

BAI feedback statement

Targeted consultation on the EU venture and growth capital funds reform

I. Preliminary Note

The German Alternative Investments Association (Bundesverband Alternative Investments e.V. - **BAI**) welcomes the opportunity to give feedback on the current regulations of EU venture and growth capital funds. As an industry association we represent more than 300 national and international members active in the institutional alternative investments sector (i.e. infrastructure, private equity, private debt, liquid alternatives), representing the entire value chain (asset manager, funds, banks, service providers, etc.). Likewise institutional investors (insurance companies, pension funds, occupational pension schemes, etc.) are represented in our investor board so that our activities have a dedicated focus on the asset owner side and their investment topics and needs as well.

We support the European Commission's (EC's) ambitions in reforming the regulatory landscape for venture and growth capital funds in the EU as well as small AIFMs. The development of deep, integrated, and efficient capital markets across the EU needs regulatory frameworks that must be designed in a way that promotes accessibility, innovation, and competitiveness, while safeguarding market integrity and investor protection.

II. Venture and Growth Capital Funds Reform

Investment structures and fund regimes

The scope of eligible investment assets under the EuVECA regime is appropriate (including the geographical limitations, the scope and concept of "qualifying venture capital fund", "qualifying portfolio undertaking", "qualifying investments", etc.)

Disagree.

We encourage the clarification, that EuVECA funds may invest in qualifying portfolio companies via holding companies or special purpose vehicles, directly and indirectly. This becomes relevant in particular in the light of the proposal for multi-level investment structures, as multi-level investment structures are becoming increasingly important in later investment and company phases. Additionally, EuVECA's should be allowed to invest in fintechs in the same way that ELTIFs to enable portfolio

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diversification and mitigating risks while providing long-term capital to companies enhancing financial innovation. This would also fit in with the ELTIF and EuVECA labels and support digital transformation, while providing investors with potential higher returns.

What specific changes in applicable rules for EuVECA managers would you consider most appropriate and impactful and why?

More flexibility regarding fund structures

We call for fund of fund structures to be allowed for EuVECA via an extension of the existing Art. 3 (e)(iv). This would increase the flexibility of fund structures for EuVECA funds, similar to the ELTIF 2.0 regulation. Additionally, the eligible target funds should also include non-EuVECA VC funds like ELTIFs, EuSEFs or other AIFs. It would also be desirable for target funds in umbrella structures to be managed by small AIFMs or third-country AIFMs in contrast to ELTIF 2.0.

We suggest extending the current scope of the EuVECA regulation on venture capital (with focus on young SMEs) to more private equity strategies without regard to company size in order to enable an EU-wide distribution for growth and buy-out funds as well. These companies also need capital to promote innovation and fund their transformation but often find themselves in a dilemma: they are too small for large PE firms but already too big for regular EuVECA AIFMs. Expanding the scope of the EuVECA regulation can close this financing gap and further promote economic growth in the EU.

We also urge the EC to abolish the “prohibition on secondary activities” for small AIFMs and EuVECA managers. This prohibition does not arise from either the AIFM Directive nor the EuVECA regulation and unnecessarily restricts the freedom to provide services.

We also suggest the reduction of AML obligations for small investment companies and EuVECA managers such as the obligation to appoint a second (deputy) Anti Money Laundering Officer. This requirement is disproportionate and, in some cases, nearly impossible to implement in practice. Small investment companies may be established with only one managing director under current law – therefore, the requirement for at least two AML Officers seems to be exuberant.

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III. AIFM

Do you consider that the requirements under the current AIFMD framework adequately take into account the diversity of business models and risk profiles of small and mid-sized AIFMs?

No.

The current AIFMD framework does not adequately account for the diversity of business models and risk profiles among small and mid-sized AIFMs, particularly in the venture capital sector. Additionally, Article 9 funds often have a high demand for capital because of higher fixed costs. We are calling for measures that would notably simplify the registration, reporting, governance and operational requirements for small and mid-sized AIFMs, including EuVECA, and for a more harmonised approach across Member States.

Do the current national regimes applicable to nationally registered, small-size AIF managers (AuM < EUR 500 million) need a more proportionate regulatory approach?

Yes.

For the German regime, AIF managed by a registered manager can only have investors with a minimum investment of EUR 200,000 (so-called "semi-professional investors"). Additionally, their status as a semi-professional investor has to be confirmed by the AIFM or a distribution partner. This limits the pool of potential investors for registered AIFM in Germany, while the bureaucratic burden is significantly increased. This leads to a significant disadvantage for Germany as a fund domicile, since this "gold plating" raises the burden for small AIFM compared to Luxembourg and its SIF/RAIF regulation.

Are there restrictions in EU or national legislation that in your view directly or indirectly impose undue constraints on investment strategies of EU venture and growth capital fund managers or their limited partners (e.g. stage restrictions, sector limitations, geographic limitations, ownership restrictions)?

Yes.

EuVECA managers are confronted with restrictions regarding capital sources, which limit their flexibility. Additionally, the investment targets for EuVECAs are fairly limited

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compared to ELTIFs, which leads to less diversification in EuVECA portfolios. EuVECA are also not permitted to use funds of funds structures, which also limits their flexibility and minimises the pool of potential professional investors, since they prefer enhanced risk diversification.

Do you find the current AIFMD framework – featuring two separate AuM thresholds (EUR 100 million for leveraged AIFs and EUR 500 million for unleveraged AIFMs), both incorporating leverage in the calculation – appropriate?

Yes.

Having two different thresholds considers the higher risks due to leverage, as leverage increases market exposure and potential contagion. Therefore, the lower threshold of EUR 100 Mio. ensures proper supervision by falling into the fully authorised regime earlier. On the other hand, unleveraged funds with long lockups, such as private equity or infrastructure funds, create lower liquidity and systemic risks: these funds typically use more stable capital and operate with long term investment horizons, which leads to limited redemption pressure and justifies the higher threshold.

Is the current EUR 500 million AuM threshold as triggering the requirement to obtain an AIFM license appropriate, particularly considering market evolution, inflation, effective oversight and other factors?

No.

The current thresholds have been established in 2011. Since then, the alternative assets market has grown significantly and inflation and market evolution have increased fund sizes. Consequently, EUR 500 Mio. may now capture relatively small managers, pushing them into full compliance earlier than originally intended. This also adds to the burden on the supervisory authorities, as they must use resources on relatively small managers. As a result, the effectiveness of oversight is compromised.

In addition, the threshold triggers a sudden jump in the regulatory burden, which can create incentives for AIF managers to artificially limit their growth or restructure their managed funds.

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In your view, what upper AuM threshold(s) should apply, if any, to mid-size AIFMs?

2.5 billion.

Introducing a mid-size regulatory tier could smooth the regulatory transition for small-size AIFM growing out of the sub-threshold regime and therefore, reduce incentives to cap AuM while allowing proportionate compliance requirements. The threshold of EUR 2.5 billion would be easy to implement but still keeps the largest systemic managers fully regulated under AIFMD. However, emerging managers would get a better environment for scaling up.

What are the impacts of the transition from small-size AIF managers to full scope AIFMD in terms of, among others, impacts on costs and staffing, effectiveness of regulatory oversight, investor confidence?

The most immediate effect is a substantial increase in compliance and operational costs because of the authorisation process with the national competent authority, the implementation of risk management and compliance frameworks, complying with the regulatory reporting requirements and external legal, audit and regulatory advisory services. Initial costs, such as the authorisation costs or costs of implementation of risk management and compliance frameworks can reach several hundred thousand of euros, while ongoing compliance costs can be EUR 100,000 – EUR 300,000 p.a.

Regarding impacts on staffing, full scope authorisation typically requires significant internal upgrades such as expanding compliance teams, hiring regulatory reporting specialists and general headcount. Many small-size AIFM operate with small teams, so they must add at least one Risk Officer and a Head of Compliance and additional staff for regulatory reporting and monitoring.

Transitioning from small-size to full scope can significantly improve investor confidence, especially with institutional investors as pension funds or insurers.

Which regulatory measures and policy approaches could enable small-size AIF managers managing less than EUR 500 million in AuM to scale up without facing abrupt administrative or compliance requirements, whilst maintaining a coherent and proportionate regulation and effective oversight?

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To support the growth and competitiveness of Europe's venture capital ecosystem, a more proportionate, harmonised and innovation-friendly approach is essential. The proportionality principle should be applied consistently across regimes to ensure that smaller, non-systemic managers benefit from the reliefs available under the AIFMD. Any alleviations (e.g. in reporting, valuation, remuneration, risk and liquidity management or depositary oversight) should apply in a coherent and consistent manner to managers under the EuVECA, EuSEF and ELTIF frameworks, without creating duplicative, overlapping or contradictory obligations.

Additionally, the extension of the deadline to file for full authorization under AIFMD should be extended. The current deadline of 30 days is too short for small-size AIF managers to prepare for the authorization process, especially hiring additional staff for regulatory reporting and monitoring. At least, small-size AIF managers, that have to transition to full authorization under AIFMD, should be able to keep their status as a small-size AIF manager for longer, while filing for the authorization with the competent authorities.

Which specific regulatory requirements or conditions linked to the registration, organisation, operation, and ongoing oversight of small-size nationally registered AIF managers managing less than EUR 500 million in AuM (excluding EuVECA managers) hamper their ability to scale up and remain competitive?

One of the biggest issues is the lack of possibility for international distribution since small-size AIFM have no EU passporting rights. If they want to operate in different Member States, small-size AIFM have to register with the national competent authorities, which may have different regulatory interpretations and regulations. This leads to higher legal and administrative costs and delays their market entry. For emerging managers trying to raise capital internationally, the inability to access the EU marketing passport is often the single biggest barrier to growth. Additionally, small-size AIFM must constantly monitor their AuM relative to the EUR 500 Mio. threshold, as they only have 30 days to file for full authorisation under AIFMD. This creates major effort in monitoring and may lead to limited fundraising, which ultimately hampers their ability to scale up.

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Considering that small-size AIF managers with less than EUR 500 million in AuM cannot manage funds in other Member States outside that of their original registration, would a full-scope management passport facilitate the operation of those managers on a cross-border basis?

Yes.

Introducing a full-scope management passport for small AIFMs would likely facilitate cross-border operations and would lead to lower regulatory fragmentation. This could harmonise supervisory access, simplify and accelerate regulatory procedures and improve capital market integration, which contributes to the goals of the Capital Markets Union by helping small-size AIFM allocate capital across Member States more efficiently. However, to preserve investor protection and regulatory consistency, it would probably need to be accompanied by minimum harmonised regulatory standards or a proportionate supervisory framework.

Would a marketing passport or other improvements facilitating the cross-border marketing of AIFs for small-size AIF managers improve their access to investors in other Member States and under which conditions?

Yes.

We believe that cross-border distribution and, where applicable, pre-marketing of AIF units should be permitted for registered AIFMs so that they can expand their business. Extending the current restriction to fully authorised AIFMs to include registered AIFMs would also benefit the *Savings and Investment Union*.

A standardization of cross-border distribution opportunities for registered AIFMs outside the EuVECA regulation regarding professional investors under MiFID would greatly improve their financing options and would lead to significantly reduce market barriers. Currently, the administrative practices among Member States vary extremely, ranging from a complete ban on cross-border marketing to the permissibility of a mere distribution notification to the permission of distribution exclusively to professional or institutional investors, even without a distribution notification. This restricts the freedom of establishment as well as the free movement of capital. It would be sufficient to allow pre-marketing in general, without further notification or distribution bans.

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What specific challenges or inefficiencies within the current regulatory framework (outside the scope of the EU market integration and which reviews the AIFMD regarding supervision package fund managers operating in a group structure, passporting for depositary services and improved cross-border marketing of funds) have not been addressed in this consultation, and should be considered by the Commission in the EU venture and growth capital funds reform?

We call for the implementation of a "semi-professional" investor category in EU law. The concept of semiprofessional/sophisticated client exists in several key markets e.g., LU, IE and it is indeed not harmonised. Professional and semi-professional investors should be able to invest in AIF managed by small-size managers. This would broaden the distribution opportunities for small-size AIFM, while still making sure to keep investor protection in mind by excluding retail investors. Hence, we would like to use the VC package review to clarify there is an exemption from the obligation to produce a KID where an investor category in-between retail and professional clients is recognised either by EU law, the laws of a Member State or an NCA.

Additionally, the categorisation as a professional investor should be revised. Typically, private asset investments are marked by fewer, but more significant trades compared to publicly traded investments, where it is easier and – arguably – also more meaningful in terms of experience gained to achieve a high number of trades. "10 transactions over EUR 30,000 in unlisted companies over the last five years" could be helpful in that regard. However, it would still not help with market entry, as most funds are eligible for professional investors only. It may be better to further decrease the number of transactions required, e.g. from 10 to 5, and accept a higher per investment minimum amount, say 60k instead of 30k. This would allow UHNWIs to achieve the relevant numbers more quickly to be eligible for professional opt-up based on trading experience.

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The **Bundesverband Alternative Investments e.V. (BAI)** is the cross-asset and cross-product lobby association for the alternative investment industry in Germany and we consider ourselves as a catalyzer between professional German investors and suppliers of Alternative Investment products worldwide. The overarching goal is that German institutional and professional investors must be able to diversify their investment with regard to Alternatives better and more easily. The BAI is promoting a broad diversification which includes Alternative Investments as indispensable, in particular in terms of safeguarding long-term retirement pensions and the provision of money for construction, maintenance, and development of public infrastructure and renewable energies.

BAI members are recruited from all areas of the Alternative Investments' industry, e.g., AIF managers and banks as well as service providers. At present, the BAI counts more than 300 national and international member companies and is growing continuously.