



EUROPEAN COMMISSION

DIRECTORATE-GENERAL FOR FINANCIAL STABILITY, FINANCIAL SERVICES AND CAPITAL MARKETS UNION

Director General

Brussels,
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Authority (ESMA)
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Subject: Formal request to ESMA for technical advice on the report to be submitted by the Commission under Article 27 of Regulation (EU) No 346/2013 on European social entrepreneurship funds

Dear [REDACTED],

Under Article 27 of Regulation (EU) 346/2013 on European social entrepreneurship funds ('EuSEF Regulation'), the Commission is required to review the functioning of the EuSEF Regulation. The review shall include a general survey of the functioning of the rules of the EuSEF Regulation and the experience acquired in applying them.

Pursuant to Article 27(3) of the EuSEF Regulation, following the review and after consulting ESMA, the Commission shall submit a report to the European Parliament and to the Council, accompanied, if appropriate, by a legislative proposal. The Commission will take that report into account as a basis for any legislative action it may deem appropriate. In light of the Commission's obligation under Article 27 of the EuSEF Regulation and ESMA's consultation requirement, I am hereby seeking ESMA's technical advice on the elements set out in the first section below.

Given the non-exhaustive nature of factors laid down in Article 27(1) and the right of the Commission to consider other elements of the EuSEF legal framework it deems necessary in order to put forward purposeful legislative amendments, ESMA is hereby invited to consider in its technical advice not only the mandatory elements indicated in the first section, but also to provide its input on the considerations specified in the second section below.

1. Advice on the mandatory elements of the review

The first paragraph of Article 27 calls on the Commission to review the EuSEF Regulation. The review shall include a general survey of the functioning of the rules in the

EuSEF Regulation and the experience acquired in applying them, including at least the following elements:

- (a) the extent to which the designation ‘EuSEF’ has been used by managers of qualifying social entrepreneurship funds in different Member States, whether domestically or on a cross-border basis;
- (b) the geographical and sectoral distribution of investments undertaken by qualifying social entrepreneurship funds;
- (c) the appropriateness of the information requirements under Article 14 of the EuSEF Regulation, in particular whether they are sufficient to enable investors to take an informed investment decision;
- (d) the use of the different qualifying investments by qualifying social entrepreneurship funds and what impact this has had on the development of social undertakings across the Union;

Broad and well-tailored scope of qualifying investments and qualifying portfolio undertaking is key to ensuring a broad investment mandate and flexibility of EuSEF managers in pursuing their management mandate. In this connection, the Commission services would in particular need to know whether and to what extent to which the scope of qualifying investments could or should be broadened or tailored to cater to the broader priorities of the market and investors, as well as to the evolving priorities of the Union. This concerns, but is not limited to, the scope of the EuSEF regulatory framework and particularly the legal notions of ‘qualifying portfolio undertaking’ and ‘qualifying investments’ (also see point (g) below).

- (e) the appropriateness of establishing a European label for ‘social enterprises’;

ESMA is encouraged to analyse the appropriateness of establishing a European label for ‘social enterprises’ with respect to EuSEFs and/or investee companies of EuSEFs.

- (f) the possibility of allowing social entrepreneurship funds established in a third country to use the designation ‘EuSEF’, taking into account experience in applying the Commission Recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters;
- (g) the practical application of the criteria for identifying qualifying portfolio undertakings, the impact of this on the development of social undertakings across the Union and their positive social impact;
- (h) an analysis of the procedures implemented by managers of qualifying social entrepreneurship funds so as to measure the positive social impact generated by the qualifying portfolio undertakings referred to in Article 10 and an assessment of the feasibility of introducing harmonised standards for measuring the social impact at Union level in a manner consistent with Union social policy;
- (i) the possibility of extending the marketing of qualifying social entrepreneurship funds to retail investors;

The current EuSEF Regulation permits EuSEF managers to market the units and shares of qualifying social entrepreneurship funds exclusively to investors which are

considered to be professional clients in accordance with Section I of Annex II to Directive 2004/39/EC ('MiFID', now Directive 2014/65/EU, 'MiFID II') or which may, on request, be treated as professional clients in accordance with Section II of Annex II to MiFID. As such, retail investors are excluded from the scope of marketing of EuSEFs. Given the underlying reasons for the low uptake of EuSEFs and the potential in the evolution of the EuSEF market going forward, the Capital Market Union objectives and the opportunity for a wider participation of retail investors in the financial market, the Commission would appreciate ESMA's input on whether EuSEFs could be marketed to retail investors, and if so, based on which conditions and investor protection safeguards.

In its assessment, ESMA should give due regard to whether national competent authorities ('NCAs') have the necessary regulatory tools to effectively and efficiently supervise the marketing of EuSEFs to retail investors. To that effect, ESMA is invited to analyse and take into account the comparative approach of European national social entrepreneurship funds frameworks, in particular where such legal frameworks exist, and the conditions under which units and shares of qualifying social entrepreneurship funds similar to EuSEFs are marketed to retail investors, including on a cross-border basis.

- (j) the appropriateness of including qualifying social entrepreneurship funds within eligible assets under Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities ('the UCITS Directive');
- (k) the appropriateness of complementing the EuSEF Regulation with a depositary regime;
- (l) to the extent appropriate and possible, an examination of possible tax obstacles for social entrepreneurship funds and an assessment of possible tax incentives aimed at encouraging social entrepreneurship in the Union; and
- (m) an evaluation of any barriers that may have impeded investment into funds using the designation 'EuSEF', including the impact on institutional investors of other Union law of a prudential nature.

Furthermore, with reference to Article 27(4) of the EuSEF Regulation, and in particular as regards sub-EUR 500 million threshold managers specified in point (b) of Article 3(2) of Directive 2011/61/EU on Alternative Investment Fund Managers ('the AIFMD'), ESMA is hereby invited to analyse:

- (n) the management of qualifying social entrepreneurship funds and the appropriateness of introducing changes to the legal framework including the option of a management passport; and

In this connection ESMA is particularly invited to analyse the factual circumstances pertaining to the marketing of existing EuSEFs in specific jurisdictions, the market and regulatory insights that could be drawn from such an analysis, including market fragmentation, uneven distribution of funds, under-representation of certain jurisdictions, accumulation of risks, etc. In this connection, ESMA is invited to analyse the effectiveness and the proportionality of alternative regulatory approaches, including the option of a management passport, the possibility of marketing on a cross-border basis akin to that set out in the current Regulation (EU) 760/2015 (the ELTIF Regulation) without prejudice to the ongoing revision of the ELTIF Regulation

or alternative regulatory approaches or their combinations with a view to ensure a proper functioning of the EuSEF market.

Pursuant to the EuSEF Regulation, EuSEF managers may engage in pre-marketing in the Union, except where under certain circumstances. There are additional provisions that set out conditions, requirements, documentation, etc. pertaining to pre-marketing.

To gain a better picture of the use of this distribution mechanism, ESMA is invited - to the extent permitted by the data at its disposal – to provide information on the extent and frequency of the use of pre-marketing, the effectiveness, the corresponding operational conditions and administrative burdens related to such a pre-marketing by EuSEF managers. ESMA is also invited to put forward an assessment of the current functioning of the distribution and pre-marketing arrangements and provide any suggestions or feedback pertaining to improved or alternative regulatory approaches linked to pre-marketing that could suggest a more effective, proportionate and less burdensome functioning of the EuSEF regime.

In addition, ESMA is invited to provide feedback on the operational requirements set out in the EuSEF Regulation and the extent to which such requirements are effective, necessary and proportionate and contribute to developing the EuSEF market and ensuring investor protection.

- (o) the suitability of the definition of marketing for qualifying social entrepreneurship funds and the impact that that definition and differing national interpretations thereof have on the operation and viability of qualifying social entrepreneurship funds and on the cross-border distribution of such funds;

Pursuant to Article 27(3) and (4) of the EuSEF Regulation, the Commission must consult ESMA prior to submitting its report. I am hereby seeking ESMA's contribution on this matter, so that the Commission can proceed in preparing the report accompanied, if appropriate, by a legislative proposal.

2. Advice on additional elements of the review

- (p) issues and procedures related to the authorisation of EuSEF managers and EuSEFs;

In providing its technical advice, ESMA is invited to provide the Commission its feedback on whether the scope, procedures and the process for becoming a EuSEF manager or obtaining a separate EuSEF authorisation are appropriate, effective and proportionate. Against this background, ESMA is requested to indicate any instances of duplications, authorisation-related burdens and frictions that could potentially be eliminated, without a corresponding loss of the effectiveness of the regulatory oversight, in the course of the review of the EuSEF Regulation.

- (q) issues pertaining to the eligibility of qualifying investments, calibration of thresholds, operating conditions and removal of certain requirements;

The Commission would appreciate if ESMA, in providing its answer, provide its feedback information on the following:

- the appropriateness of any qualifying investment assets and qualifying portfolio undertakings that could or should be included, whether directly or indirectly, within the scope of qualifying investments (indicative albeit non-exhaustive examples could comprise investments in social, sustainable and green projects, sustainability- and/or social needs focused SMEs at equity, quasi-equity or debt level or

otherwise, research and development, EU taxonomy-compliant assets, green and sustainable securitisations, etc.);

- the appropriateness and the calibration of the requirement to invest at least 70% of aggregate capital contributions and uncalled committed capital in assets that are qualifying investments;
- the appropriateness and the calibration of the limitation not to use more than 30% of aggregate capital contributions and uncalled committed capital for the acquisition of assets other than qualifying investments;
- the appropriateness of limitations and thresholds with which qualifying portfolio undertakings must comply and other product design rules, such as exclusion of financial undertakings from the scope of qualifying portfolio undertakings, requirement of being majority-owned, 30% borrowing threshold; etc.;
- investments in debt instruments or loans, and appropriate conditions thereof;
- the restrictions on the borrowing of cash, issuing debt obligations or providing guarantees at the level of the qualifying social entrepreneurship funds, including the way in which the operation of the EuSEF market can be facilitated by use of additional or better tailored amounts or modalities of the recourse to leverage, as well as additional safeguards, if any, that could be warranted where borrowing of cash would exceed a certain threshold;
- the effectiveness and the functioning of the conflicts of interest provisions of the EuSEF Regulation, including the advantages and disadvantages of aligning the conflicts of interest provisions of the EuSEF Regulation to those set out in Directive 2011/61/EU (the AIFMD);
- the necessity and the appropriateness of any the additional product rules on the portfolio composition, diversification and concentration;
- the introduction of a redemptions regime specific to the EuSEF legal framework and the extent to which such redemptions regime could increase the attractiveness of EuSEFs;
- other provisions and limitations on the functioning of the EuSEF managers and EuSEFs.

In particular, since the EuSEF label pre-dates the some of the well-established sustainability preferences frameworks, including the Regulation (EU) 2019/2088 on sustainability-related disclosures in the financial services sector ('SFDR') and MiFID II, and clearly aims at promoting social investment, ESMA is invited to analyse whether and to what extent the definitions set out in the EuSEF Regulation are compatible with the existing definitions of the EU acquis, and whether there is a need for the review of certain legal concepts, terms, cross-references, etc. For the sake of consistency, ESMA is particularly requested to analyse the merits of ensuring that the product design of the EuSEF label clearly takes into account the MiFID distribution criteria as regards sustainability and other key regulatory aspects.

- the necessity of any additional rules on the portfolio composition, diversification and concentration.

3. Guiding principles

In carrying out its analysis of the elements covered by the mandate and set out in sections 1 and 2, ESMA is invited to take into account the following principles:

- Contribution of the EuSEFs to the CMU and sustainability objectives, including the potential role of EuSEFs in channelling financing to companies and projects covered by the scope of the EuSEF regulatory framework.
- Effective investor protection, market transparency and cost-effectiveness of investor protection safeguards.
- The proper functioning of the internal market and the conditions to improve its functioning, in particular with regard to the financial markets, which are among the objectives of this Regulation.
- The principle of proportionality: the technical advice should not go beyond what is necessary to achieve the objectives of the Regulation and should not lead to undue burdens.
- ESMA is requested to take into account the existing EU acquis (including the requirements of the MiFID II and the PRIIPs Regulation pertaining to the marketing of complex financial products) and the preservation of a level playing field in the marketing, distribution and product design of substantially similar financial products.
- While preparing and delivering its advice, ESMA should seek and ensure coherence within the regulatory framework of the Union.
- ESMA will determine its own working methods, including the roles of ESMA staff or internal committees. Nevertheless, horizontal questions should be dealt with in such a way as to ensure coherence between different work streams pursued by ESMA.
- ESMA is invited to conduct a survey and seek input from market participants and stakeholders on issues pertaining to the functioning of the EuSEF market. When doing so, ESMA's advice should take account of different opinions expressed by the market participants and stakeholders.
- The technical advice should contain sufficient and detailed explanations of the assessment done, and be presented in an easily understandable language respecting current legal terminology used in the field of securities markets and company law at European level.
- ESMA is invited to provide sufficient empirical evidence and factual data backing its analyses.
- Throughout its technical advice, and especially in those instances where ESMA recommends any particular policy action or policy alternative, ESMA should include information on costs and benefits of such respective policy choices.
- To meet the objectives of this mandate, it is important that the presentation of the advice produced by ESMA makes maximum use of the data gathered during the assessment.
- ESMA should provide a comprehensive technical analysis on the subject matters included in this mandate.

4. Timeline and final provisions

ESMA is requested to provide its contribution by no later than **15 December 2023**.

The Commission reserves the right to revise and/or supplement this formal mandate. The technical advice received on the basis of this mandate should not prejudice the Commission's final policy decision.

The Commission services reserve the right to carry out additional consultations of market participants to cover any additional elements to support the review of the EuSEF legal framework. This request for technical advice will be made available on DG FISMA's website once it has been sent to ESMA.

I look forward to receiving ESMA's input and remain at your disposal for any questions.

Yours sincerely,

Electronically signed

John BERRIGAN

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