European Innovation Council

EIC FUND INVESTMENT GUIDELINES

(Horizon Europe Compartment)

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INVESTMENT GUIDELINES FOR THE HORIZON EUROPE COMPARTMENT

Target company development stage: Pre-Seed, Seed and Early-stage SMEs, and small mid-caps[1]

1.1 Eligible applicants under the EIC Accelerator are for-profit highly innovative SMEs, including start-ups and early-stage companies and small mid-caps, from any sector, and typically with a strong intellectual property component.

1.2 The EIC Accelerator support aims to address high-risk projects that are not yet sufficiently attractive for investors, also considering the scale of investment required, with the aim to de-risk such projects and catalyse private investment throughout the lifetime of the EIC investment thanks to the leverage provided by the EIC blended finance.

Type of innovations

1.3 The Compartment will support different types of innovation, in particular those based on deep-tech or radical thinking, but also social innovation.

1.4 For the purpose of the present document, "deep-tech" refers to a technology based on cutting-edge scientific advances and discoveries. It is characterised by the need to stay at the technological forefront by constant interaction with new ideas and results from the lab. The deep tech definition is distinct from 'high tech', which tends to refer only to R&D intensity.

1.5 Whilst open to innovation in all areas presenting high technological or market or financial risks, the EIC Accelerator may also focus part of its support, provided that it cannot be financed by the implementing partners of InvestEU, on capital-intensive strategic technologies.

Protection of EU interests

1.6 In case the EU Commission identifies the need for investment safeguards in relation to a specific case in its award decision in order to protect EU interests, the Compartment will take at least one of the investment-related measures in relation to the EIC Fund Final Recipient concerned: secondary share purchase, acquiring a blocking stake, investing in EIC Applicant Companies even if potential investors show immediate interest in providing the full investment, the disposal of Compartment's interest in the investing scheme via a secondary sales transaction, Follow-on Investments or securing European ownership of intellectual property and of the company.

Geographical scope

1.7 Eligible companies must be established and operating in the EU Member States or Associated Countries to Horizon Europe Pillar III Equity component.

1.8 The External AIFM may decide to invest for the Compartment not in the entity having submitted the proposal ("operating company") but in its holding or parent established in the territory of a EU Member State or a Country Associated to Horizon Europe Pillar III, upon a recommendation from the investment advisor that contains:

(a) justification of the need, in the professional judgement of the investment advisor, to invest in the holding or parent in the specific case in question; and

(b) confirmation that the holding or parent fulfils all eligibility criteria, in particular SME status and non-bankability for the purpose of the EIC Accelerator.

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[1] An enterprise within the meaning of Article 1 of the Title I of the Annex of the EU Commission SME Recommendation which (i) has up to 499 employees calculated in accordance with Articles 3, 4, 5 and 6 of the Title I of the Annex of the EU Commission SME Recommendation, and (ii) is not a micro, small or medium-sized enterprise as defined in the EU Commission SME Recommendation.

1.9 When negotiating, implementing and monitoring investments, the External AIFM, with the support of the Adviser, will ensure that supported companies keep most of their value, including their intellectual property, in the EU or in Associated Countries, in order to contribute to their economic growth and job creation.

1.10 Having regard to the Compartment's public policy role, the External AIFM, with the support of the Adviser, will also take into account the EU initiatives to create a Capital Markets Union, including an attractive landscape for the financing of companies in the European Union that ensures a very high level of protection, effectiveness and easiness of operation.

1.11 In order to comply with the EU guidelines on the eligibility of Israeli entities and their activities in the territories occupied by Israel since June 1967 for grants, prizes and financial instruments funded by the EU from 2014 onwards (Commission Notice 2013/C 205/05) (OJEU C205 of 19.07.2013 – EN), which stipulate that only Israeli entities having their place of establishment within Israel's pre-1967 borders and not operating in the Golan Heights, the Gaza Strip and the West Bank, including East Jerusalem, either in the framework of EU-funded financial instruments or otherwise, are eligible[2], the Compartment shall ensure that any agreement signed between the Compartment and an Israeli EIC Fund Final Recipient shall include by default the following article: "*Following the signature by the State of Israel of the agreement to join the Horizon Europe programme, the new EU research and innovation programme, dated 6 December 2021 and the terms set out therein, the [EIC Fund Final Recipient's name to be included] by signing this agreement commits to comply with the EU Guidelines (Commission Notice 2013/C 205/05) (OJEU C205 of 19.07.2013 – EN) on the eligibility of Israeli entities for financial instruments funded by the EU from 2014 onwards*".

Exclusions

1.12 In addition to applicable exclusions, including those set out in the EU Financial Regulation and other applicable legislation, in particular the restrictive measures adopted on the basis of Article 215 TFEU, the Compartment shall not invest in economic sectors that are considered incompatible with the ethical and social basis of the Horizon Europe mission. Such restrictions are summarised in the Horizon Europe Regulation including Article 19 (Ethical principles), the EU Financial Regulation including Article 138 (Exclusion criteria and decisions on exclusions) and other applicable legislation. Companies benefitting from the EIC support shall not engage into these sectors.

1.13 In addition, each EIC Fund Investment Agreement will contain the undertakings and/or representations by each EIC Fund Final Recipient set out in Annex 1 in order to comply with certain exclusion criteria as at the date of the Compartment's initial Investment, namely:

(a) undertakings and/or representations, consistent with prevailing market practice for Luxembourg funds, intended to fulfil the requirements listed in the EU Financial Regulation (Articles 138 to 143 and 158.2), relating to its financial and legal standing and that of the natural and legal persons with which it has financial or other relations; and

(b) undertakings and/or representations, consistent with prevailing market practice for Luxembourg funds, intended to fulfil the ethical principles of Articles 18 and 19 of the Horizon Europe Regulation as further detailed in the Horizon Europe Guidance "How to complete your ethics self-assessment[3]".

[2] Activities which, although carried out in the mentioned territories, aim at benefiting protected persons under the terms of international humanitarian law who live in these territories and/or at promoting the Middle East peace process in line with EU policy are also eligible (Point 15 of the EU guidelines).

[3] https://ec.europa.eu/info/funding-tenders/opportunities/docs/2021-2027/common/guidance/how-to-complete-your-ethics-self-assessment_en.pdf

Investment size and equity stake targets

1.14 Adding to a grant component for activities at the TRL levels set out in the applicable EIC Work Programme, representing up to seventy per cent (70%) of these activities' costs, the investment component may be tailored and take different forms. It may consist of convertible instruments (i.e. loans/bonds/notes and other similar instruments such as participation rights and SAFE), a combination of such quasi-equity instruments and direct equity, or direct equity. The Investment component may cover from seed-stage up to growth equity rounds – to support the innovator along its journey from concept to scale up.

(a) In some cases, including in relation to protecting EU interests (for example, when linked to the exercise of pre-emptive-rights to buy out existing investors in order to secure European ownership and when required to align with the conditions set up for an investment round so as to restructure the cap table of pipeline or portfolio companies), it is confirmed that the Compartment can make secondary share purchases. Such decisions will be taken by the Compartment on a case-by-case basis on the basis of the requirement set out in the EU Commission award decision in question.

(b) For this purpose, the Compartment, subject to the applicable company law in the jurisdiction in question, will strive to have a preferential right (right of first refusal) to purchase the shares of any other exiting shareholder on a pro rata basis, and could exercise such preferential right inter alia in case the shares would be otherwise sold to a company established to in/an individual of a non-eligible country for the purposes of economic security considerations.

1.15 The Compartment's investment (in particular equity or quasi-equity) will range between five hundred thousand euro (EUR500,000) and thirty million euro (EUR 30,000,000) per company, without prejudice to the specific provisions of the applicable EIC Work Programme, which may provide for a higher amount in specific cases.

1.16 Where it provides equity or quasi-equity, the Compartment will target minority ownership stakes (aiming in general at stakes between ten per cent (10%) and twenty per cent (20%)) It may acquire a blocking stake (through minority or majority ownership) in order to protect EU and Associated Countries interests as identified in the award decision by the EU Commission related to the specific case in question.

1.17 The investment amount decided by the External AIFM, with the support of the Adviser, may be lower or higher[4] than the one proposed by the independent expert evaluators during the evaluation process run by the EISMEA. Maximum investment amounts per EIC Fund Final Recipient will have to be authorised *ex ante* through an EU Commission award decision covering the specific case in question.

1.18 In the case of investment in tranches, the External AIFM will take a position on the entire amount considered for funding. The timing and conditions for investment in tranches (upon achievement of predefined milestones) will be negotiated with the EIC Fund Final Recipient, agreed and managed by the External AIFM, under the operational co-ordination of the EISMEA as long as the EIC Accelerator support is in force.

1.19 For the purposes of these guidelines, milestones will be meaningful achievements in the development of the innovative project of a company, reflecting maturity stages and TRLs achieved, including co-investment leveraged. The EIC Accelerator support will finance the activities of the company as long as relevant milestones are achieved. In accordance with the applicable EIC Fund Grant Agreement, support shall be suspended, amended, or, if duly justified,

[4] Subject to the terms of the EU Commission award decision.

terminated if measurable milestones are not reached, or it may be terminated where the expected market deployment, especially in the EU, cannot realistically be met.

1.20 A material breach of the EIC Accelerator contract related to the grant component shall prevent the Compartment from further investing in a company and eventually lead to early exit, and vice-versa.

Investment/co-investment scenarios

1.21 From the onset and during the lifetime of the Compartment investment, and subject to non-disclosure obligations, the External AIFM will connect the potential EIC Fund Final Recipient to the EIC Accelerator investor community ecosystem, to leverage co-investment opportunities.

1.22 EIC Selected Applicants are also entitled to and even encouraged to seek on their side for co-investors, building on the EIC Accelerator support.

1.23 If the EIC Fund Final Recipient and the External AIFM, upon recommendation from the Adviser, consent to the proposed co-investment opportunity, financial and commercial due diligence and negotiations may then be performed jointly and in agreement with the potential co-investor(s), however under the control of the External AIFM and the Adviser to ensure sufficient due diligence and implementation of required conditions to be included in the investment documentation.

1.24 The EIC Accelerator focusses on innovators and entrepreneurs, and complements the financial products offered by implementing partners under the InvestEU, which is investor and financial intermediary driven. It aims at directly de-risking selected operations in order to better bridge these two worlds and crowd-in investors. For that purpose, the EIC Accelerator is designed to fulfil the role of initial or first risk-taker, where needed.

1.25 Without prejudice to applicable provisions, when investing in direct equity, hence excluding the investments in quasi-equity instruments, the Compartment will systematically seek co-investment from and syndication with other investors, at least on a matching basis 1:1 (and seeking a leverage effect of 1:3 throughout the investment horizon), and even alternate investors. It will aim to crowd-in significant and fit-for-purpose additional or alternate funding needed to successfully develop an innovation, deploy it to the market and scale-up, whilst ensuring its sustainability. In these cases, the Compartment should only invest if market support including from InvestEU cannot be secured.

1.26 In addition to enhancing the impact of the EU support and contributing to stimulate the overall European investment ecosystem, bridging with and crowding-in Qualified Investors at the earliest stage is essential for the success of the applicants and their innovations. More than funding only, Qualified Investors can add critical value to a company: they also have the knowledge, the expertise, the teams and the networks of contacts needed to help applicants reinforce their teams and business strategies, and achieve a successful commercialisation and scale up in the specific verticals, in accordance with their high-growth potential and ambition.

1.27 Depending on the starting stage of the operation and its nature, investors may include Business Angels, Venture Capital funds, Impact investment funds, Family offices, Venture debt funds, National Promotional Banks and Institutions (NPBIs) or corporate venture arms.

1.28 Following an initial assessment implying some level of due diligence, including KYC compliance checks (led by the External AIFM and the Adviser), and market consultation (led by the Adviser), a transactions' categorisation will be done by the Adviser into the "buckets" presented below.

1.29 This classification will not be static, as cases may be moved from one bucket to the other as the due diligence process evolves, based on its findings, or on the initiation of co-investment interest

– resulting inter-alia from the de-risking operated by the EIC Accelerator support, or at later stage as the project evolves and milestones are reached.

(a) **Bucket 0**: this category includes cases for which initial assessment or due diligence, at any stage, reports substantial negative issues preventing any investment by the Compartment.

(i) Compared to the evaluation and selection process run by EISMEA, the due diligence that will be performed by the External AIFM and the Adviser is by definition a more in-depth examination of an operation. Whilst its purpose is not to re-evaluate the proposal or question the rationale of the EIC Accelerator support awarded by the EU Commission but to implement its investment component, findings may lead to question the legality or the rationale of the operation.

(ii) Negative issues include but are not limited to: fraud, money issues listed in Article 158(2) and 158(3) of the EU Financial Regulation like money laundering or tax avoidance, non-compliance issues including in relation to the Sanctions, exclusion criteria, misrepresentation, refusal or failure to submit requested information or lack of sufficient information for the Investment Committee to be able to take, in its professional judgement, a sufficiently informed decision, manifest error at the evaluation and selection process, substantial negative changes of circumstances (together the **Material Adverse Changes** or **MAC**) as compared to those existing at the time of the initial EU Commission award, reputational risk for the EU, and other findings affecting the EU financial interests. For example:

(A) The innovation does not show the expected solid, long-lasting competitive advantage and impact on the basis of which the operation was selected.

(B) The team has changed since the evaluation and does not anymore gather the strong skills, capabilities and motivation needed to get the company off the ground and scale-up.

(C) Other examples of MAC have occurred since the initial assessment of the company undertaken by EISMEA, including major changes in management, changes in control, use of bad leaver provisions, serious litigation situations, including among Shareholders, or loss of major suppliers or clients or partners on which the company is heavily dependent.

(D) The cap table of the applicants evidences strong misalignment of existing shareholder's interest vis-a-vis the EIC Fund Final Recipient, lack of sufficient incentive for founders and key team, etc.

(E) The EIC Selected Applicant refuses or is unable to provide information considered necessary by the Investment Committee, in its professional judgement, to take a sufficiently informed decision, including information on an existing investor/shareholder and its ultimate beneficial owner(s) ((UBO(s)), in relation among others to a possible reputational risk for the EU.

(F) An existing shareholder and/or its UBO falls under the cases of exclusion from EU support in accordance with the EU Financial Regulation.

(G) Financial data and documentation submitted at proposal stage contradicts the applicant's books.

(H) Alleged intellectual property is not directly owned by or accessible to the applicant or is the subject of litigation.

(I) An existing shareholder and/or its UBO is established in/is a national of a non-eligible country for the purposes of the award decision by the EU Commission related to the specific case in question aiming to protect EU interests, or in the case a Legal Entity, is effectively controlled by companies or nationals from such countries.

(iii) Where no remedies are possible, the External AIFM will decide not to proceed with such investment, a decision that may lead the EU Commission to reconvene a jury of external independent experts to re-evaluate the proposal, condition its grant (only) support, but also terminate or even cancel the already concluded EIC Accelerator grant agreement depending on the case.

(b) **Bucket 1**: unlike Bucket 0, where issues are fatal to investment, this category covers target companies with addressable shortcomings that can be remedied through the Compartment’s support. These target companies are not yet private investor ready due to very high risk despite the awarded EIC Accelerator support in the form of a grant.

This lack of traction may result from various shortcomings, such as the very early stage of the underlying technology, a too long planned time to market, a too small market compared to the investment needed, or the low readiness of the applicant to absorb additional equity in terms of its team or cap table, etc.

Three types of cases are envisaged – they do not constitute an exhaustive list of possible cases and are not mutually exclusive:

(i) The EU Commission may award the support on the condition that it acquires a blocking minority, in order to protect EU interests, as identified by the award decision by the EU Commission related to the specific case in question.

The External AIFM and the Adviser will perform due diligence on the applicant and will proceed in principle with the awarded investment using quasi-equity or a combination of quasi-equity and equity or direct equity.

Without prejudice to the necessary flexibility required in each case, the External AIFM may offer to make its investment in at least two tranches in Bucket 1 cases, besides the possibility to provide a single tranche in the form of a convertible instrument.

In the first tranche, the Compartment would invest upon signature the maximum of either (I) fifty per cent (50%) of the estimated Compartment investment, or (II) the unfunded cash needs of the applicant over a period of generally up to eighteen (18) months in the form of a convertible loan to be converted at the next qualified round (i.e., a subsequent equity financing round raising a minimum aggregate amount to be determined by the External AIFM upon recommendation from the Adviser). Consequently, and generally speaking, such convertible loan will have a maturity of generally eighteen (18) months, interest rates of eight per cent (8%) being fixed interest, accruing and capitalized at prepayment or upon conversion) and standard discount rates at conversion depending on the length of its maturity (twenty per cent (20%) discount for eighteen (18) months maturity). The valuation to be taken into account if no round is achieved by maturity will in general be the post-money valuation resulting from the last round into the applicant or a lower amount if conditions have materially changed since the last investment round. The External AIFM, upon recommendation from the Adviser, may, on a case-by-case basis, decide to introduce a cap for the conversion of the Compartment convertible loan at the next round. In case the convertible loan reaches its maturity without occurrence of a qualified round sufficient to convert the full amount, the External AIFM, upon recommendation from the Adviser, will engage with the founders and other investors on a way forward. In addition, the External AIFM, upon recommendation from the Adviser, may advise on potential co-investment opportunities for the subsequent round.

In the second tranche, the Compartment would invest in an equity round in principle the remaining estimated investment subject to the co-investment by private investors of an amount fully matching the totality of the Compartment investment, including the convertible loan provided by the Compartment in the first tranche. The Compartment may require that such private investors co-investing with the Compartment are Qualified Investors – with the purpose of both valuing the applicant on market terms and providing it with subsequent crucial support for a successful market entry and scale-up. The External AIFM, upon recommendation from the Adviser, may also decide on a minimum size of the round for the Compartment to invest its second tranche – considering the financing needs estimated by it for the applicant to successfully reach the market and scale up, based on the outcome of the due diligence and the Adviser's recommendation.

It will include an adequate package of support measures to address shortcomings to a sufficiently high degree.

In such cases, operating as a major investor, the Compartment will ensure a board member seat in the target companies. External mentoring will be sought.

(ii) The innovation has the potential to have a high impact by addressing a societal need or an EU priority.

The Compartment may decide to proceed using quasi-equity or a combination of quasi-equity and equity. It will include an adequate package of support measures to address shortcomings to a sufficiently high degree.

In such cases, operating as a major investor (equal or more than ten per cent (10%) ownership), the Compartment will pursue a board member seat in the EIC Fund Final Recipients. External mentoring will be sought.

(iii) In all other cases, the Compartment may either invest with quasi-equity or a combination of quasi-equity and equity, or equity in a future round (led by a Qualified Investor) on Compartment own standard terms. or recommend milestones that once reached, may attract co-investors and may hence trigger the investment component initially awarded by the EU Commission.

(c) **Bucket 2**: this category includes cases where potential investors, including a Qualified Investor, show immediate interest in co-investing into EIC selected applicants.

(i) The Compartment will seek that the equity investment is at least matched by these potential investors (i.e. which will cover at least fifty per cent (50%) of the round), having an objective of 1:3 leverage for the full EIC investment cycle. To this end, the Compartment may rely on financial, commercial and technology due diligence performed by Qualified Investors and should seek alignment to their terms.

(ii) The Compartment may also reserve a part of the initially awarded investment as possible top-up investment (i.e., an additional investment of the unused portion of the amount already authorised by the EU Commission award decision) for a subsequent investment step of a future investment in steps.

(iii) Where the awarded EIC support is conditioned to the acquisition of a blocking minority by the Compartment in order to protect EU interests, as identified by the award decision by the EU Commission related to the specific case in question and in order to align interests, the Compartment may opt to substitute direct blocking minority by a shareholder agreement[5] providing for similar guarantees regarding EU interests.

(iv) On behalf of the Compartment, the Adviser will negotiate the terms with potential co-investors, including possible mentoring tasks, to be approved by the External AIFM.

(d) **Bucket 3**: this category includes cases where potential investors show immediate interest in providing the full investment into EIC Applicant Companies.

(i) The External AIFM, upon recommendation from the Adviser, could nevertheless decide to co-invest, in order to secure a blocking minority to protect EU interests, as identified by the award decision by the EU Commission related to the specific case in question.

(ii) The External AIFM, upon recommendation from the Adviser, may also reserve the initial investment authorised by the EU Commission as a possible top-up Investment for a subsequent investment step.

1.30 The terms to be negotiated by the External AIFM would seek to ensure sufficient incentives of the founders/employees of the applicant while applying market terms to attract private investors. Equally, they would seek to ensure investor friendly terms to attract potential private capital. While the EIC Accelerator may potentially disrupt the investment ecosystem by enhancing risk-taking attitude among investors, it remains of the utmost importance that it does not create market distortion in filling the financing gap for its high-risk targets.

(Pre-) Due diligence process

1.31 Compliance and some due diligence checks will be performed by the External AIFM based on standard compliance rules[6] (including in order to identify existing shareholders and/or UBOs established in/nationals of (non-eligible) countries for the purposes of the award decision by the EU Commission related to the specific case in question aiming to protect EU interests, or in the

5 The External AIFM will agree with other shareholders on modalities to safeguard EU interests as an alternative to take a blocking minority on their own.

6 The External AIFM shall apply EU rules, policies and procedures, addressing the requirements in respect of money laundering, terrorism financing, tax avoidance, tax fraud and tax evasion that are contained in Article 158(2)(a) of the EU Financial Regulation. Such rules also reflects the prohibition to enter into new or renewed operations with entities incorporated or established in jurisdictions: (i) listed under the relevant Union policy on non-co-operative jurisdictions; such as the list of non-co-operative jurisdictions (as amended from time to time) for tax purposes issued by the Council (OJ C 438, 19.12.2017, p. 5); or (ii) that are identified as high-risk third countries pursuant to Article 9(2) of Directive (EU) 2015/849 of the European Parliament and of the Council of 20 May 2015 on the prevention of the use of the financial system for the purposes of money laundering or terrorist financing, amending Regulation (EU) No 648/2012 of the European Parliament and of the Council, and repealing Directive 2005/60/EC of the European Parliament and of the Council and EU Commission Directive 2006/70/EC (OJ L 141, 5.6.2015, p. 73), as may be amended; or (iii) that do not effectively comply with Union or internationally agreed tax standards on transparency and exchange of information, as well as the possibility to derogate from this requirement when the action is physically implemented in one of those jurisdictions, contained in Article 158(2)(b) of the EU Financial Regulation.

case a Legal Entity, is effectively controlled by companies or nationals from such countries), anti-money laundering (AML), anti-terrorism financing, tax-avoidance, non-compliant/non-co-operative jurisdictions (NCJ) and Sanctions.

1.32 Compliance and KYC checks will be performed prior to the initial investment[7], as well as prior to possible subsequent tranches, top-up and Follow-on Investments. KYC checks on the selected applicant will be extended to the shareholder and their UBOs.

1.33 Non-compliance issues could also be linked to political or integrity aspects creating a high reputational risk for the EU as assessed, after consultation with the EU Commission, by the External AIFM, on the basis of the Adviser's recommendation on a case-by-case basis, and the External AIFM may hence recommend to the EU Commission to terminate or even cancel its support (see Bucket 0).

1.34 The breach of any of these obligations at any stage may lead to the interruption or cessation of the EIC Accelerator support in all its components, and even its cancellation.

1.35 The financial and commercial due diligence process will focus on the following aspects related to the detailed risk assessment of the potential investment:

(a) Governance and quality of the company's management

(b) Capital structure and financial planning

(c) Business strategy

(d) Competition

(e) Market assessment

(f) Value creation

(g) Legal form and jurisdictions

1.36 Additional technology due diligence may be required by the Investment Committee on a case-by-case basis in addition to the systematic technology due diligence to be performed in the context of the initial assessment. Whilst technology is assessed prior to the EU Commission award decision, it may need to be complemented by a more in depth and "investor angle" due diligence, in order to have a more complete view of the operation as well as to investigate any concerns that may have been raised in the initial due diligence concerning misrepresentation or manifest error in respect to the technology and market prospects.

1.37 The Advisory Committee, the Adviser or the Investment Committee may call for different options in this regard, including when appropriate, by EU Commission staff with the relevant technology experience, EIC Programme Managers or technology expertise in national innovation agencies.

Rejection

1.38 Some applications must be dismissed following the due diligence process where fraud, misrepresentation, exclusion, ineligibility or non-compliance, including in relation to the

[7] A compliance KYC self-certification may be collected together with the full accelerator proposal. However, it will not be considered during the evaluation, only by the External AIFM where the proposal is retained by the EU Commission.

Sanctions, issues are established. In such cases, EISMEA should be notified in case of any implications for the grant agreement.

1.39 The eligibility of the EIC Fund Final Recipient, including any possible fraud, misrepresentation and non-compliance, including in relation to the Sanctions, will be checked at each tranche disbursement by the External AIFM as well as the EISMEA in a co-ordinated manner. Ineligibility may lead the Compartment to terminate the EIC Fund investment Agreement and hence any further investment step from the Compartment will stop and the Compartment will exit from the EIC Fund Final Recipient. Where fraud is detected, the EU Commission may terminate and even cancel the EIC Accelerator support and recover all amounts paid, in addition to additional sanctions provided for by the EU Financial Regulation.

1.40 The investment documentations concluded by the Compartment will contain protection clauses for the Compartment in case of, for example, material breach/fraud, or non-compliance, including with the Sanctions, as well as in case the applicant has fallen under the control of investors from non-eligible countries for the purposes of the award decision by the EU Commission related to the specific case in question aiming to protect EU interests, or in the case a Legal Entity, is effectively controlled by companies or nationals from such countries. In such cases, the EIC Fund Final Recipient may have to fully reimburse/cash settle the EIC support received. Regarding the equity component, the remedial measures shall include, but shall not be limited to, the disposal of Compartment's interest in the investing scheme via a secondary sales transaction, including the right to sell its share in the equity for one Euro (EUR1) to the remaining shareholder/owners that are established in or are nationals of an EU Member State or a country associated to HE Pillar III Equity component, provided that in the case of legal entities, they are not controlled by companies or nationals from the above-mentioned (non-eligible countries).

1.41 Non-compliance issues could be linked to tax, political or integrity aspects. Information provided by the EIC Selected Applicant at application stage and during due diligence will be assessed in detail.

Possible forms of equity-type financial instruments to be used

1.42 There are different types of instruments an emerging business may use to finance its growth. The financial instruments used by the Compartment will take, in priority, the form of equity or quasi-equity investments.

1.43 Standard equity and quasi-equity instruments are summarised as follows:

(a) Common shares: represent an ownership interest in a corporation, including an interest in earnings and dividends. They may be voting or non-voting and may be divided into classes with special voting privileges assigned to each class. In the VC market, founders and management team usually hold common shares.

(b) Preferred shares: represent a hybrid in the sense that it is an equity interest with debt-type features such as seniority at dividend payments and liquidation proceeds. VC funds usually hold preferred shares.

(c) Convertible instruments: like convertible loans/bonds/notes, participation rights, Simple Agreements for Future Equity ("SAFEs") etc that have a convertibility feature attached to a debt instrument that is attractive to the issuing company, since they are aimed to postpone dilution until the company's next equity funding round. They offer flexibility to investors allowing them to shift the risks and rewards of their investment to some point in the future after the initial investment.

(d) Other equity-type instruments appropriate to achieve the objectives of the Compartment.

Investment implementation

1.44 The External AIFM will proceed in a timely manner with the execution of the investment. This includes the closing of the final legal documents, including in particular the investment agreement and, *inter alia*, subscription agreements, side letters, etc. The External AIFM will contract with and finance the EIC Fund Final Recipient on behalf of the Compartment.

Publication of information on EIC Fund Final Recipients

1.45 Each EIC Fund Investment Agreement shall include an acknowledgment by the EIC Fund Final Recipient that the Compartment and/or the Adviser may communicate information regarding the EIC Fund Final Recipient, irrespective of the amount of the financial support received from the Compartment. This acknowledgement will be required because the Compartment may provide to the EU Commission or otherwise publish information on EIC Fund Final Recipients, including, but not limited to the name and locality of the EIC Fund Final Recipient; the amount invested by the Compartment in the EIC Fund Final Recipient; and the nature of the EIC Fund Final Recipient's business and the Compartment's investment. For the avoidance of doubt, Articles 36 and 38 of the EU Financial Regulation shall apply in relation to this Compartment.

Visibility

1.46 Each EIC Fund Investment Agreement shall include the obligation for the EIC Fund Final Recipient to provide the Compartment with a written acknowledgment (whether in the EIC Fund Investment Agreement or by separate acknowledgment) in substantially the terms set out below:

"*[EIC Fund Final Recipient] hereby acknowledges that [this] investment [is]/[has been] provided by the EIC Fund set up under the European Innovation Council. The purpose of the European Innovation Council is to identify, develop and deploy breakthrough technologies and disruptive and market creating innovations, and support the rapid scale-up of innovative firms at EU and international levels along the pathway from ideas to market.*"

Monitoring and follow-up investments

1.47 The External AIFM will manage individual investments. This includes monitoring and acting on milestone funding, financing events (conversions, follow-on, etc), write-downs and restructurings, exits, etc. The Adviser shall promptly inform the External AIFM and the Board if it becomes aware that an EIC Fund Final Recipient did not meet any applicable exclusion and eligibility criteria on the date of the Compartment's initial Investment.

1.48 Given the equity and quasi-equity nature of the Compartment's Investments, it is recognised that the Compartment will typically have no or limited remedies or exit/repayment possibilities in the event that an EIC Fund Final Recipient does not meet the applicable exclusion and eligibility criteria or otherwise breaches any term of the relevant EIC Fund Investment Agreement, including any terms and conditions deriving from the Investment Policy or other relevant provisions.

1.49 The External AIFM shall ensure, subject to the policy decided by the Board, that qualified representatives or independent experts may be appointed by the Compartment to sit on boards of EIC Fund Final Recipients as voting members. Such appointments may be discussed on a case-by-case basis during the due diligence and investment process and the details of such appointments, if opted for, shall be, (subject to the terms and provisions of the AIFM Services Agreement), included in the legal documents to be signed.

1.50 In addition to the above, subject to the Adviser's internal clearances, approvals and procedures, investment officers of the Adviser will be appointed at any time and from time to time by *the External AIFM on behalf of* the Compartment as proxies (**Appointed EFFR Shareholder**

Representatives) to carry out the voting instructions of the Compartment, as Shareholder of EIC Fund Final Recipients (**EFFR**), at general or extraordinary Shareholders' meetings of an EFFR. The Appointed EFFR Shareholder Representatives will exercise the Compartment's voting rights (for, against or abstention), as Shareholder in the EFFR, strictly in accordance with the prior written voting instructions received from the External AIFM, as such instructions are recorded and set out in a proxy appointment (**Proxy Appointment**). The Proxy Appointment will not authorise the Appointed EFFR Shareholder Representatives to exercise any discretion to vote on behalf of the Compartment on any matter of any other business, or on any resolution that does not match the resolutions of the meeting agenda that are set out in the Proxy Appointment instructions. In addition, subject to the Adviser's internal clearances, approvals and procedures, and subject to a corresponding appointment to be effected by the External AIFM on behalf of the Compartment, the Adviser will nominate its investment officers in accordance with its procedures to sit on a non-voting observer board seat of an EFFR.

Follow-on Investments

1.51 Subject to an *ex ante* amending award decision by the EU Commission, the Compartment can do Follow-on Investments[8] in those EIC Fund Final Recipients which remain eligible to EIC Accelerator support and according to the conditions set out in the applicable EIC Work Programme.

1.52 Follow-on Investments will not crowd out smaller investments and will fulfil the requirements of Horizon Europe for EIC blended finance support (i.e. that Final Recipients are SME (or, in exceptional cases, small mid-caps), continued EIC support is necessary, support through InvestEU is not yet possible and consistency with state aid rules is ensured) as well as the matching requirements under the Compartment's Investment Guidelines without prejudice to other applicable provisions. Furthermore, such support requires that a budget is still available to the EU Commission in the year in question and will be subject to a valid financing decision by the EU Commission.

1.53 Where following an EIC Call for proposals the EU Commission awards an additional investment to a Horizon 2020 EIC Pilot operation, the latter is transferred under the Compartment.

Mentors

1.54 The Adviser and EISMEA will put the EIC Fund Final Recipient, with its consent, in contact with its network of mentors, which could also be potential investors, in order to provide advice and recommendations for the business development of the target company and for any potential corporate actions.

1.55 In some cases such as those under "Bucket 1", mandatory mentoring may be required as a condition to the investment.

Duration of the investment and exit strategy

1.56 The Compartment will invest patient capital, with a long average perspective on return on the investment (seven (7) to ten (10) years) with a maximum of fifteen (15) years in general. The levels of returns sought will be assessed on a case-by-case basis. The Compartment's main objective is "impact investment" rather than maximizing return on the investment, while of course a positive

[8] Follow-on Investments should be considered to include only investments that would go beyond the maximum amount set out in the award decision by the EU Commission. Investments in different steps, i.e. when the Compartment decides first to invest one part of the equity amount, and subsequently – e.g. during a subsequent funding round – another part of that equity amount, are not considered as follow-on investments for the purposes of this Memorandum as long as the total equity invested remains within the equity amount set out in the award decision of the EU Commission.

return is always planned at the time of the investment as well as in compliance with general market practice.

1.57 The Compartment's exit strategy for each EIC Fund Final Recipient is to be set on a case-by-case basis in close co-operation with co-investors in the EIC Fund Final Recipient given the specificities of each business plan, the founder team, industry, expected holding period as well as the development of the companies compared to the initial milestones set. Exit routes may include IPOs, management buy-outs, secondary sales or liquidations.

1.58 If an EIC Fund Final Recipient becomes insolvent, the Compartment may not be able to control the exit process if, for example, the Compartment is obliged to comply with restructuring arrangements approved under applicable national laws, or a liquidator is appointed to sell the EIC Fund Final Recipient's assets and pay creditors. The Compartment will not rule out, if and to the extent possible under the relevant EIC Fund Investment Agreement, in case of a non-performing EIC Fund Final Recipient, an exit via redemption or sale of the Investment to a third party at a symbolic price.

1.59 Any exit (divestment) decision is made by the External AIFM in its full discretion, in accordance with regulatory requirements, market practice and the Compartment's Investment Guidelines. The Compartment's approach is to act as a patient investor. This allows the Compartment to be different from the qualified lead investor (i.e., the main investor in a given round, whose commercially driven investment horizon determines the exit timeline contrasting with the Compartment patient approach) who may or may not have a different investment horizon. It is meant to accompany its EIC Fund Final Recipients during the period when it is considered necessary to provide the public de-risking support that is requested and validated. This can mean market deployment of a technology, and the scale up to fill a financing market gap that is not addressed by private players. Thus, the Compartment should be prudent in determining when the timing is deemed right to exit.

1.60 In general, the exit process should be driven by the Compartment's co-investors, in particular, a lead investor. It follows that the Compartment should generally seek to divest of its participation in an EIC Fund Final Recipient alongside the lead investor, or one of the lead investors, except if it is justified to extend the Compartment's participation, for example, for reasons that would otherwise justify obtaining a blocking minority, and always subject to the entry of a new investor as a co-investor to the Compartment. Where it is however clear that the co-investor intends staying for a very long time and EIC support is no longer needed, the Compartment should exit before, in order to make EIC funding available for new companies.

1.61 Divestment should also take place when companies can be financed from market sources including InvestEU, as EIC support is no longer needed. Other, less favourable scenarios (e.g. exiting below the initial investment amount) should be considered if the conditions for more customary exit strategies are not met, including if the EIC Fund Final Recipient has failed to achieve a successful development, taking into consideration the Compartment's objective of investing patient capital. Failure to find co-investors should also be taken into account in order to exit.

1.62 The Compartment should, guided by *pari-passu* investment terms, and supported by the Adviser, ensure through regular interactions with other investors that the preparation for the exit phase starts in due time. This should entail in particular:

(a) the initial setup of the proper conditions to ensure the alignment of investor interests, the Compartment's public service mission and EIC Fund Final Recipient management interest. The initial setup should also ensure the EIC Fund Final Recipient managements' support to the exit transaction, in particular, in the case of an envisaged trade sale whereby the management team would be replaced by the team of the strategic buyer. Such alignment will generally be ensured by the implementation of a solid incentive program in the form of an employee stock ownership plan;

(b) the definition of metrics deemed key to a successful exit on the sector concerned, and a related plan to optimize such metrics in view of the foreseen exit; and

(c) at an initial stage, except in the case of an initial public offering (IPO), the identification of a pool of potential acquirers; at a subsequent stage, direct engagement with them; and at a later stage, the initiation of the exit process either in the form of an exclusive process with one of them or in the form of an auction.

Intellectual Property management for grants (in grant-only and grant component of blended finance)

1.63 Grant-only support and the grant component of blended finance under the EIC Accelerator shall be subject to the Horizon Europe intellectual property rules of Horizon Europe Regulation, in particular its articles 38 to 41.

1.64 Within applicable national legislation, the EIC Fund Final Recipient and co-investors will be given maximum autonomy regarding intellectual property management, to the best interests of the deployment of the innovation and the companies' development, in order to attract further investments to scale-up and to allow for an effective exit strategy for the Compartment.

1.65 Yet, and in particular but not only in the cases where the EU interests need to be protected in line with the award decision by the EU Commission related to the specific case in question, including when the Compartment acquires a blocking minority, the Compartment will seek to secure that intellectual property remains within the EU and Associated Countries and with the EIC Fund Final Recipient wherever it makes sense for its development. The same guiding principle will apply for the Compartment's exit from EIC Fund Final Recipients.

Excluded Activities

1.66 The Compartment will not invest in any person that conducts any Excluded Activities.

1.67 **Excluded Activities** means any of the following activities:

(a) production or activities involving harmful or exploitative forms of forced labour[9]/harmful child labour[10];

(b) production or trade in any product or activity deemed illegal under host country laws or regulations or international conventions and agreements;

(c) any business relating to pornography or prostitution;

(d) production or trade in wildlife or wildlife products regulated under the Convention on International Trade in Endangered Species or Wild Fauna and Flora (CITES);

(e) production or use of or trade in hazardous materials such as radioactive materials, unbounded asbestos fibres and products containing Polychlorinated Biphenyls;

[9] Forced labour means all work or service, not voluntarily performed, that is extracted from an individual under threat of force or penalty.

[10] Harmful child labour means the employment of children that is economically exploitive, or is likely to be hazardous to, or to interfere with, the child's education, or to be harmful to the child's health, or physical, mental, moral or social development. In addition any labour that is performed by a person which has not yet reached the age of 15 is considered to be harmful, unless the local legislation specifies compulsory school attendance or the minimum age for working to be higher; in such cases, the higher age will be applied for defining harmful child labour.

(f) cross-border trade in waste and waste products unless compliant with the Basel Convention and the underlying national and EU regulations but for the avoidance of doubt, use of waste as a fuel in district heating is not excluded;

(g) unsustainable fishing methods (ie drift net fishing in the marine environment using nets in excess of 2.5 km in length and blast fishing);

(h) production or trade in pharmaceuticals, pesticides/herbicides, chemicals, ozone depleting substances and other hazardous substances subject to international phase-outs or bans;

(i) destruction of Critical Habitats[11];

(j) production and distribution of racist, anti-democratic and/or neo-Nazi media;

(k) tobacco, if it forms a substantial part of the business activities of the proposed EIC Fund Final Recipient;

(l) live animals for scientific and experimental purposes, including the breeding of these animals;

(m) gambling, casinos and equivalent enterprises or hotels hosting such facilities;

(n) commercial concessions over, and logging on, tropical natural forest; conversion of natural forest into a plantation;

(o) purchase of logging equipment for use in tropical natural forests or high nature value forest in all regions; and activities that lead to clear cutting and/or degradation of tropical natural forests or high nature value forest;

(p) new palm oil plantations;

(q) any business with a political or religious content;

(r) projects which have the effect of limiting people's individual rights and freedoms or violating their human rights;

(s) activities referred to in Article 18 of Horizon Europe Regulation (Ethical principles); and

(t) actions for the development of lethal autonomous weapons without the possibility for meaningful human control over selection and engagement decisions when carrying out strikes against humans, without prejudice to the possibility of providing funding for actions for the development of early warning systems and countermeasures for defensive purposes.

[11] Critical habitat is a subset of both natural and modified habitat that deserves particular attention. Critical habitat includes areas with high biodiversity value that meet the criteria of the World Conservation Union (IUCN) classification, including habitat required for the survival of critically endangered or endangered species as defined by the IUCN Red List of Threatened Species or as defined in any national legislation; areas having special significance for endemic or restricted-range species; sites that are critical for the survival of migratory species; areas supporting globally significant concentrations or numbers of individuals of congregatory species; areas with unique assemblages of species or which are associated with key evolutionary processes or provide key ecosystem services; and areas having biodiversity of significant social, economic or cultural importance to local communities. Primary Forest or forests of High Conservation Value will be considered Critical Habitats.

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