneurship funds, persons who effectively conduct the business of those managers, employees of, or any person who directly or indirectly controls or is controlled by, those managers, and the qualifying social entrepreneurship fund managed by those managers, or the investors therein;*
- b) *a qualifying social entrepreneurship fund or the investors therein, and another qualifying social entrepreneurship fund managed by the same manager, or the investors therein;*
- c) *the qualifying social entrepreneurship fund or the investors therein, and a collective investment undertaking or UCITS managed by the same manager, or the investors therein.*

3. Managers of qualifying social entrepreneurship funds shall maintain and operate effective organisational and administrative arrangements in order to comply with the requirements laid down in paragraphs 1 and 2.

4. Disclosures of conflicts of interest as referred to in paragraph 1 shall be provided, where organisational arrangements made by a manager of a qualifying social entrepreneurship fund to identify, prevent, manage and monitor conflicts of interest are not sufficient to ensure, with

reasonable confidence, that risks of damage to investors' interests will be prevented. A manager of a qualifying social entrepreneurship fund shall disclose in clear terms the general nature or sources of conflicts of interest to the investors before undertaking business on their behalf. [...]

IV. Questions and issues to be addressed

ESMA's advice should take into account the fact that although EuSEF are alternative investment funds, they are managed by entities below the threshold set out in Article 3(2) of Directive 2011/61/EU. They will by virtue of this regulation have a simpler structure with less opportunity for many of the types of conflicts of interest foreseen in Article 14 of Directive 2011/61/EU and Commission Delegated Regulation (EU) No 231/2013 Articles 30 to 37.

In doing this it should also recognise the need for proportionality in its advice, in particular recognising that the qualifying portfolio undertakings are likely to be small in scale and therefore have limited resources. Any advice should therefore avoid being burdensome in nature for both the underlying qualifying portfolio undertakings as well as for the EuSEF managers themselves.

It should also take into account the work carried out by the GECES and in particular the report by the GECES sub-group on social impact measurement and other organisations such as the OECD and the Impact Measurement Working Group of the G8 Social Impact Investment Taskforce. ESMA should also take into consideration expected small size of EuSEF so that its advice follows the principle of proportionality in relation to both the fund manager and the social enterprises being invested in.

3. Article 10(2)EuSEF – social impact measurement

I. Background

ESMA is requested to give advice on delegated acts to specify the details of procedures on how EuSEF managers will assess whether the qualifying portfolio undertakings they invest in achieve their stated social impacts. The assessments procedures have to be clear and transparent. They must also be proportionate, recognising the size and what will often be limited resources of the undertakings invested in.

II. Scope of the Commission's delegated powers

Article 10(2): The Commission shall be empowered to adopt delegated acts specifying the details of the procedures referred to in Article 10 (1) of EuSEF, in relation to different qualifying portfolio undertakings.

III. Excerpt from level 1 text

Article 10 of EuSEF

1. Managers of a qualifying social entrepreneurship fund 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. The managers shall 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 one or more of the following subjects:

- a) employment and labour markets;*
- b) standards and rights related to job quality;*
- c) social inclusion and protection of particular groups;*
- d) equal treatment, equal opportunities and non-discrimination;*
- e) public health and safety;*
- f) access to and effects on social protection and on health and educational systems.*

[...]

IV. Questions and issues to be addressed

Any assessment must relate to the stated objective on the qualifying portfolio undertaking invested in. ESMA's advice should take into account the work carried out by the GECES subgroup on social impact measurement and other organisations such as the OECD and the Impact Measurement Working Group of the G8 Social Impact Investment Taskforce. In particular ESMA should consider the methodologies for measuring social impact set out in the relevant reports. In doing so ESMA should consider not only the methodologies themselves but also the need for them to be applied in a proportionate manner that take account of the wide variety of social businesses and their often small scale and limited resources. In particular it should ensure that EuSEF managers are not required to put unnecessary procedural requirements in place for the qualifying portfolio undertakings they invest in. This should also take account of the fact that the qualifying portfolio undertakings being invested in will be non-financial firms and so are unlikely to be familiar with the processes involved in financial regulation.

4. Article 14(4) EuSEF – information to investors

I. Background

ESMA is requested to provide advice on delegated acts in relation to the following information that must be disclosed by EuSEF managers to investors before they commit their money. ESMA must also give advice on how this information is to be set out in a clear, understandable and uniform manner. ESMA must give advice on information given on how EuSEF set out the objectives of the fund and the investment strategy to achieve this. This must give information on the types of qualifying portfolio undertakings that will be targeted; and other EuSEF it intends to invest in and in turn the types of EuSEF invested in by that fund; the non-qualifying investments it plans to hold; the investment techniques it will use and any investment restrictions it has in place.

Advice is required on information on the investment policy of the EuSEF and where it is relevant, projections of expected performance or outcomes as well as past performance if it is reasonable to do so.

ESMA must also give advice on the information given on the methodologies used to measure social impacts. It must also give advice on how the EuSEF describes non-qualifying assets other than cash or cash equivalents that it intends to hold and the process for selecting those non-qualifying assets. Where a EuSEF provides business or other types of support directly or via third parties to help the qualify portfolio undertakings it invests in, this must be explained. ESMA must give advice on the contents of this explanation.

II. Scope of the Commission's delegated powers

Article 14(4): The Commission shall be empowered to adopt delegated acts specifying:

- a) the content of the information referred to in points (c) to (f) and (l) of paragraph 1 of Article 14 of EuSEF;
- b) how the information as referred to in points (c) to (f) and (l) of paragraph 1 of Article 14 can be presented in a uniform way in order to ensure the highest possible level of comparability.

III. Level 1 text

Article 14 of EuSEF

1. Managers of qualifying social entrepreneurship funds shall, in relation to the qualifying social entrepreneurship funds that they manage, inform their investors, prior to the investment decision of the latter, in a clear and understandable manner, of the following:

(c) a description of the investment strategy and objectives of the qualifying social entrepreneurship fund, including:

- (i) the types of qualifying portfolio undertakings in which it intends to invest;*
- (ii) any other qualifying social entrepreneurship fund in which it intends to invest;*
- (iii) the types of qualifying portfolio undertakings in which any other qualifying social entrepreneurship fund, as referred to in point (ii), intends to invest;*
- (iv) the non-qualifying investments which it intends to make;*
- (v) the techniques that it intends to employ; and*
- (vi) any applicable investment restrictions;*

(d) the positive social impact being targeted by the investment policy of the qualifying social entrepreneurship fund, including, where relevant, projections of such outcomes as may be reasonable, and information on past performance in this area;

(e) the methodologies to be used to measure social impacts;

(f) a description of the assets other than qualifying portfolio undertakings and the process and the criteria which are used for selecting these assets unless they are cash or cash equivalents;

(l) the business support services and the other support activities the manager of a qualifying social entrepreneurship fund is providing or arranging through third parties in order to facilitate the development, growth or in some other respect the ongoing operations of the qualifying portfolio undertakings in which the qualifying social entrepreneurship fund invests, or, where these services or activities are not provided, an explanation of that fact;

[...]

IV. Questions and issues to be addressed

ESMA's advice should consider level of detail required to ensure potential investors have clear and understandable description of the risks inherent in a particular EuSEF. It should recognise that some of the methodologies used will be non-financial in nature and so may pose different challenges in their explanation. ESMA should therefore consider whether it would be appropriate

to use formulations for social impact measurement used in the work carried out by the GECES and in particular the report by the GECES sub-group on social impact measurement.

EuSEF are available to both institutional and high net worth individual investors. ESMA's advice should take account of this and, where it is relevant, the fact that a Key Information Document under the key Information for Packaged Retail Insurance-based and Investment Products regulation, will be provided.

III. Request to ESMA for Technical Advice on Possible Delegated Acts concerning the Regulation on European venture capital funds

Article 9(5) EuVECA – conflicts of interest

I. Background

Article 9(5) – conflicts of interest. ESMA is requested to provide advice on delegated acts to:

- a) specify in detail the nature and risks posed by the conflicts of interest listed in Article 9(2) of EuVECA; and
- b) set out requirements for the operation of the internal governance, operational and administrative systems needed for EuVECA managers to be able to identify, prevent, manage, monitor and disclose conflicts of interest.

II. Scope of the Commission's delegated powers

Article 9(5): The Commission shall be empowered to adopt delegated acts specifying:

- a) the types of conflicts of interest referred to in Article 9 (2) of EuVECA;
- b) the steps that managers of qualifying venture capital funds must take, in terms of structures and organisational and administrative procedures in order to identify, prevent, manage, monitor and disclose conflicts of interest.

III. Level 1 text

Article 9 of EuVECA

[...]

2. Managers of qualifying venture capital funds shall identify in particular those conflicts of interest that may arise between:

- a) managers of qualifying venture capital funds, persons who effectively conduct the business of those managers, employees of, or any person who directly or indirectly controls or is controlled by, those managers, and the qualifying venture capital fund managed by those managers, or the investors therein;*
- b) the qualifying venture capital fund or the investors therein, and another qualifying venture capital fund managed by the same manager, or the investors therein;*
- c) the qualifying venture capital fund or the investors therein, and a collective investment undertaking or UCITS managed by the same manager, or the investors therein.*

[...]

IV. Questions and issues to be addressed



ESMA's advice should take into account the fact that although EuVECA are alternative investment funds, they are managed by entities below the threshold set out in Article 3(2) of Directive 2011/61/EU. They will by virtue of this regulation have a simpler structure with less opportunity for many of the types of conflicts of interest foreseen in Article 14 of Directive 2011/61/EU and Commission Delegated Regulation (EU) No 231/2013 Articles 30 to 37.

In doing this it should also recognise the need for proportionality in its advice, in particular recognising that the qualifying portfolio undertakings are likely to be small in scale and therefore have limited resources. Any advice should therefore avoid being burdensome in nature for both the underlying qualifying portfolio undertakings as well as for the EuVECA managers themselves.

Annex II – Cost-benefit analysis

I. Size of the industry

1. The data available show that the funds investing in social enterprises represent a small portion of the asset management industry. A recent study by the Global Impact Investing Network (GIIN) identifies \$46 billion invested in impact investments²³, 58% of which is proprietary capital and 42% managed on behalf of clients²⁴. In the EU, the European Venture Philanthropy Association (EVPA) reports €2.5 billion invested in venture philanthropy and social investment²⁵. In the impact assessment report of the EuSEF proposal, the Commission cites a report of J. P. Morgan where it is suggested that social investments could grow rapidly to become a market well in excess of EUR 100 billion²⁶.
2. To date (7 January 2015) there are only three EuSEF registered in ESMA's central database²⁷. The German BonVenture Management GmbH has two EuSEF: the BonVenture Management GmbH & Co. KG and MRI-Pilotfonds GmbH & Co. KG and the French fund managed by Phitrust Partenaires. ESMA is aware that there may be other EuSEF funds in the pipeline.
3. Preliminary data that shows that asset managers and venture philanthropy organisations manage around 110 impact funds in the EU. This means that the number of registered EuSEF could increase in the future.
4. So far there are 15 EuVECA managers registered in ESMA's central database, marketing 25 EuVECA in the EU Member States. The number of registered managers and funds are likely to increase in the future.

II. Examples of social enterprises

5. As background for this cost benefit analysis, it is useful to consider some concrete examples of social enterprises. The following are mentioned in the impact assessment made by the Commission for the purposes of the EuSEF proposal:
 - In Italy, a medical centre provides high-level specialised assistance to people in need (immigrants for example), particularly in areas poorly served by public services.

²³ Impact investments are investments made into companies, organizations, and funds with the intention to generate measurable social and environmental impact alongside a financial return (<http://www.thegiin.org/cgi-bin/iowa/home/index.html>)

²⁴ *Spotlight on the Market*. Research report released by J.P. Morgan and the GIIN in January 2014. <http://www.thegiin.org/binary-data/2014MarketSpotlight.PDF>

²⁵ EVPA's annual survey of European Venture Philanthropy and Social Investment (2012-2013). <http://evpa.eu.com/knowledge-centre/publications/evpa-publications/>. The report defines venture philanthropy as follows: "Venture philanthropy works to build stronger investee organisations with a societal purpose (SPOs) by providing them with both financial and non-financial support in order to increase their societal impact. The venture philanthropy approach includes the use of the entire spectrum of financing instruments (grants, equity, debt, etc.), and pays particular attention to the ultimate objective of achieving societal impact. The key characteristics of venture philanthropy include high engagement, organisational capacity-building, tailored financing, non-financial support, involvement of networks, multi-year support and performance measurement."

²⁶ J.P.Morgan, *Impact Investments: An Emerging Asset Class*, 2011

²⁷ <http://www.esma.europa.eu/page/Venture-Capital-and-Social-Entrepreneurship-Funds>

- In Romania, a company with five members of staff and five volunteers has been working since 1996 to provide cultural services in the Romanian language to approximately 90 000 blind people by adapting media (especially audio books and films) to their needs.
- In 2004, in France, a business launched an innovative concept of water-free car washing services by using biodegradable products and employing unqualified or marginalised staff in order to reintegrate them in the labour market.
- In Hungary, a foundation set up a restaurant employing disabled staff (40 employees) and provided them with training and childcare to ensure the transition to stable employment.
- In The Netherlands, a company teaches reading using innovative digital tools and a method based on playing. This method is particularly suitable for hyperactive or autistic children but can also be used for illiterate people and immigrants.
- In Poland, a social cooperative comprising two associations employs long-term unemployed and disabled staff. It provides a variety of services: catering and food services, small construction and handicraft jobs and employability training for disadvantaged people.
- In Germany, a business organizes exhibitions and business workshops in total darkness. Blind guides lead attendees through a completely dark environment, where they learn to interact by relying on other senses than sight.
- In Denmark, a business exclusively hires employees with autism spectrum disorder (ASD). The business' objective is to tailor a working environment for specialist people such as people with ASD in order to let them solve valuable tasks for the business sector at market terms.
- In some jurisdictions specific legal forms have been developed so as to aid wider steps to support such enterprises, such as 'Impresa a Finalità Sociale' in Italy, or a 'Community Interest Company' in the UK.

6. In addition, ESMA has come across the following examples of social enterprises:

- [Trampolin Solidario](#) (Tenerife, Spain) is a company that produces organic agriculture by employing people at high risk of exclusion.
- [Banco Inovação social](#) (Portugal) is an initiative launched by "Santa Casa de Misericórdia", an long-established Portuguese charity, as a platform to support social innovation in Portugal. The BIS invests in social business and promotes impact investments.

- [Quid](#) (Italy) is a company that employs disadvantaged women in order to produce fashion dresses recycling leftovers clothes from big fashion firms like Inditex, Intimissimi, etc.
- [Urban Farm Lease](#) (Belgium) is a start-up that intends to re-use big unexploited green spaces in Brussels to produce organic farming.
- [Voidstarter](#) (Ireland) is a company that employs the long-term unemployed to transform abandoned houses in Dublin into hubs for co-working and incubators for start-ups.
- [Huertos de Soria](#) (Soria, Spain) is a social enterprise that employs mentally handicapped people working the land. They sell the products that they grow employing environmental friendly techniques. The company is successful and has plans to expand.
- [La Exclusiva](#) (Soria, Spain) is a social enterprise that sells basic products in small towns in Soria (Soria is a rural region with high levels of depopulation and an ageing population in small, remote villages with inadequate infrastructure). By getting reduced prices on products from the supplier (Leclerc), La Exclusiva can sell them to the elderly in these villages (where there are no shops), at a profit. The elderly population receives very valuable services and improves their standard of living, because for many of them it is very difficult to drive to the regional capital to buy basic products.
- [Adapt](#) (UK) is an organisation for persons with disabilities who provide community transport for a wide range of people, undertaking home-to-school contracts for children with disabilities, and dial-a-ride shopping services for the elderly. It is financed by Big Issue Investment.
- [Birtenshaw](#) (UK) is a charity that provides high-quality services to children with physical and learning disabilities. It is financed by Big Issue Investment.
- [Charity Technology Trust](#) (UK) is a commercially run, IT systems integration business that takes pro-bono or discounted products and services from the IT sector and packages them into value standard product offerings for charities with the aim of improving the quality and efficiency of their operations. It is financed by Big Issue Investment.
- [Social Integration Enterprises](#) are an example of social enterprises.

III. Policy options

1 Options for the advice on the types of goods and services or methods of production for goods and services embodying a social objective

1.1 Policy options

7. Three policy options were identified:

- Option 1. ESMA could propose to the Commission a closed-ended list of goods and services provided by the social enterprises, methods of production employed and financial support provided by the social enterprises.
- Option 2. ESMA could suggest to the Commission an indicative list of goods and services provided by the social enterprises, methods of production employed and financial support provided by the social enterprises. This would be an open-ended list that would not necessarily exclude from the scope of the Regulation goods, services, methods of production and financial support activities other than those reflected in the list.
- Option 3. ESMA could propose to the Commission a number of high-level principles that could be applied to different enterprises in order to determine whether the goods and services they provide, the methods of production that they apply or the financial support provided embed a social objective.

1.2 The likely impacts

1.2.1 Costs

8. Option 1. This option seems too rigid an approach. As the list of examples of social enterprises at the beginning of this cost benefit analysis shows, social enterprises cover a wide range of activities and the social impact that they seek is varied. It is difficult to develop in the Level 2 measures a fully exhaustive list of goods, services and methods of production that embed the social objective. With such an approach, new or innovative social enterprises that do not fit within the original list would risk being unduly excluded from the scope of the EuSEF Regulation. Narrowing in such a manner the range of undertakings in which EuSEF can invest as part of the core investment is likely to constitute a serious obstacle for the viability of the industry and could hinder the whole purpose of the EuSEF Regulation.
9. Option 2. An open-ended list of goods, services, methods and financial activities of the social enterprises provides for a lower level of legal certainty and raises the question of whether the request of the EuSEF Regulation is addressed in a satisfactory manner, since many social undertakings may develop strategies that do not fall within any of the goods, services, methods and financial activities listed of the list.
10. Option 3. The downside of this option is that it leaves to each EuSEF and NCA a margin of discretion when deciding what is social, which ultimately could lead to an inconsistent application of the Regulation within the EU.

1.2.2 Benefits

11. Option 1. This option would be optimal in terms of harmonisation of EU rules and would provide for a high level of legal certainty. The EuSEF industry would enjoy an optimal level of clarity in terms of identifying whether an undertaking would qualify as social and, as a consequence, the EuSEF could safely count the investment as part of the 70% of qualified investments set out in the Article 3(1)(b)(1) of the EuSEF Regulation.
12. Option 2. While providing for some degree of legal certainty, this option also seems to be more flexible than the previous one, since it would not exclude social undertakings that are not reflected in the list.
13. Option 3. This option has the advantage of being flexible and potentially encompassing the widest possible population of social enterprises, including those with innovative and creative strategies. At the same time this option provides for a clear framework capable of differentiating a social enterprise from entities that do not have this dimension.

1.3 Policy choice

14. ESMA is of the view that the preferable solution would be a combination of the second and third options. In this manner the necessary flexibility provided by the third option would be supplemented with the benefit of legal certainty afforded by the indicative list of goods and services provided by the social enterprises, methods of production employed and financial support provided by the social enterprises.
15. As to the list of high level principles, ESMA considered whether the advice should provide for a more precise definition of the addressees of the goods or services to be produced by the social undertaking in accordance with the first indent of Article 3(1)(d)(ii) of the EuSEF regulation, which refers to situations of exclusion, disadvantage, marginalisation and persons that are vulnerable. Taking into account the sensitivity of the task and the complexity of the endeavour due to the lack of a harmonised framework of these concepts in the different Member States, ESMA concluded that it would not be appropriate to define these situations in the implementing measures of the EuSEF Regulation.
16. Following the feedback received in the consultation, ESMA decided to introduce the following aspects:
 - The advice underlines some of the elements of the definition of social enterprise definition set out in the Social Business Initiative of the European Commission. In particular, the text reflects the fact that the social mission should be at the core of the enterprise and that the distribution of profits should not undermine the achievement of the social mission that is at the heart of the social enterprises. Both aspects, therefore, should be reflected in the articles of association, statutes or instruments of incorporation establishing the social enterprises.

- To stress its open and indicative character, the list of services and activities provided by the social enterprises has been moved to an annex.
- The services include also those that, being addressed to the public in general, have a pre-emptive purpose (i.e., the purpose is to avoid a potential problem in the future).
- It is clarified that, where the activity of the enterprise concerns environmental protection, this activity should aim at having a societal impact.

2 Options for the advice on conflicts of interest of EuSEF managers

2.1 Policy options

17. Two options were identified:

- Option 1. ESMA could advise the Commission to impose on EuSEF managers the rules on conflicts of interest set out in Articles 30 to 37 of the Commission delegated Regulation (EU) No 231/2013 (the AIFMD Level 2 Regulation).
- Option 2. ESMA could produce a proportionate advice, tailored to the particular types of conflict of interest that could be present in EuSEF structures, with relatively simple requirements in terms of organisation and administrative procedures. These requirements should not generate high costs for the EuSEF managers.

2.2 The likely impacts

2.2.1 Costs

18. Option 1. This option would impose very burdensome requirements on the EuSEF managers. The rules on conflicts of interest in the AIFMD Level 2 Regulation are devised for entities with a significant size (those above the AIFMD threshold of €500 M). In view of their nature and size, it does not seem proportionate to apply these rules to the EuVECA and EuSEF managers.
19. Option 2. This option may also lead to costs for EuSEF managers (albeit at a lower level than under option 1).

2.2.2 Benefits

20. Option 1. This option would ensure that the highest policy standards in terms of management of conflicts of interest that are currently applicable to asset managers in the EU would be extended to EuSEF managers.
21. Option 2. This option fits better with the size of the typical EuSEF manager and the nature of their activity, because these requirements should not generate high costs for the EuSEF managers.

2.3 Policy choice

22. In view of the relevant costs, the size of the industry and the nature of the activity of the managers and applying the principle of proportionality, the second option seems to be more appropriate. The actual impact of implementing this option depends on how much this will change the internal policies and behaviour of EuSEF managers, which itself depends on whether the EuSEF manager already applies the proposed rules or similar ones, or whether these are required at national level. No relevant input was received on this point in the consultation.

3 Options for the advice on conflicts of interest for EuVECA managers

3.1 Policy options

23. Two options were identified:

- Option 1. Apply to EuVECA managers the same rules as those proposed for EuSEF managers.
- Option 2. Apply to EuVECA managers specific rules on conflicts of interest that may emerge in the management of the companies in the portfolio of the EuVECA.

3.2 The likely impacts

3.2.1 Costs

24. Option 1. This option would generate for the EuVECA manager the same costs as the ones generated for the EuSEF managers by the approach described under the previous section.

25. Option 2. As a consequence of the additional requirements, this option is likely to generate slightly higher costs for the EuVECA manager.

3.2.2 Benefits

26. Option 1. This option would ensure consistency in the implementation of the conflicts of interest rules of the EuSEF and EuVECA Regulations. This is likely to facilitate the operations of managers that manage both types of funds.

27. Option 2. The burden generated by this option is proportionate, since the specific obligations can be seen as a mere extension of the requirement of having an appropriate conflicts of interest policy, which in any event the EuVECA manager has to develop and apply. The existence of specific rules on conflicts of interest in the management of the EuVECA portfolio companies would ensure that those conflicts of interest would be properly addressed by the manager and, thus, the interest of the EuVECA and its investors would be better protected.

3.3 Policy choice

28. Taking into account that the proposal from ESMA is to have similar rules on conflicts of interest for the EuSEF and EuVECA managers, the considerations made in the previous section apply here. As in the previous case, no relevant input was received on this point in the consultation.
29. Concerning the issue of whether to propose specific rules for the management of conflicts of interest that could be generated in the management of the EuVECA portfolio companies, option 2 looks more appropriate. This option is preferable because it would ensure a better management of those conflicts and, thus, the interests of the EuVECA and the investors would be better safeguarded.

4 Options for the advice on social impact measurement

4.1 Policy options

30. The following policy options were identified:

- Option 1. Require the EuSEF manager to measure the impact in accordance with a specific methodology that is widely accepted.
- Option 2. Require the EuSEF manager to measure the impact in accordance with the steps and characteristics of the method described in the relevant section of the consultation paper.

4.2 The likely impacts

4.2.1 Costs

31. Option 1. This option would require a significant effort of adaptation and important costs for those EuSEF managers and social enterprises that do not apply the specific selected methodology. In addition, taking into account the diversity of social enterprises, the methodology chosen may not prove appropriate for measuring properly the social impact of all the social enterprises. This could result in artificial and non-meaningful measurement.
32. Option 2. This option would require the EuSEF managers and social enterprises that already apply a generally accepted methodology to review their methodology in order to ensure that it is consistent with the steps and characteristics described in the relevant section of the consultation paper.

4.2.2 Benefits

33. Option 1. This option would ensure that all the EuSEF managers and the social enterprises apply the same standards in terms of impact measurement. Therefore, stakeholders, (particularly investors) would be able to compare the results more easily.

34. Option 2. This option provides for a flexible, non-prescriptive arrangement that permits the adaptation of the methodology to the different situations and activities performed by the social enterprises.

4.3 Policy choice

35. The GECES sub-group recognises that some of these methods for social impact measurement are becoming more widely used than others. Regarding the development of a single, universally-applicable standard, GECES considers that 'one size does not fit all', stating:

"It is unlikely that any [of the methods] will become a 'gold standard' since diversity of social need, intervention, scale, and stakeholder interest demand different information and presentation of it."

In addition, the GECES expresses "a strong scepticism towards the idea that social impacts might be summarised in one single measure capable of supporting fair and objective comparisons between different types of enterprise and different types of social impact."

36. Despite the absence of such a 'gold standard', GECES points out that there is agreement among the different stakeholders on the main steps of the process that should constitute the basis for any measurement of social impact. "These steps involve, broadly, identifying clearly the social impact sought, the stakeholders impacted, a "theory of change" for social impact, putting in place a precise and transparent procedure for measuring and reporting on inputs, outputs, outcomes and for assessing thereby the impact actually achieved, followed by a 'learning' step to improve impacts and refine the process. This is recognised as an iterative process."²⁸
37. GECES proposes, therefore, a standard for the measurement of the social impact that balances the need for sound information with the need for proportionality and practicality, because "there is little point setting measurement standards that are excessively costly to meet, or are impractical in requiring so complex an analysis that it cannot be supported by information from the social enterprise and its beneficiaries. The other key aspect of the social business environment across Member States that has been important to address has been the sector's diversity. Whatever standard is set, it must meet the needs of large as well as small social enterprises, those operating across a wide range of social needs and interventions, and Member States with public funding and infrastructure that is experienced in this field, to those where it is new and still being developed and understood."²⁹
38. For these reasons, the preferred option is option 2. However, EuSEF managers and the social enterprises could combine both options. A EuSEF manager could use a measurement method widely used insofar as this method is applied following the steps and the characteristics of the process described in the relevant section of the consultation paper.

²⁸ GECES Report, p. 10

²⁹ Idem. p.iii

39. In light of the input received during the consultation, ESMA has introduced a number of small changes in the text of the initial proposal in order to make sure that the requirements are proportionate and to avoid overburdening the EuSEF managers. For instance, it has been clarified that the EuSEF manager should provide information to investors about the positive social outcome being targeted where this is pertinent, e.g. in cases where the manager has identified the investment targets.

5 Options for the advice on information to EuSEF investors

5.1 Policy options

40. The main issues considered by ESMA were the following:

- a) First, in case the support services are provided to the portfolio companies by a third party, it was discussed whether the EuSEF has to disclose to the investors the identity of these third parties. There are two policy options:
 - (i) Option 1. The EuSEF manager should disclose to the investors the identity of the service providers.
 - (ii) Option 2. It should suffice if the EuSEF manager informs that the support services would or may be provided by third parties, without necessarily disclosing their identity.
- b) Second, in case the EuSEF manager does not provide any support service to the portfolio companies, it was discussed whether it should explain to the investors the reasons for not doing so. There are two policy options:
 - (i) Option 1. The EuSEF manager should disclose to the investors the reasons for not providing support services to the portfolio companies.
 - (ii) Option 2. It should suffice if the EuSEF manager informs investors that it does not intend to provide support services to the portfolio companies.
- c) Finally, ESMA considered whether there was merit in advising the Commission to develop a model or a template that the EuSEF managers could use when providing to investors the information required by letters (c) to (f) and (l) of Article 14(1) of the EuSEF Regulation. ESMA identified two policy options:
 - (i) Option 1. Develop a common template for the provision of the information.
 - (ii) Option 2. Do not develop such a template.

5.2 The likely impacts

5.2.1 Costs

41. The following costs have been identified:

- a) Disclosure of the identity of the third parties that provide support services:
 - (i) Option 1. This option requires the manager to provide longer explanations in the disclosure material. In addition, it imposes an additional burden because the EuSEF manager will have to adapt the disclosure materials in case there is a change in the identity of the suppliers of the support services (in accordance with Article 14(2) of the EuSEF Regulation, the information shall be kept up-to-date and reviewed regularly).
 - (ii) Option 2. This option provides less detailed information to the investors.
- b) Type of explanation in case the EuSEF manager does not provide support services to the portfolio companies:
 - (i) Option 1. As in the case of option 1 under the previous point, the manager will have to provide longer explanations in the disclosure material and will have to remain attentive in order to adapt the disclosure materials in case there is a change in the information provided.
 - (ii) Option 2. Similarly, this option provides less detailed information to the investors.
- c) Development of a model for the information:
 - (i) Option 1. This option would require EuSEF managers to adapt their reporting standards in order to fit with the model.
 - (ii) Option 2. EuSEF managers will provide the same information, but in different formats. This is likely to result in more complex for the investors that intend to compare the information referred to different EuSEFs.

5.2.2 Benefits

42. The following benefits have been identified:

- a) Disclosure of the identity of the third parties that provide support services:
 - (i) Option 1. EuSEF investors will get more insightful information concerning the identity and capacity of the third parties that provide the support services to the portfolio company. This may be important information for a number of investors in order to take the investment decision.
 - (ii) Option 2. This option is simpler and would alleviate the requirements imposed on EuSEF managers. It would also be a flexible solution because

it does not prevent EuSEF managers from providing more detailed information to the investors concerning the providers of the support services, if they wish to do so.

b) Type of explanation in case the EuSEF manager does not provide support services to the portfolio companies:

- (i) Option 1. EuSEF investors will get better and more precise information as to the involvement of the EuSEF manager in the activity of the portfolio company. Investors may also wish to understand why the EuSEF manager does not provide any support services to the portfolio companies.
- (ii) Option 2. This option is simpler since it imposes fewer burdens on the EuSEF manager. Investors will get the essential information, which is whether the EuSEF manager provides support services or not.

c) Development of a model for the information:

- (i) Option 1. EuSEF managers will benefit from the existence of common guidance on the presentation of the information. EuSEF investors will also benefit from greater comparability between the different EuSEF investment proposals.
- (ii) Option 2. The EuSEF investors will receive the same information, but in different formats. This will permit EuSEF managers to provide the information following their own models of disclosure. This will create more challenges for investors seeking to compare different proposals. However, this option is positive for the EuSEF managers because they would save the cost of having to adapt their own models to the common template.

5.3 Policy choice

43. The following are the preferred options:

- a) Disclosure of the identity of third party service providers: option 2 seems to be more flexible and less cumbersome for the EuSEF manager. At the same time, it should be noted that EuSEF managers willing to expand and provide more detailed information, as identified in option 1, will be perfectly entitled to do so.
- b) Type of explanation in case the EuSEF manager does not provide support services to the portfolio companies: ESMA initially considered that option 2 represents a simpler and more flexible approach, and therefore was more appropriate. In addition, this option does not prevent the EuSEF manager expanding the relevant explanation in the way it is described in option 1.

However, in line with the input received during the consultation, in particular, the opinion of the experts during the open hearing held in EMSA on 10 November 2014, it was decided that option 1 is preferable, because it is more in line with the spirit and purpose of the EuSEF Regulation.

- c) Development of a model of the information: whereas there could be merit in producing a common model or template for the provision of the information to investors, in view of the small number of EuSEF managers at present, option 2 seems to be more appropriate. In addition, it should be noted that the AIFMD does not require the information to investors to be presented in a uniform manner (Article 23(5) and Articles 108 and 109 of the AIFMD Level 2 Regulation).

Annex III – Technical advice

1 Advice to the Commission on the delegated acts concerning the specification of the definition of qualifying portfolio undertaking

1. The EuSEF manager shall take into account the conditions established in the following paragraphs in order to consider that an enterprise qualifies as a portfolio undertaking, as defined in Article 3(1)(d) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.
2. The primary purpose of the enterprise, irrespective of the legal form it adopts, shall be to address a social problem. The social mission of the enterprise should be the basis of its activities and it should be secured in its articles of association, statutes, or any other rules or instruments of incorporation establishing the business.
3. The enterprise shall use its profits primarily to achieve its social objective. The articles of association, statutes, or any other rules or instruments of incorporation establishing the business shall determine the circumstances in which profits are distributed to shareholders and owners to ensure that any such distribution does not undermine its primary purpose.
4. Ordinary companies having a positive social or environmental impact, including a Corporate Social Responsibility plan, that is nevertheless incidental to their commercial activities shall not be accepted as qualifying portfolio undertakings.
5. The goods or services produced shall be addressed primarily to persons that are in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable. The EuSEF manager shall assess on a case by case basis whether the addressees of the goods or services provided by the qualifying portfolio undertaking can be identified as being in a situation of exclusion, disadvantage or marginalisation, or as being vulnerable, in accordance with the general meaning of these situations.
6. The qualifying portfolio undertaking may produce goods or services that are not necessarily addressed to persons in situation of exclusion, disadvantage, marginalisation or that are vulnerable, as defined in paragraph 3, insofar as the primary purpose of the enterprise is to produce a positive social impact by other means. In particular, the qualifying portfolio undertaking may apply methods of production that embody a social objective. These could be the case in the following, non-exhaustive circumstances:
 - e. Where the main purpose of the enterprise is to provide the persons that are in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable, as described in paragraph 5, with a job, or to integrate these persons in whatever way with the labour force. Where this happens incidentally, but not as the main purpose of the enterprise, the enterprise shall not be deemed as a qualifying portfolio undertaking.

- f. Where the enterprise provides goods or services directed at total populations having a pre-emptive purpose, i.e., aiming at reducing the possibility of the appearance of damage in the future. These could include, but are not limited to, the following: early childhood education and care, active employment, health education and disease prevention and life-long learning.
- g. The activity of the enterprise concerns environmental protection with societal impact.
- h. The enterprise provides financial support solely to other qualifying portfolio undertakings. This includes, but is not limited to, the following entities: credit institutions, investment funds, special purpose vehicles, crowdfunding platforms, micro-finance institutions, social investment finance intermediaries and community development finance institutions.

2 Advice on the delegated acts on conflicts of interest of EuSEF managers

2.1 Advice on types of conflicts of interest

For the purpose of identifying the types of conflicts of interest that arise in the course of managing a EuSEF, the EuSEF manager shall take into account, in particular, whether any of the relevant persons mentioned in Article 9(2) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds:

- a) is likely to make a financial gain, or avoid a financial loss, at the expense of the EuSEF or its investors;
- b) has an interest in the outcome of a service or an activity provided to the EuSEF or its investors or to a client or of a transaction carried out on behalf of the EuSEF or a client, which is distinct from the EuSEF's interest in that outcome;
- c) has a financial or other incentive to favour:
 - (i) the interest of a client or group of clients or another AIF or a UCITS over the interest of the EuSEF,
 - (ii) the interest of one investor over the interest of another investor or group of investors in the same EuSEF;
- d) carries out the same activities for the EuSEF and for another AIF, UCITS or client;
- e) receives or will receive from a person other than the EuSEF or its investors an inducement in relation to collective portfolio management activities provided to the EuSEF, in the form of monies, goods or services other than the standard commission or fee for that service; or

- f) may be in a position, by virtue of personal interests, to dominate the development of the qualifying portfolio undertaking to the disadvantage of the EuSEF or its investors or at the expense of the achievement of the EuSEF's social objective.

2.2 Advice on the steps to identify, prevent, manage, monitor and disclose the conflicts of interest

1. The EuSEF manager shall establish a conflicts of interest policy in writing.
2. The policy shall be appropriate to the size and organisation of the EuSEF manager and the nature, scale and complexity of its business.
3. The policy shall identify the circumstances that may give rise to a conflict of interest and shall include procedures and measures in order to prevent, manage and monitor such conflicts on an ongoing basis. These measures could include one or more of the following, as appropriate:
 - a) preventing the exchange of information between relevant persons where needed;
 - b) separating the supervision of relevant persons whose interest may conflict;
 - c) removing links in the remuneration of relevant persons engaged in different activities where a conflict may arise;
 - d) measures to prevent a relevant person from exercising inappropriate influence over the management of the EuSEF;
 - e) measures to prevent or control the involvement of a relevant person in different activities where a conflict of interest may arise;
 - f) other alternative measures, where appropriate.
4. Where the measures included in the conflicts of interest policy are not sufficient to ensure in a reasonable manner the prevention of the damages caused by conflicts of interest, the senior management of the EuSEF shall be informed and shall take the necessary action to ensure that the EuSEF manager acts in the best interest of the EuSEF or the investors.
5. If, notwithstanding the existence of conflicts of interest that cannot be avoided the senior management of the EuSEF takes the decision to carry on with the business, the EuSEF manager shall disclose these conflicts promptly to the investors prior to undertaking the business on their behalf. In every case, the EuSEF manager shall disclose the general nature or sources of conflicts of interest to the investors before undertaking business on their behalf.

6. The EuSEF manager may decide to include this disclosure in the information that it has to provide to investors in accordance with Article 14 of Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.

3 Advice on the delegated acts on conflicts of interest of EuVECA managers

3.1 Advice on types of conflicts of interest

For the purpose of identifying the types of conflicts of interest that arise in the course of managing a EuVECA, the EuVECA manager shall take into account, in particular, whether any of the relevant persons mentioned in Article 9(2) of the Regulation (EU) N. 345/2013, of 17 April 2013, on European Venture Capital Funds:

- a) is likely to make a financial gain, or avoid a financial loss, at the expense of the EuVECA or its investors;
- b) has an interest in the outcome of a service or an activity provided to the EuVECA or its investors or to a client or of a transaction carried out on behalf of the EuVECA or a client, which is distinct from the EuVECA's interest in that outcome;
- c) has a financial or other incentive to favour:
 - (i) the interest of a client or group of clients or another AIF or a UCITS over the interest of the EuVECA,
 - (ii) the interest of one investor over the interest of another investor or group of investors in the same EuVECA;
- d) carries out the same activities for the EuVECA and for another AIF, UCITS or client; or
- e) receives or will receive from a person other than the EuVECA or its investors an inducement in relation to collective portfolio management activities provided to the EuVECA, in the form of monies, goods or services other than the standard commission or fee for that service

3.2 Advice on the steps to identify, prevent, manage, monitor and disclose the conflicts of interest

1. The EuVECA manager shall establish a conflicts of interest policy in writing.
2. The policy shall be appropriate to the size and organisation of the EuVECA manager and the nature, scale and complexity of its business.
3. The policy shall identify the circumstances that may give rise to a conflict of interest and shall include procedures and measures in order to prevent, manage and monitor such

conflicts on an ongoing basis. These measures could include one or more of the following, as appropriate:

- a) preventing the exchange of information between relevant persons where needed;
 - b) separating the supervision of relevant persons whose interest may conflict;
 - c) removing links in the remuneration of relevant persons engaged in different activities where a conflict may arise;
 - d) measures to prevent a relevant person from exercising inappropriate influence over the management of the EuVECA;
 - e) measures to prevent or control the involvement of a relevant person in different activities where a conflict of interest may arise;
 - f) other alternative measures, where appropriate.
4. Where the measures included in the conflicts of interest policy are not sufficient to ensure in a reasonable manner the prevention of the damage caused by conflicts of interest, the senior management of the EuVECA shall be informed and shall take the necessary action to ensure that the EuVECA manager acts in the best interest of the EuVECA or the investors.
 5. If, notwithstanding the existence of conflicts of interest that cannot be avoided, the senior management of the EuVECA takes the decision to carry on with the business, the EuVECA manager shall disclose these promptly to the investors prior to undertaking it on their behalf. In any case, the EuVECA manager shall disclose the general nature or sources of conflicts of interest to investors before undertaking business on their behalf.
 6. The EuVECA manager shall decide whether to include this disclosure in the information that it has to provide to investors in accordance with Article 13 of Regulation (EU) N. 345/2013, of 17 April 2013, on European Venture Capital Funds.
 7. The EuVECA manager shall develop adequate and effective strategies for determining when and how any voting rights held in the EuVECA portfolio are to be exercised, to the exclusive benefit of the EuVECA concerned and its investors. These strategies should determine measures and procedures for:
 - a) monitoring relevant corporate actions,
 - b) ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant EuVECA, and
 - c) preventing or managing any conflicts of interest arising from the exercise of voting rights.

8. The EuVECA manager shall make available to the investors on demand a summary description of the strategies and details of the actions taken on the basis of the strategies referred to in paragraph 7.

4 Advice on the delegated acts on social impact measurement

1. The EuSEF manager shall employ procedures to measure the extent to which the qualifying portfolio undertakings achieve the social impact to which they are committed.
2. According to the principle of proportionality, the methodology selected shall be adapted to the size of the EuSEF manager, and the complexity of its business and of the qualifying portfolio undertakings in which the EuSEF invests.
3. The measurement shall be performed by the EuSEF manager itself or by third parties, including the qualified portfolio undertakings themselves. The EuSEF manager shall ensure that the relevant stakeholders, in particular the qualifying portfolio undertakings, are involved in the measurement process, by agreeing with the qualifying portfolio undertaking the measurement to be applied.
4. The measurements shall be conducted with a view to providing results which are clear, transparent and relevant having regard to the social impact objectives disclosed to the investors.
5. The EuSEF manager shall inform investors, prior to their investment decision, about the methodologies that it uses to measure social impacts. This could be done in summary form or by reference to a website.
6. The manager shall ensure that the methodology chosen in order to measure the social impact of the qualified portfolio undertakings follows these steps:
 - a) The objectives sought shall be clearly identified (target beneficiaries, outcomes and activities)
 - b) The stakeholders shall be identified
 - c) The relevant measurement of the results shall be set in terms of inputs, outputs and outcomes. The EuSEF manager shall set relevant indicators of the outcomes achieved and should take into account the following:
 - (i) The *inputs* are the resources with which the qualifying portfolio undertaking counts (human, financial, intellectual, buildings, equipment, etc)
 - (ii) The *outputs* are the results of the activity, the tangible products from the activity of the qualifying portfolio undertaking (number of people reached, items sold, etc)

- (iii) Finally, the *outcomes* are the changes, benefits or effects resulting from the activity of the qualifying portfolio undertaking on the target population.
 - d) The outcomes shall be measured. For this purpose, the manager shall use reasonable efforts to, where possible and appropriate:
 - (i) assess to which extent the outcomes are attributable to the specific activities delivered by the enterprise;
 - (ii) adjust the outcomes to remove what would have happened anyway, the effect of the involvement of others, and any reduction of the effect over time; and
 - (iii) ensure that there is proportional evidence underpinning the assessment, either through an internal (or outsourced) process of validation with appropriate supporting evidence or as a result of a third party independent review or audit assurance.
 - e) The results of the impact measurement shall be reported in a transparent and clear manner.
7. Where the EuSEF manager decides to follow a generally accepted methodology it shall be deemed compliant with the requirement set out in Article 10 of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds, provided that the methodology follows the steps described in the paragraph above.
8. The EuSEF documentation (including constitutional documents or subscription documents) shall provide information on the periodicity, content and format of the reporting. The EuSEF manager shall:
- a) where pertinent, such as in cases where the investment targets have been identified, inform the investors about the positive social outcomes being targeted by the EuSEF and about the past performance in this area, if available, in accordance with Article 14(1)(d) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.
 - b) include information on the overall social outcomes achieved by the investment policy and the method used to measure those outcomes in the annual report produced in accordance with Article 13 of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.

5 Advice on the delegated acts on information to EuSEF investors

1. The information that the EuSEF manager shall provide to the investors in accordance with Article 14 of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds, shall include the elements set out in the following paragraphs.
2. The information about the investment strategy and objectives, required under Article 14(1)(c), shall include:
 - a) With regard to the types of qualifying portfolio undertakings in which the EuSEF intends to invest:
 - (i) The social sector or sectors where the qualifying portfolio undertakings are active
 - (ii) The geographical area where the qualifying portfolio undertakings carry out their activities
 - (iii) The sector of the society to which the activity of the qualifying portfolio undertakings is addressed
 - (iv) Whether the qualifying portfolio undertakings limit the investment targets to companies with specific legal forms (public limited company, limited liability company, cooperatives, foundations, NGO, other)
 - b) With regard to the other EuSEF in which the EuSEF intends to invest and the qualifying portfolio undertakings in which these are invested, the EuSEF manager shall describe the profile of the target EuSEF.
 - c) With regard to the non-qualifying investments that the EuSEF intends to make, the EuSEF manager shall provide information on the type of assets, investment techniques and any applicable investment restrictions.
 - d) With regard to the investment techniques that the EuSEF intends to employ, the EuSEF manager shall inform in general terms, whether it intends to use equity instruments, quasi-equity instruments, securitised or unsecuritised debt instruments, secured or unsecured loans or any other type of participation in the qualifying portfolio enterprise. It shall inform whether the EuSEF investment strategy envisages any investment restriction, in terms of sectors, activities or geographical areas excluded, investment percentages, limits or any other restrictions.
3. The information on the positive social impact targeted and the projections of such outcomes required under the Article 14(1)(d) shall be presented in a clear and understandable manner, and shall include:
 - a) the objectives pursued by the EuSEF manager in terms of social impact foreseen;

- b) the periodicity in which EuSEF manager will report about the social impact achieved by the qualified portfolio undertakings; and
 - c) where the EuSEF has a recorded performance in terms of social impact, a copy of the last annual report or a summary of the relevant information reported in the annual report in accordance with the Article 13(2)(a) of the Regulation (EU) N. 346/2013, of 17 April 2013, on European Social Entrepreneurship Funds.
4. The information on the methodologies for measuring the social impact required under the Article 14(1)(e) shall describe in a clear and understandable manner the methodology applied by the EuSEF manager.
5. The description of the non-qualifying assets other than cash or cash equivalents that the EuSEF manager intends to hold and the process for selecting those non-qualifying assets, required by the Article 14(1)(f), shall specify the following:
- a) The types of financial instrument and other assets that are held in the EuSEF portfolio;
 - b) The sector or sectors of activity of the companies to which the non-qualifying assets refer;
 - c) The geographical area where the companies to which the non-qualifying assets refer carry out their activities;
 - d) The process and criteria used for selecting the non-qualifying assets.
6. The information about the business support services and other support activities required under the Article 14(1)(l), shall specify the following:
- a) Whether the EuSEF manager provides these services to the qualifying portfolio undertakings. In case the manager does not provide these support services, it shall explain the reasons behind the choice not to provide capacity building services.
 - b) Indication of the types of support services that the EuSEF manager intends to provide to the qualifying portfolio undertaking. These could be advisory services, consultancy, resources, development monitoring, guidance, training, material support (hubs, enterprise incubators, accelerators), networking, legal support, or others;
 - c) Whether the support services are totally or partially provided by third parties.

Annex – Indicative list of examples of (i) persons that are in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable (ii) goods or services provided by the qualifying portfolio undertaking

The following examples are merely indicative. Social enterprises may address new or emerging categories of people at risk of exclusion or could develop innovative products, services and organisational models that are not included in these lists. Therefore, the examples are non-exhaustive.

Indicative examples of persons that are in a situation of exclusion, disadvantage or marginalisation, or that are vulnerable:

These include, but are not limited to, the following persons: economically disadvantaged persons or communities, the homeless, persons with disabilities, the long-term unemployed, convicts, ex-convicts, non-integrated immigrant populations, people or communities that are discriminated against for racial, political, religious, cultural or gender reasons, minorities, children, the elderly and sick persons, isolated communities, persons with addiction problems, underqualified persons, etc.

Indicative examples of goods or services provided by the qualifying portfolio undertaking:

These may include, but are not limited to, the following: access to clean water, education, energy, financial services or information; active inclusion (including through cultural activities and language courses); affordable housing; programmes for people with learning or physical disabilities; agricultural productivity; active inclusion; capacity-building; community development; conflict resolution; disease-specific prevention and mitigation; early child education and care; employability; employment generation; equality and empowerment; food banks; food security; generate funds for charitable giving; health improvement; human capital (skills update/re-orientation/upgrade); human rights protection or expansion; medicine banks; migrants' integration and palliative care.

Annex IV – Opinion of ESMA’s Securities and Markets Stakeholder Group

ADVICE TO ESMA

Securities and Markets Stakeholder Group –

Advice on Consultation Paper – Draft Technical Advice on the implementing measures of the Regulations on European Social Entrepreneurship Funds (EuSEF) and European Venture Capital Funds (EuVECA)

I. Executive summary

The objective of this paper is to provide high level advice to ESMA on the Consultation Paper – Draft Technical Advice on the implementing measures of the Regulations 346/2013 on European Social Entrepreneurship Funds (EuSEF) and 345/2013 on European Venture Capital Funds (EuVECA). ESMA is required to provide such technical advice by 30 April 2015 to the European Commission as per their request on 27 May 2014.

The SMSG very much appreciates the opportunity to comment on this consultation paper. While the four areas of advice specifically addressed by the consultation paper are in themselves relatively straightforward and largely uncontroversial the SMSG would like to call ESMA’s attention to the following general key considerations when finalizing its advice:

- While both the EuVECA and EuSEF regulations and hence registrations are voluntary and not mandatory they in many cases provide the only opportunity for EU-based smaller managers of qualifying venture capital and/or social entrepreneurship funds to market these funds cross-border to European professional and semi-professional³⁰ investors.
- One of the main sources of equity financing for EU SMEs in their early stages of development, i.e. before becoming eligible for listing on an SME growth market or other trading venue, but after they have outgrown the friends and family stage of financing (but without yet being “bankable” as they do not generate revenue) are managers of smaller private equity and venture capital funds as well as, more recently, social impact investment funds. These managers raise funds from insurance companies, pension funds, family offices, foundations etc. across Europe, in some cases also globally, and channel these funds as equity or shareholder loans into

³⁰ The definition of semi-professional investor varies somewhat across the Member States but may typically encompass investing at least 100,000 EUR and signing a statement acknowledging awareness of risks involved in this type of investment.

SMEs. In parallel these managers also provide the active ownership which these young companies need in order to develop from “garage-stage” to a more professional and investable company (better governance, stronger management, stronger operations, better processes), but which operational ownership service most institutional investors are typically not themselves staffed to provide.

- The sector for social investment is still emerging in Europe and lags some 30 years behind the venture capital sector in development, depth, width and maturity. Hence the importance of the Level II rules being supportive and sufficiently flexible as the sector develops, adapts and grows while catering to the EU Social Business Agenda for inclusive growth.
- As mentioned also by ESMA in its advice proportionality is important. For an absolute majority of these managers it is not an option to opt into the full AIFMD authorization in order to obtain the EU-marketing passport due to the resources required and costs involved.
- As underlined also by the current push to a Capital Markets Union and focus on encouraging market (i.e. equity) financing it is imperative to get the regimes for these new labelled vehicles right. Hence the SMSG strongly advocates a principle based approach for these Level II implementing measures. Examples provided should be viewed only as examples, ideally Annexed for ease of ongoing update, leaving sufficient flexibility and proportionality for the market to find its “level” in terms of how these funds are constituted and how they constitute their portfolios.
- As some managers have already been registered under the EuVECA and EuSEF labels and are operating in accordance with their respective current parameters, the SMSG advises ESMA to put in place so called grandfathering provisions for such registered managers.

II. Introduction

59. On 26 September 2014 ESMA published a discussion paper in order to seek stakeholders' views on the technical advice ESMA is required to provide by April 30, 2015 to the European Commission on the implementing measures of the Regulations 346/2013 on European Social Entrepreneurship Funds (EuSEF) and 345/2013 on European Venture Capital Funds (EuVECA).
60. The input from stakeholders will help ESMA in the development of the final technical advice to be drafted. ESMA has invited for comments on the consultation paper to be submitted until 10 December 2014.

III. General remarks

61. The introduction of the AIFMD (implemented since July 22, 2014) implies that all non-UCITS managers of funds (e.g. real estate, hedge, venture capital, private equity, social entrepreneurship, art, forests, wine etc) now have to be authorized³¹ or registered in order to manage and market their funds across the EU, even if only to institutional investors.
62. Prior to the AIFMD, this type of fund offering/marketing by venture capital, private equity and social entrepreneurship fund managers was mainly done by following the national so called private placement rules – which are not rules in themselves, but rather the exemptions granted under the Prospectus Directive (limited numbers of qualified investors approached etc).
63. While the full AIFMD authorization also provides those managers with a so called EU-marketing passport, the smaller sub-threshold managers have to rely on these private placement regimes, or, if they qualify, can apply for the EuVECA or EuSEF registration and labels. In theory these managers can also subject themselves to a full AIFMD authorization by opting in, but for smaller fund managers the costs involved and administrative burdens imposed by the full AIFMD are disproportionate and unmanageable.
64. As many Member States have as a result of the national implementation of the AIFMD de facto tightened their private placement rules - basically closing their borders to smaller non-domestic funds - it is for example today, in many cases impossible for a Swedish venture capital fund manager to be able to market its fund to German institutional investors.
65. Many EU-based venture capital, private equity and social entrepreneurship funds are currently excluded from being able to use the EuVECA and EuSEF regulations/labels as already the Level 1 text imposes a number of restrictions on e.g. what constitutes a qualifying investment (types of financial instruments that can be used and % of company acquired) and what constitutes a qualifying portfolio company into which such qualifying investment is to be made (e.g. only SMEs as per the EU state aid definition – max 250 employees and either turnover of max 50 MEUR or a balance sheet of max 43 MEUR).
66. One of the main sources of equity financing for European small and medium sized companies (as per the SMSG definition in our SME financing paper (ESMA 2012 SMSG 59)) in their early stages of development, i.e. before becoming eligible for listing on an SME growth market or other trading venue, but after they have outgrown the friends and family stage of financing (but without yet being “bankable” as they do not generate revenue) are managers of smaller private equity and venture capital funds as well as, more recently, social impact investment funds.

³¹ Different thresholds apply to registered AIFMD managers. When the funds they manage are closed-ended and unleveraged (as is typical for venture capital, private equity and social entrepreneurship funds) and total less than 500 MEUR in assets under management (AUM) then such managers are only subject to registration. Otherwise the general threshold below which registration only applies is below 100 MEUR in AUM; most social investment fund managers manage far less than 100 MEUR – on average 13.8 MEUR.

67. These managers raise funds from insurance companies, pension funds, family offices, foundations etc across Europe, in some cases also globally, and channel these funds as equity or shareholder loans into these SMEs. In parallel these managers also provide the active ownership which these young companies need in order to develop from “garage-stage” to a more professional and investable company (better governance, stronger management, stronger operations, better processes), but which operational ownership service most institutional investors are typically not themselves staffed to provide.
68. Neither the US-originated Amazon, Google and Facebook; nor the EU-originated MySQL, Spotify and Skype, would be where they are today without the “intelligent and patient capital” provided to them along the way by different venture capital funds and their managers.
69. Investments into young and growing companies need to be flexible and catered to the needs of these companies, their capital providers and founding entrepreneurs, be they social or not. Too many limitations on what constitutes “qualifying” or not (and especially where investment is not necessarily linked to specific tax incentives offered), and which then in turn makes cross-border fund-raising difficult or even impossible is not in the interest of the EU nor the SMSG when promoting the single market, the financing of SMEs to foster growth and innovation across Europe as well as social inclusion.

SMSGs Advice

70. In view of the above the SMSG strongly advocates a principle based approach for all of these Level II implementing measures. Examples provided should be viewed as examples only, ideally Annexed for ease of ongoing update, leaving sufficient flexibility and proportionality for the market to find its “level” in terms of how these funds are constituted and how they constitute their portfolios.
71. As mentioned also by ESMA in its advice proportionality is important. For an absolute majority of these small managers concerned it is not an option to opt into the full AIFMD authorization in order to obtain the EU-marketing passport due to the resources required and costs involved.
72. The sector for social investment is still emerging in Europe and lags some 30 years behind the venture capital sector in development, depth, width and maturity. Hence the importance of the Level II rules being supportive, rather than restrictive as the sector develops, adapts and grows while catering to the EU Social Business Agenda for inclusive growth.
73. While not part of this consultation the SMSG would also like to point out the importance of a harmonization of tax laws across the EU for the social impact investment market to become truly cross-border. This relates both to the fund vehicles as such being seen as tax transparent (i.e. avoiding double taxation of investors) irrespective of the domicile of the

respective investors as well as of the investee into which investments are made. Differences in tax deductibility for investments into SMEs in general or social investments in particular and their importance for allocating funds to the sectors should be analyzed.

74. The SMSG also notes that while it is for investors investing their own funds, like family offices or HNI, is easier to take a holistic view on risk, financial return and societal impact and any potential trade-offs, for institutional investors like pension funds to generally be able to do the same will require changes to their fiduciary duty.
75. Acknowledging the general importance of transparency and harmonized reporting for attracting investors to an asset class, the SMSG is of the view, that in consideration of the different investment strategies sought by social impact investors and the broad range of causes being addressed, as long as the EuSEF manager follows a “general type of process” (i.e. the five step process recommended by the GECES), the pre-contractual information about the methodologies that a fund will use to measure inputs, outputs and outcomes (and where at all possible also impact) can remain general.
76. The SMSG would also like to draw ESMA’s attention to the fact that the EuSEF definition of a “qualifying portfolio undertaking” is narrower than the definition of a “social enterprise” as contained in the SBI.
77. The SMSG further believes it to be important that such EuSEF definition of “qualifying portfolio undertaking” does not exclude those companies engaged in preventive measures, i.e. not necessarily addressing the already marginalized, but to broader populations as addressing the issue before it becomes a problem is typically both cheaper and more effective.

Adopted on 10 December 2014

A handwritten signature in blue ink, appearing to be 'Jesper Lau Hansen', written over a horizontal line.

Jesper Lau Hansen
Chair
Securities and Markets Stakeholder Group

Annex V – Feedback statement

Q1: Do you agree with the identified policy options set out in the cost benefit analysis (Annex III)? Could you identify any other options?

The majority of respondents agreed with the identification of the policy options set out in the cost benefit analysis.

Q2: Do you agree with the proposal set out in the consultation paper? Are there any additional principles or criteria that you would like to propose?

The majority of respondents to the consultation agreed with the policy option chosen by ESMA, but favoured a more principles-based approach rather than a list. A number of stakeholders stressed the importance of following the definition of social enterprise provided by the Commission in the Social Business Initiative. In particular, it was pointed out that the social mission should be embedded in the articles of association or instruments of incorporation of the social enterprise and that the distribution of profits should not undermine the achievement of the social purpose of the enterprise.

Some stakeholders pointed out that there are different types of social enterprise and there are cases where their services or activities may not necessarily be directed exclusively to persons in situation of exclusion, disadvantage, marginalisation or that are vulnerable, but could also incorporate services or activities addressed to the community in general, provided that the primary purpose of the undertaking is social. This would include, for instance, companies providing goods or services having a pre-emptive purpose i.e. services addressed to the population as a whole (not only vulnerable groups) that intend to prevent a particular damage, rather than focusing on the curative process, after the damage has appeared.

Q3: Do you think that it is useful to provide an indicative open-ended list of goods and services provided by the social enterprises, methods of production employed and financial support provided by the social enterprises?

As to the examples of goods and services provided, some stakeholders indicated that the open-ended list was useful while stressing the need for competent authorities to be flexible in their interpretation of the list. In other words, the list should be understood as being merely indicative, so that new and innovative forms of social enterprises that may arise in the future are not excluded from the EuSEF scope of investment. Some stakeholders proposed adding the list in an annex of the advice, stressing that the list of examples is non-exhaustive.

Q4: If so, do you agree with the list of situations described in the proposed advice? Would you like to suggest any more?

ESMA has incorporated in the list the suggestions made by respondents.

Q5: Do you agree with the description of the types of conflicts of interest? Would you like to suggest any other type?

In general, respondents agreed with the description of the types of conflicts of interest identified by ESMA.

Q6: Do you agree with the standards proposed in terms of the measures that EuSEF managers should adopt in order to identify, prevent, manage, monitor and disclose the conflicts of interest?

In general, respondents agreed with ESMA's proposal in terms of the measures that EuSEF managers should adopt in order to identify, prevent, manage, monitor and disclose conflicts of interest. A number of respondents stressed the relevance of the principle of proportionality in this regard.

Q7: Could you quantify the costs that the implementation of these standards could generate for a EuSEF manager?

ESMA did not receive any input on this point.

Q8: Are there any other measures that you would like to propose? If so, could you quantify the costs of your proposal for the EuSEF manager?

Respondents did not suggest any other measures.

Q9: Do you agree with the proposed approach?

In general, respondents agreed with the description of the types of conflicts of interest identified by ESMA. A number of respondents underlined the importance of ensuring proportionality and allowing for sufficient flexibility for EuVECA managers, taking into account the specificities of the venture capital model and the small scale of the EuVECA.

Q10: Are there any other measures that you would like to propose? If so, could you quantify the costs of your proposal for the EuVECA manager?

Respondents did not suggest any other measures.

Q11: Do you agree with the general approach on social impact measurement?

Respondents generally supported ESMA's approach, but made a number of concrete suggestions to improve the text with a view to avoiding placing undue burdens on the EuSEF manager.

Q12: Could you help us estimate the costs to which the proposed approach would give rise for the EuSEF manager and the social enterprises?

Estimations vary. EVPA conducted a survey in 2011 that showed an average annual budget for measuring social impact of over €63,000, with a median value of €15,000.

Q13: Which option would you favour? Why?

- (i) Imposing on all EuSEF managers a single method for measuring the social impact (SROI, IRIS, other – please specify)**
- (ii) Relying in generally on accepted existing methods, at the discretion of the EuSEF manager (SROI, IRIS, other – please specify)**
- (iii) Allowing EuSEF managers to create their own method, following the principles and basic steps described above.**
- (iv) A combination of (ii) and (iii).**

The majority of respondents agreed with ESMA's preferred policy option (option iv).

Q14: Could you please quantify the costs for the EuSEF manager of your preferred option?

ESMA did not receive specific input on this point.

Q15: Do you have any alternative proposals? If so, please quantify the costs involved.

No alternative proposals were presented, but a number of respondents stressed the need for practical guidance documents and tools to help the EuSEF managers to implement the rules on social impact measurement.

Q16: Do you agree with the proposed approach with regard to the information on the different items of the investment strategy and objectives required under Article 14(1)(c) of the EuSEF Regulation?

There was general support for the main aspects of ESMA's proposal. However, a number of respondents pointed out that some of the information items are not relevant or they are too cumbersome for the EuSEF manager. ESMA took account of this feedback by specifying that EuSEF managers investing in other EuSEFs do not need to provide the detailed information about the investment strategy and objectives of the EuSEFs in which it invests. Concerning the information on the types of qualifying portfolio undertaking in which the EuSEF intends to invest, it was clarified that the information should refer to the social sector in which the undertakings are active.

Q17: Do you agree with the proposed approach with regard to the information on the positive social impact expected, the projections and the past performance and the methodologies for measuring the social impact (Article 14(1)(d) and (e))?

Q18: A number of respondents pointed out that it may be very difficult for the EuSEF manager to make estimations of social impact foreseen; this point was therefore deleted from the text. In addition, the text was amended to clarify that the EuSEF manager is entitled to change the methodology for the measurement of the social impact.

Q19: **Do you agree with the proposed approach on the non-qualifying assets held by the EuSEF and the process and the criteria used for selecting these assets (Article 14(1)(f))?**

Respondents generally agreed with ESMA's proposal.

Q20: **Do you agree with the proposed approach with regard to the description of the support services, as required by Article 14(1)(l)?**

A number of respondents suggested that, in case it does not provide support services to the qualifying portfolio undertaking, the EuSEF manager should explain the reasons behind this choice. In addition, given the difficulty of knowing in advance which business support services the manager will provide to the qualifying undertakings, rather than specifying the types of support services provided, the EuSEF manager should give an indication of the services that it intends to provide.

Q21: **Do you consider that it is advisable to develop an indicative model or a template for the pre-contractual information that EuSEF has to provide to the investors under Article 14 of the EuSEF Regulation?**

Respondents had mixed views on this point. ESMA finally decided not to develop a model to avoid the risk of having something rigid and not adapted to the diversity of EuSEF projects.