France Invest
Association des investisseurs pour la croissance

12 July 2021

Transparency register number: 270408511443-95

France Invest's comments on the European Commission's draft Risk Finance Guidelines

Established nearly 40 years ago, France Invest brings together venture capital (VC), private equity (PE), infrastructure and private debt teams based in France, as well as the associated professions which support them. Its membership currently counts 365 management firms and 180 associate members.

France Invest's members are active contributors to the funding and development of SMEs. During the pandemic, the sector demonstrated its resilience and adaptability, supporting existing portfolio companies as and when needed, while continuing to invest in new businesses that require capital and operational expertise to grow.

For instance, in H2 2020, over half of the capital invested by the French VC industry benefitted ICT and biotech & healthcare.

General comments

Conditions to access State aid are particularly important for EU start-ups, scale-ups and more generally innovative companies to be able to overcome the impact of the pandemic and for Europe to achieve its ambitions in terms of digital transformation and climate change. **It is indeed of utmost importance to ensure that European innovative companies can find financing in the EU and fully benefit from risk finance aid measures.**

To this aim, **we urge the Commission to first and foremost simplify the rules applicable to risk finance investment**. It should be ensured that **the EU rules governing access to risk financing are not overly complex: they should not deter EU companies from looking for financing in the EU** and not lead them to turn to non-EU funding. The development of EU unicorns and EU champions depends on their ability to find in the EU the financial means they need to grow.

We believe that **the complexity of EU rules should not discourage private market players to co-invest in innovative projects with public operators**. Otherwise, there is a risk that most quality projects end up finding private financing (through a simpler process), leaving lesser quality projects to be financed by public funds, or that public operators do no longer find any private market players to co-invest with them, which would be detrimental for innovative companies.

23 rue de l'Arcade, 75008 – Paris – France — +33(0)1 47 20 99 09 — www.franceinvest.eu
Association Loi 1901 - APE 9411 Z — Siret 349 165 779 00043 — N° de TVA FR 72 349 165 779 00043

In addition, **the controls performed should not be overly burdensome and the stability and clarity of the rules should ensure the appropriate level of legal certainty for companies**. For instance, *ex ante* assessments may no longer be valid in case the rules change. It should be recalled that, in case the rules are infringed (which may be the result of an honest mistake), **the stakes for companies are high**. Indeed, companies bear the risk of having to reimburse the public funds they were granted and being denied access to public financing over a certain period of time.

In other words, **the EU approach to risk financing should rely less on legal aspects and more on economic considerations**.

In this context, France Invest welcomes the publication of the draft Risk Finance Guidelines (the Guidelines), which clarify the conditions set out in the General Block Exemption Regulation (GBER).

We expect that the update of the Guidelines, together with the upcoming review of the GBER, will provide an opportunity to simplify the rules and introduce additional flexibility to conditions to access Sate aid, thus facilitating the deployment of State aid schemes in support of risk finance.

In particular, we would like to take the opportunity of this consultation to reiterate **our urgent call for a revision of the current definition of SMEs in the GBER at the occasion of its upcoming review**. Indeed, as recognised by the European Commission (Recommendation 2003/361/EC of 6 May 2003), the current definition of SMEs in the GBER prevents businesses which receive majority ownership from a venture capital company to be eligible to this status. Please find annexed our views on the European definition of SMEs.

Specific comments on the draft Guidelines

You will find hereafter France Invest's comments on some of the targeted amendments of the Risk Finance Guidelines proposed by the Commission.

1. **France Invest's comments on the scope of the draft Guidelines**

We fully agree that the exemption from the "undertakings in difficulty" definition available in the current Guidelines for "SMEs within 7 years from their first commercial sale" needs to be amended.

In this context, **we very much welcome the extension of the period to take into consideration from 7 to 10 years**. Indeed, a 7-year period is definitively too short for innovative companies, in particular for innovative companies operating in the biotech/medtech sector. A study by BPI France demonstrates that the initiative for encouraging investments in venture companies which are between 7 and 10 years is useful and necessary (venture companies which are between 7 to 10 years represent 52% of enterprises which realised their first commercial sale). This confirms the failure of venture capital market for enterprises aged from 7 to 10 years (SA.55869).

However, **we believe that the starting date of this 10-year period should remain unchanged** and correspond to the date of the first commercial sale of the company. Indeed, the first commercial sale of an innovative company may take place many years after its registration. For example, company Carmat[1], which has developed an artificial heart and aims to provide cardiologists with innovative

[1] https://www.carmatsa.com/en/about-carmat/#bloc36300

technologies that save lives and improve the quality of life for patients with advanced heart failure, was created by Matra Défense (Airbus Group), Truffle Capital and Professor Alain Carpentier in 2008. Carmat obtained CE marking (a prerequisite to market its product in Europe) in December 2020. To this day, it has not started commercialising its solution yet. Changing the start date of the period from first commercial sale to registration would reduce the period taken into consideration and restrict access to State aid.

2. France Invest's comments on the definitions set out in the draft Guidelines

a) First commercial sale

In order to ascertain the date of the first commercial sale more easily, **we propose introducing a threshold of EUR 250,000 of turnover**, in line with authorisations granted by the Commission, which considered the 10-year period to be counted from the year following the one when the company's turnover exceeded EUR 250,000 (SA.41265/SA.40725). In any case, a trial sale should not be considered as a first commercial sale, as stated in the Guidelines[2].

We would like to note that paragraph 74 of the draft Guidelines may appear to allow for some flexibility for undertakings which have been operating for more than ten years following their registration. However, in practice, *ex ante* assessments regarding the existence of a specific market failure are not easy to complete.

b) First loss piece

We support the definition of "first loss pieces" set out in the draft Guidelines and believe that it should also be introduced in the GBER at the occasion of its upcoming review. Indeed, the terminology used in the Guidelines and in the GBER for the most junior risk tranche that carries the highest risk of loss should be made consistent in order to avoid uncertainty for market players.

c) Independent private investor

The Guidelines require that new investors be qualified as "independent private investors"[3]. This generates a heavy administrative burden ("convention de labellisation"), which does not apply to other investors. In addition, investment funds are prohibited from making their first co-investment with investors which already hold shares in the capital of the target company, including investors which were present at the very beginning of the life of the company (e.g. business angels).

In order to allow public funds to invest in the same way as private investors (market economy operators), **we ask that the process of selection and labelling of independent private investors is no longer required**. Indeed, other investors of the financial centre do not have to establish any labelling agreements. They only use legal acts governing the investment transaction.

---

[2] 'first commercial sale' means the first sale by an undertaking on a product or service market, excluding limited sales to test the market.

[3] Draft Guidelines on State aid to promote risk finance investments: "independent private investor" means a private investor who is not a shareholder of the eligible undertaking in which it invests, including business angels and financial institutions, irrespective of their ownership, to the extent that they bear the full risk in respect of their investment; upon the creation of a new company, all private investors, including the founders, are considered to be independent from that company;

d) Innovative midcap

The current EU definition of an "innovative business" includes many VC-backed companies. It however excludes fast-growing start-ups in sectors other than ICT, biotechnology and healthcare (albeit those represent a large proportion of the VC investments). Indeed, it relies on a certain percentage of investment in R&D or in ground-breaking technology, which may not be relevant in some sectors, where innovation is incremental e.g. businesses developing personal protective equipment or applications using existing software to streamline sales in the retail sector.

In this context, we welcome the introduction in the draft Guidelines of an additional criterion based on the award of a label European Innovation Council (EIC) or funding granted by the European Innovation Council Fund.

However, in our opinion, this criterion is too restrictive, and **we suggest enlarging it to labels awarded or funding granted by other European or national public institutions** (e.g. the European Innovation Council (EIC) or, in France, BPIfrance or ADEME) **and to certifications by independent experts** (e.g. auditors). Indeed, certification by independent experts may prove more affordable (the cost of a BPIFrance label may be quite high for small start-ups), quicker and less burdensome (the administrative process in relation to the EIC may prove complex for some managers which may find it difficult to complete), in other words more efficient.

e) Market economy operator

While we understand the aim of the Commission to streamline the Guidelines and avoid overlaps with other pieces of legislation (e.g. the Notice on the Notion of Aid (NoA)), **we would recommend maintaining Section 2.1 "The market economy operator test" in the Risk Finance Guidelines**. Indeed, this would allow providing market players with a more comprehensive framework including all relevant rules and reflecting any change to the NoA in the Guidelines. **In particular, we suggest maintaining the definition of *pari passu* transactions in the Guidelines and defining private investors as "economically important" when they represent over 30% of the total relevant investment operation.**

We would like to take this opportunity to underline that **the addition of a fourth criterion**, requiring public and private organizations to be in similar initial positions for *pari passu* investments[4], **increases administrative complexity and may lead to multiple interpretations** in controls and audits.

Furthermore, the case law of the Commission and the Court of Justice of the European Union on the assessment of the market economy operator principle, which declares that "potential synergies that can be achieved" (2005/137/EC on State aid C-25/2002 Walloon region's financial stake in Carsid SA) and imposes a "principle of equal treatment" between public and private investors (CJUE 11 September 2012 Corsica Ferries France c/Commission T565/08), to which this additional fourth

[4] Commission Notice on the notion of State aid as referred to in Article 107(1) of the Treaty on the Functioning of the European Union (2016/C 262/01) paragraph 87 point d: to consider a transaction 'pari passu', the following criteria should be assessed […] "whether the starting position of the public bodies and the private operators involved is comparable with regard to the transaction, taking into account, for instance, their prior economic exposure vis-à-vis the undertakings concerned (see section 4.2.3.3), the possible synergies which can be achieved, (143) the extent to which the different investors bear similar transaction costs, (144) or any other circumstance specific to the public body or private operator which could distort the comparison

criterion refers, concerns large undertakings in which a Member State has intervened both as an investor and as a public authority.

The co-investment funds provided by a Member State have their own governance, with a decision-making system independent from the Member State, in order to intervene as an independent market economy operator, similarly to private investors of the financial centre.

Considering that situations such as that referred above remain exceptional in the context of SMEs and innovative companies, **we recommend that the Commission clarifies this fourth criterion**.

For further information, please feel free to contact [redacted], [redacted]

***

ANNEX
France Invest's views on
the European definition of SMEs

The European definition of SMEs set out in Recommendation 2003/361/EC contributes to making policies targeting SMEs in Member States and intervention areas more consistent and effective. It is crucial for the application of European policies ensuring that these companies benefit from financial support, reduced costs, reduced administrative burden, etc. In particular, it is included in regulations on state aids, notably in Annex I of the RGEC or for the purpose of obtaining public subsidies.

According to the Recommendation, an SME is a company that employs less than 250 people and whose annual turnover does not exceed EUR 50 million or whose annual balance sheet total does not exceed EUR 43 million.

However, if an enterprise has access to additional resources, it may not qualify for SME status. For instance, in order to only take into account its own workforce, turnover and balance sheet (i.e. not to include data from other enterprises), an enterprise must be considered as autonomous. In particular, according to the Recommendation, enterprises where a venture capital company owns a share exceeding 50% are not considered as autonomous. These enterprises might therefore not be considered as SMEs, even if individually they meet the staff headcount and financial thresholds.

Not obtaining the SME status has serious impacts for companies, including:

- Eligibility to apply for funding support in the context of European programmes applicable to SMEs or public national institutions/programmes aimed at SMEs;
- Social disadvantage compared to similar companies having the SME status, which can benefit from lower social charges. In particular, this creates a significant disadvantage when recruiting key talents in startups;
- Companies which do not qualify as SMEs are also placed at a competitive disadvantage as they cannot benefit from fiscal advantages granted to SMEs;
- Ability to further finance the company through venture capital or capital risk companies when the SME status is a pre-requisite;
- Ability for capital risk funds to deploy financing.

Please see below an example provided by one of our members:

The company "MEDICAL" (3 employees, turnover EUR 3,000, balance sheet EUR 2.4 million) was created in 2017. It was funded by a VC fund which currently owns 83% of its capital. It is at risk of losing its SME status and, as a consequence, of losing the benefit from national aids and subsidies ("Projets Structurants pour la Compétitivité" programme, part of BPI's "Investissements d'Avenirs" Programme).
MEDICAL was created to develop a device preventing serious heart failures. It is a very young - and small - company, which develops a solution to a key medical issue.
Due to the fact that a VC fund owns more than 50% of its capital, MEDICAL may not qualify for SME status. This implies dramatic consequences for MEDICAL. Indeed, this may limit or even prohibit its access to aids and subsidies, even though the aim of these programmes is to promote the financing of upcoming technologies and the development of projects which are key for the competitiveness of France and of the EU.

Non listed SMEs whose capital is held by Private Equity (PE) and Venture Capital (VC) Alternative Investment Funds (AIFs) are disqualified for SME status for two main reasons:

- first, the current definition of SMEs refers to venture capital *companies*. As you may know, PE and VC AIFs may take the legal form not only of companies but also mutual funds. It means that a SME whose capital is held by a PE and VC *mutual fund* cannot obtain public subsidies. Notably as we did in the context of the revision of the RGEC, **we reiterate our proposal that the reference to venture capital companies include both legal forms of VC and PE AIFs**. This is a major point for French PE and VC AIFs, which have essentially been set up as mutual funds;

- second, the concept of autonomous SMEs is difficult to understand for companies owned by private equity vehicles, in particular due to the absence of an obligation to consolidate accounts, justified by the fact that PE and VC AIFs acquire undertakings and divest after a holding period of 5 to 7 years. We believe that, as it is, this criterion applicable to VC and PE AIFs disadvantages SMEs which are funded by PE and VC AIFs and discourages them from seeking private investment. Therefore, **we call for the removal of the thresholds and the application of a full exemption for VC and PE investments to the criteria of SME's definition**.

***