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COMISIÓN NACIONAL DEL MERCADO DE VALORES

"Venture Capital: Development and Regulation"
2nd Conference on Alternative Investments
KPMG – El Confidencial

MONTSERRAT MARTÍNEZ PARERA, VICE-CHAIR OF THE CNMV

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Good morning. Thank you Juanjo for your presentation. I must also thank KPMG and El Confidencial for their invitation to this event on alternative investments. In the second year that this event is being held, I am very pleased both organisers are dedicating it to analyse and debate on such a relevant sector.

Furthermore, I am sure that extremely interesting subjects will arise from the different speeches given today. More so when we take into account the complex economic and financial context we find ourselves in, one in which uncertainty and rising interest rates may entail important changes regarding risk assessment and reallocation in portfolios.

Today I would like to acknowledge the sound development of the alternative investment and venture capital industry during the past few years in our country. This has gradually consolidated itself as an important part of the Spanish investment ecosystem and as one of the pillars financing small to medium-sized innovative enterprises, thus supplementing traditional bank financing.

The sector faces certain challenges. On one side, those resulting from the actual economic situation. On the other, we also notice a growing desire for retail investors to have access to this kind of product, this being positive in itself inasmuch the offer increases but which, in turn, requires being cautious as some investors may not be used to the characteristics of these alternatives.

I would like to dig deeper into this idea so I will focus on two areas: that of the investor, whose protection is inherent to us as the supervisor, and that of the growth of the sector and its contribution towards financing the economic activity. I will commence with the latter.

The Contribution towards Financing the Economy

Venture capital or alternative management continues to reach record highs. This sector has reached double-digit rates nearing 20% in the past five years. The number of alternative management products has more than doubled since 2018. Currently there are 739 venture capital and closed-ended collective investment firms and funds registered with the CNMV, as opposed to 369 towards the end of 2018. Of these, 88% are venture capital entities. And the trend in the first months of 2022 continue to indicate all-time highs.

On the other hand, the increase in the number of entities was accompanied by a significant increase in the assets managed. These have increased threefold in the past six years. If venture capital entities were managing €10 billion and having €15 billion committed in 2016, the volume managed towards the end of 2021 exceeded €22 billion and a committed volume of almost €40 billion. To put things in context, the committed capital is equivalent to 11% of all the assets in investment funds and companies.

Moreover, it is increasingly frequent for us to register vehicles having ambitious asset raising objectives; for instance, one venture capital fund with a €900 million objective and another aiming for €400 million were registered this year. These references are in line with other, more consolidated jurisdictions.

And the development of alternative investments has important benefits for the economy.

On one side, it contributes to reinforce the role of stock markets in business financing. This is particularly relevant when considering the huge volume of investment we will require in the next decade to face the changes in the production model, in reference both to those linked to environmental and social sustainability, and to those related to the digitalisation of the economy and businesses. In fact, a large part of venture capital investments concentrates on sectors that are crucial for this transformation of the economy, as are the technological, fintech, renewable energy or health sectors.

On the other side, it is necessary for our small firms to grow and consolidate. We should recall that, on average, businesses are small in Spain, this being a drawback regarding innovation and improvements in productivity. The average staff in Spanish SMEs is quite small when compared to the European average[1]. In addition, it can be observed that the sectors in a better position to take on future environmental and digital challenges are precisely those with companies whose average size is smaller in comparison with other sectors and countries[2].

It is also a fact that bank financing has its limits, more so when considering that Europe is more bank-dependent than other jurisdictions, which makes it more vulnerable to tighter credit conditions.

Therefore, venture capital may be an interesting alternative, especially for more innovative firms with greater growth potential but without the level of maturity required for direct access to capital markets.

Finally, it should be highlighted that venture capital not only provides financing but, depending on its definition, may aid to reinforce the credibility of the firms receiving the funds, while contributing to improve and professionalize their business management.

To sum up, inasmuch venture capital is not intended to be of a permanent nature in the companies it invests in, it becomes a facilitator for firms to resort to stock markets.

Investor Protection

All these considerations perfectly match the strategic objectives of the European Commission's Capital Markets Union (CMU), in order to boost securities markets and attract more retail investors to capital markets.

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[1] See "Strategic SME Policy Framework 2030", Ministry of Industry, Trade and Tourism.

[2] See "Challenges and Policies for a Sustainable and Balanced Growth of the Spanish Economy". Annual Report 2021, Bank of Spain.

The important issue here is how to favour an orderly development of the sector and enable the broadening of the investor base, ensuring the client understands the risks and the characteristics of the product.

This takes me to the second area I wish to cover today, that of investor protection in alternative investments. This sector has specific characteristics leading these products to be aimed mainly at professional investors, with minimum investments of €100,000.

For example, let us consider the lower liquidity of the investments, as the investment time horizon or period is usually long, even years-long, or the lower amount of information available on the companies invested in, which hinders the valuation of the shares. As the investment is not in listed companies, the information is usually scarce and with few price references.

These two characteristics, the opacity or lower transparency of the sector and the lack of liquidity, make it harder to value the product and harder to foresee the profitability or losses.

At present there are several regulatory initiatives underway, both in Europe and Spain, precisely seeking to boost the appeal of the sector to retail investors.

In Spain, the Draft Bill on the Creation and Growth of Enterprises[3] puts forward some measures to make access of investors to instruments such as venture capital more flexible. Thus, as an alternative to the current minimum initial investment of €100,000 requirement, the draft bill proposes marketing is allowed to retail clients as long as they access the investment through the recommendation of an entity authorised to provide advice, that they make an initial minimum investment of €10,000 and, furthermore, that the investment is not more than 10% of the financial assets of the client (whenever these do not exceed €500,000).

In Europe, the current proposals to encourage alternative investment are one step ahead in making access to this more flexible. Among these, I should highlight the

[3] https://www.congreso.es/public_oficiales/L14/CONG/BOCG/A/BOCG-14-A-76-1.PDF

proposal to reform the AIFMD (Alternative Investment Fund Managers Directive)[4] and the ELTIF (European Long-Term Investment Fund)[5] Regulation proposal to promote long-term investment.

Specifically, the reform of the ELTIF regulation is an example of the current debate on the extent to which investor access is to be made more accessible.

European Long-Term Investment Funds (ELTIFs) are a product which has hardly been developed, as it has not experienced the growth that was expected, either in terms of the amount of funds or their volume (there are just 67 in Europe[6] and 2 in Spain). In this case it is also necessary to specify the tax regime applicable in Spain.

The proposal published by the EC towards the end of last year seeks to boost its function, making it more flexible and broadening the investor base. The latter is achieved by simplifying the conditions for access in a significant manner: eliminating the current minimum investment amount requirement of €10,000, the 10% client financial asset threshold and the need for advisory services. All this is replaced by maintaining the product suitability valuation regarding the client, while requiring the inclusion of written warnings whenever the investment exceeds 10% of the investor's portfolio or the investment period is more than 10 years. If the current terms are maintained, this European proposal is more flexible than the current project for regulation in Spain as, in the Spanish draft bill, the client only has access to the product if this is recommended by the distributing entity, which the latter may only do if the product is appropriate according to the financial situation and investment objectives of the client, that is to say, if it is suitable for the investor. The European proposal is still under discussion and may vary, but this must be followed up closely as, in principle, it is desirable for the different alternative investment vehicles to have marketing rules that are aligned. Therefore, following this argument, if the ELTIF Regulation were finally approved with its current content, it may be appropriate to adapt the Spanish draft bill along the same lines.

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[4] https://eur-lex.europa.eu/legal-content/ES/TXT/?uri=CELEX%3A52021PC0721
[5] https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52021PC0722
[6] Opinion of the European Economic and Social Committee (EESC) on the Review of the European LongTerm Investment Funds (ELTIFs) Regulation.

Final Reflections

In order to conclude. The issue therefore is the point up to which we wish to make the requirements for access to venture capital more flexible.

Once again, I will highlight the specific characteristics of alternative investments.

These are illiquid investments, usually having more complex cost structures than traditional investment funds, generally being larger and on which the information available is scarce, which may lead to doubts on the reliability of portfolio valuations given the lack of representative prices for underlying investments.

As already explained, there is no doubt that this type of investment provides important benefits to many firms, particularly to the smaller ones, and that the promotion of this sector is being crucial to finance extremely relevant projects. Venture capital may also be a previous step for future IPOs.

Furthermore, the increase in the offer of products to clients is also beneficial in itself. Therefore, I agree with increasing the access of retail investors to this type of product, which broadens the investor base and also fits in with the growing interest of the sector, particularly that of private banking, in increasing the range of products for its clients.

However, we must be careful and strive to increase transparency and ensure that investor clients have a good understanding of the product.

It would be desirable for these products to always be sold following the provision of advice and for entities to pay special attention to product governance, to having a correct valuation of the suitability of the product for the client, while also to managing any possible conflicts of interest that may arise when the investment managers are also directly marketing the product.

This becomes particularly relevant at times of uncertainty such as the present. As mentioned at the start, we are facing a complex economic and financial scenario. Our economy is proving to be highly resilient, although it is also true that the growth prospects of the main economies have worsened, the global production chains have been altered and inflationary pressure has become more intense, resulting in interest rate increases. At moments of change is precisely when it is most important to reinforce marketing practices and transparency with clients.

Thank you once more for your invitation.