Submission

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August 29, 2014

To ESMA

Re **Response to**

ESMA Consultation Paper on MiFID II/MiFIR, 22 May 2014, ESMA/2014/549

ESMA Discussion Paper on MiFID II/MiFIR, 22 May 2014, ESMA/2014/548

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Introduction

1. The European Private Equity and Venture Capital Association (EVCA) is the voice of European private equity. Our members cover the whole investment spectrum, including the institutional investors investing in a broad range of private equity and venture capital (PE/VC) funds, as well as the PE/VC firms raising such funds, which in turn invest in the full life-cycle of unlisted companies, from high-growth technology start-ups, to the largest global buyout funds turning around and growing mature companies. Thus we speak on behalf of the entire European PE/VC industry, investors as well as managers.

2. We welcome the opportunity to respond to ESMA's consultation on MiFID II/MiFIR. For many years, the EVCA has been an engaged interlocutor with the European Commission and other European institutions like the European Securities and Markets Authority (ESMA), following closely the different discussions and initiatives affecting the European private equity and venture capital industry.

3. In this response, we have focused solely on those aspects of the Consultation Paper and the Discussion Paper which are of particular importance to the PE/VC industry. EVCA members may be affected in a number of ways.

4. MiFIR and MiFID II are primarily designed to regulate dealings in listed securities and analogous derivative markets. These markets are characterised by generally liquid markets in which securities and derivatives are frequently traded on both the primary and secondary markets. Where MiFID firms do invest in the real economy through investing in shares issued by privately held companies which are not traded on any trading venue, such investments tend to be short term and limited to minority holdings (often less than 10% of issued shares). By contrast the private equity industry focuses on purchasing significant holdings in privately held companies operating in the real economy. These investments are then held for a period of ownership typically lasting 3–5 years, during which the private equity firm works to increase the value of the company. When seeking to acquire unlisted companies, private equity firms often compete with strategic buyers (and sometimes wealthy individuals) who are not subject to financial services regulation.

5. Some of the requirements are proposed to be applied to European alternative investment fund managers subject to the full requirements of the Alternative Investment Fund Managers Directive (2011/61/EC) ("AIFMs"). This is the main EU legal instrument regulating the management and marketing of private equity funds. It applies mandatorily to managers of

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private equity funds with €500 million or more under management. Smaller EU managers may voluntarily opt in to the Directive or may opt in to EuSEF (Regulation (EU) No 346/2013) or EuVECA (Regulation (EU) No 345/2013).

6. Where affiliates of PE/VC AIFMs have the role of identifying transaction opportunities, negotiating them and advising the AIFM or an affiliate on their merits, it is possible that the affiliate would fall within an exemption from MiFID, such as the group exemption. Alternatively the affiliate may conclude that their services are limited to transactions in instruments falling outside of the scope of MiFID. The exact analysis differs based on the specific structures in different EU jurisdictions. In some EU jurisdictions, these activities are considered to be MiFID business requiring a licence.

7. Some affiliates of a PE/VC AIFM are involved in investor relations and/or marketing fund interests to EEA investors. Some jurisdictions require entities to be regulated for these tasks, even where the fund manager is an affiliate and falls below the AIFMD size threshold, so would not itself need to be authorised under AIFMD.

8. Moreover, in some EU jurisdictions, private equity managers who exercise discretion over managed accounts not structured as collective investment undertakings are considered to be providing the MiFID service of "portfolio management". These entities will be subject to the requirements.

9. Against this background, our main comment is that it is taken into consideration that **many of the MiFID rules** - being designed to regulate dealings and trading of securities - **do not seem to be appropriate to be applied to advisory, management and marketing activities around private equity funds and their managers and advisors**. This should be taken into consideration when applying and interpreting these rules. In light of the foregoing, we have provided answers only to some questions and the following sections of the Consultation paper:

    a. Section 2.3 – Compliance function

    b. Section 2.6 – Recording of telephone conversations and electronic communications

    c. Section 2.7 – Product governance

    d. Section 2.9 – Conflicts of interest

    e. Section 2.10 – Underwriting and placing

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f. Section 2.11 – Remuneration

g. Section 2.12 – Fair, clear and not misleading information

h. Section 2.13 – Information to clients about investment advice and financial instruments

i. Section 2.14 – Information to clients on costs and charges

j. Section 2.15 – Inducements paid to/by a third person

k. Section 2.16 – Investment advice on an independent basis

l. Section 2.20 – Reporting to clients

m. Section 6.1 – SME Growth Markets

and of the Discussion Paper:

n. Section 2.1 – Authorisation of investment firms

10. We stand ready to provide whatever further contribution to this work ESMA might find helpful, including attending meetings and contributing further materials in writing.

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General comments

11. As stated above, our commentary focuses on areas where we consider amendment is needed to ensure that the underlying policy intentions behind MiFIR and MiFID II do not result in European private equity players being subject to requirements:

    - which fail to realise the policy objectives which we understand to be behind the suggested measure;
    - which are disproportionate to the stated policy objectives;
    - which may be impossible to comply with in practice;
    - which result in an un-level playing field for the European private equity industry; or
    - which we consider would otherwise give rise to significant concerns for our members.

12. In many cases, our comments relate to differences between the workings of the European discretionary management industry for which the relevant policy has been primarily developed and the workings of private equity firms. A legal requirement may work in addressing a policy issue relating to the former but may give rise to a poor result when applied to the latter.

13. One mechanic used to recognise these differences in EU financial services legislation is the concept that a firm may not be required to comply with a particular requirement if it is "able to demonstrate that in view of the nature, scope and complexity of its business, and the nature and range of investment services and activities". We refer to this as the "**Proportionality Principle**" and have referred to it in a number of places in our response.

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Specific Response to Sections and Questions of the Discussion Paper

I. Section 2.3 - Compliance function

Q3: Do you agree that the existing compliance requirements included in Article 6 of the MiFID Implementing Directive should be expanded?

14. We do not object to the proposed approach in principle. We welcome the proposal in paragraph 6 of the proposed technical advice on page 21. This continues the existing application of the Proportionality Principle to the requirements that compliance personnel not be involved in the performance of services they monitor or be paid in a way which potentially risks compromising their objectivity. This approach is consistent with AIFMD. Some affected private equity firms will be small and would not have sufficient compliance work for a full time senior member of staff who performs no other function. We also suggest that the reference in paragraph 5(iii) of the proposed technical advice to reporting to the management body "a significant risk of failure to comply with its obligations under MiFID II" should be amended to refer to "a significant risk of material non-compliance by the firm", in order to avoid a situation where a compliance officer feels compelled to report minor infringements.

Q4. Are there any other areas of the Level 2 requirements concerning the compliance function that you consider should be updated, improved or revised?

15. We do not consider additional amendments are required. If additional amendments are added we would request that the Proportionality Principle is duly reflected to prevent disproportionate application to smaller firms.

* * * * * * * *

II. Section 2.6 - Recording of telephone conversations and electronic communications

16. Article 16(7) requires recording of telephone conversations relating to, at least, transactions concluded when dealing on own account and the provision of client order services that relate to the reception, transmission and execution of client orders in all MiFID financial instruments.

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This is also deemed to include conversations that are intended to result in transactions concluded in this manner, even if those conversations do not do so.

17. Despite previous advice from the CESR from 29 July 2010 which suggested that such reporting requirements should not capture internal conversations and communications within firms, ESMA has indicated that it considers that some internal calls are subject to the recording requirement where the internal call “relates to or is intended to result in transactions”.

18. The application of the recording requirements to conversations deemed as intended to result in transactions and, in particular, in respect of internal communications which relate or may potentially relate to transactions adds a level of unnecessary ambiguity to the requirements. Firms will struggle to determine which internal conversations need to be included and divergent interpretations could result in differing practices. The uncertainty may cause resource inefficiencies and will cause additional unnecessary costs as recordings are made and retained in circumstances where this is not actually required. This is likely to have a disproportionate effect on private equity. Whilst investment managers dealing in listed securities may engage in thousands of transactions per year, even mid-sized private equity houses will typically buy or sell less than ten companies per year. This means there will be very few conversations with a buyer or seller which is intended to result in a transaction, so if the recording requirement is limited to these calls, the impact of the requirements could be limited. However many internal calls will need to take place around due diligence relating to a transaction. If all such calls need to be recorded, this will/may result in a vast volume of unnecessary recorded material.

19. Furthermore, the financial instruments for which the recording requirements apply may include shares and loan notes issued by privately held companies which are not traded on any trading venue, thus extending the scope of the requirements beyond the usual order execution context and into the field of alternative investment fund investments (as private shares and loan notes may be covered). In addition, the stated reasons for requiring telephone recordings include ensuring that there is evidence to prove the terms of any orders given by clients as well as to detect any behaviour that may have relevance in terms of market abuse. However, these factors will not be relevant in circumstances where transactions are agreed after extensive negotiations and formalized in a written agreement or relate to fund-related transactions. We accordingly advocate limiting the scope of the recording requirement to orders relating to financial instruments to which the market abuse regime is applicable in order to more clearly achieve the stated policy intention.

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20. In the same way as provided for under Recitals 45 and 46 of the Level II Implementing Regulation in respect of the AIFMD, we consider that differences between various asset types and transaction types should be taken into account in the way in which the telephone recording requirements apply and could therefore be addressed by the technical advice.

21. We consider that there would be merit in attributing a level of proportionality to the requirements in MiFID II, using the Proportionality Principle.

22. Furthermore, the rules as drafted will result in a duplication of recordings between brokers and their investment manager clients. This duplication could be removed consistently with achieving the stated policy intention by exempting telephone calls made by a discretionary investment manager with, sent to or received from a firm which the discretionary investment manager reasonably believes is subject to the same recording obligation (e.g. a broker). We understand that at least one EU member state currently permits an exemption for discretionary investment managers, in respect of telephone conversations made with, sent to or received from a person who is not subject to the same recording obligation, provided that such telephone conversations are made with, sent to or received from such persons on an infrequent basis, and represent a small proportion of the total telephone conversations made, sent or received by the discretionary investment manager to which the recording requirements apply.

Q8. What additional measure(s) could firms implement to reduce the risk of non-compliance with the rules in relation to telephone recording and electronic communications?

23. If the proportionality proposals suggested above are adopted by ESMA, we consider that it should be straightforward for private equity firms to monitor the small number of relevant telephone calls taking place each year.

Q9. Do you agree that firms should periodically monitor records to ensure compliance with the recording requirement and wider regulatory requirements?

24. Where firms complete a *de minimis* number of transactions each year it would be disproportionate to apply to them the same obligation to listen to sample telephone records as those firms which complete many transactions each year. Application of the Proportionality Principle would be necessary.

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Q10. Should any additional items of information be included as a minimum in meeting minutes or notes where relevant face-to-face conversations take place with clients?

25. Article 16(7) of MiFID II refers to records of relevant face-to-face meetings with clients and its purpose is to capture the details of conversations relating to "orders". Paragraph 9 of the proposed ESMA guidance on page 37 is not on its face limited to "orders". It is very important that the requirement is limited in this way, to avoid imposing on firms the need to minute in detail every single client interaction. This is particularly important for dealings with clients who are other companies in the same group as the investment firm, to avoid the risk that all inter-company interactions need to be recorded in this way, which would be an unworkable requirement.

Q11. Should clients be required to sign these minutes or notes?

26. Where the record is of a meeting at which no direct instruction was given to make a sale or purchase, we consider this to be of no value.

Q12. Do you agree with the proposals for storage and retention set out in the above draft technical advice?

27. The storage requirements will result in additional cost. We do not support incurring additional cost where this is disproportionate to any legitimate regulatory objective.

Q13. More generally, what additional costs, impacts and/or benefits do you envisage as a result of the requirements set out in the entire draft technical advice above?

28. If the comments set out above are not reflected and/or the Proportionality Principle is not appropriately applied, the costs could be significant. Firms which do not already record phone calls could incur significant costs if they need to record every phone line of the entire office. If firms also need to minute in detail every single interaction with clients, this could require additional staff to be employed to produce such minutes. This could give rise to material additional administrative burden without a commensurate benefit.

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III. Section 2.7 – Product governance

29. Generally the managers of private equity AIFs will not be covered by these rules (as managers of alternative investment funds they will be outside the scope of MiFID), but we do have some concerns about the manner in which distributors of their funds could, in some circumstances, be affected by the rules.

30. In this regard our general view is that alternative investment funds and alternative investment fund managers are now subject to sufficient regulation and, most importantly, because they can generally only be marketed to professional investors there is little or no need for further consideration or segmentation of this target market. Most such investors will be investing as part of a diversified investment strategy (and not to meet some specific need such as hedging etc.) and it seems to us disproportionate to expect any manager or distributor of AIFs to be required to segment the target market further once they have ensured that the investor is a professional investing as part of a diversified investment strategy. Having established that fact it would seem to us that the governance rules within the AIFMD should be sufficient to ensure investors are appropriately protected.

Application to private funds marketed in compliance with the AIFMD

31. Following the recent implementation of the Alternative Investment Fund Managers Directive, funds which qualify as Alternative Investment Funds (AIFs) are now required to comply with strict requirements if marketed to investors in the European Economic Area (EEA). Our assumption is that AIFMs themselves as operators of collective investment undertakings remain outside the scope of MiFID. However, it would be helpful if that were confirmed.

32. It would also be helpful if it could be confirmed that where their AIFs are distributed by an investment firm that is subject to MiFID, this does not indirectly result in the AIFM having to consider product governance rules when manufacturing the AIF.

33. It would also be helpful if it were confirmed that the rules on distributors of products do not apply to investment firms when they are distributing an AIF to professional investors. Our view would be that the detailed rules already set out in the AIFMD governing how AIFMs and AIFs must operate and be marketed are already sufficient to ensure appropriate investor protection.

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Product information in respect of AIFs

34. Private fund managers marketing AIFs to EEA-based investors are subject to detailed product information requirements under Article 23 of the AIFMD. Therefore, even if the AIF is marketed by someone other than the AIFM, no additional product information requirements should apply.

35. Paragraph 26 of the proposed guidance sets out situations in which information prepared in accordance with a directive is sufficient to satisfy product information requirements under MiFID II, including the requirements in the Prospectus Directive and the Transparency Directive.

36. We would recommend that the proposed guidance is amended to clarify that the Alternative Investment Fund Managers Directive is included in this list of examples.

Application to professional investors and proportionality

37. We would recommend that the proposed guidance is amended to clarify that the detailed requirements in relation to manufacture and distribution can be disapplied under the principle of proportionality when dealing with professional investors investing as part of a diversified investment strategy, or at least clarified to state which requirements can be disapplied when dealing with professional investors.

38. If proposing a positive duty on firms to check that a product functions as intended (as set out in paragraph 13 of the Consultation Paper), in particular if (as proposed by ESMA) options 1, 2 and 3 should apply, the proposed guidance should set out that these requirements may be disapplied in the case of AIFs (in particular, closed-ended AIFs).

Q14: Should the proposed distributor requirements apply in the case of distribution of products (e.g. shares and bonds as well as over-the-counter (OTC) products) available on the primary market or should they also apply to distribution of products on the secondary market (e.g. freely tradable shares and bonds)? Please state the reason for your answer.

39. In our view the rules are intended to regulate manufacturers and their distribution networks and so it is likely to be difficult to apply the rules to participants in secondary markets. Furthermore we would expect that by applying the rules appropriately to the original manufacturer and primary market activity, appropriate investor protection should be assured.

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40. We would also note that in many circumstances manufacturers and 'primary' distributors will not be able to control later secondary market activity. So our view would be that there should either be no application to secondary market activity, or if there is, that it should be clear that the responsibilities of the original manufacturer and distributor are not affected by that secondary market activity.

Q15: When products are manufactured by non-MiFID firms or third country firms and public information is not available, should there be a requirement for a written agreement under which the manufacturer must provide all relevant product information to the distributor.

41. Our view is that such rules should not apply to AIFMs/AIFs which are marketed subject to the rules of AIFMD. In any event, we take the view that there is no need to impose a requirement for a written agreement. Distributors are under an obligation to put in place adequate arrangements to obtain appropriate information but there is no need to be prescriptive about those arrangements or require them to be achieved by contract. The rules cover a potentially wide range of products and it should be for the distributor to determine how best to meet its obligations taking into account the principle of proportionality.

42. In addition to our overarching point that the governance rules should not apply to AIFs (on the basis that AIFs are now already adequately regulated under the AIFMD and can only be freely marketed to professional investors under the AIFMD marketing passport), we would stress that even absent the sort of clear exemption that would be appropriate all relevant 'product' information in relation to an AIF would already be made available to European investors under Article 23 of the AIFMD (which also applies to third country AIFs that may be placed into the EU). An acknowledgement that Article 23 disclosures are sufficient in this regard could be helpful.

Q16: Do you think it would be useful to require distributors to periodically inform the manufacturer about their experience with the product? If yes, in what circumstances and what specific information could be provided by the distributor.

43. See generally above, we think that such rules should not apply. This being said, generally it should be for the manufacturer to determine whether it requires information from the distributor. We do not think it necessary to impose a strict further obligation. In many cases the manufacturer will have a direct relationship with the investor or client and may well be

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reporting to them directly. In these circumstances securing additional information from the distributor could create a disproportionate and unnecessary burden. This is particularly the case in relation to AIFs where the manufacturer would be well aware of the performance of the product and will be reporting to investors regularly.

Q17: What appropriate action do you think manufacturers can take if they become aware that products are not sold as envisaged (e.g. if the product is being widely sold to clients outside of the product's target market)?

44. We would envisage that manufacturers should be required to use reasonable efforts to inform distributors of this fact and, where it is reasonably possible, inform end-clients known to them and prohibit or limit further marketing of the product outside the intended client market.

45. In the context of UCITS and AIFs and other collective investment undertakings we would note that their manufacturers are typically their managers or operators and so are exempt from MiFID.

Q18: What appropriate action do you think distributors can take, if they become aware of any event that could materially affect the potential risk to the identified target market (e.g. if the distributor has misjudged the target market for a specific product)?

46. In circumstances where the distributor is of the view that the target market will not otherwise become aware of such events (such as where existing investors in a product will have a direct relationship and receive reports from the relevant manufacturer), then we would anticipate the distributor using reasonable efforts to inform existing investors/clients of such events and seeking to ensure that appropriate adjustments are made to the future target market.

Q19: Do you consider that there is sufficient clarity regarding the requirements of investment firms when acting as manufacturers, distributors or both? If not, please provide details of how such requirements should interact with each other.

47. As noted we would not typically expect managers of collective investment undertakings (whether UCITS, AIFs or otherwise) to be subject to MiFID or these product governance rules. We think that a clear statement that the manufacturer of an AIF would, for the purposes of these rules, typically be its AIFM would be a helpful clarification.

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48. We also think it would be helpful to clarify that where a manager or operator of a collective investment undertaking also performs non-core services according to Article 6 (3) MiFID or Article 6 (4) AIFMD, it should not be subject to these rules in respect of its activities in respect of the collective investment undertakings that it manages. Those activities are already adequately regulated (including appropriate governance arrangements) under UCITS or AIFMD.

Q20: Are there any other product governance requirements not mentioned in this paper that you consider important and should be considered? If yes, please set out these additional requirements.

49. We do not think that any other governance requirements need to be considered.

Q21: For investment firms responding to this consultation, what costs would you incur in order to meet these requirements, either as distributors or manufacturers?

50. We have no comment on the potential costs.

* * * * * * * *

IV. Section 2.9 - Conflicts of interest

Q54: Should investment firms be required to assess and periodically review - at least annually - the conflicts of interest policy established, taking all appropriate measures to address any deficiencies? Please also state the reason for your answer.

51. We agree with the requirement to periodically review conflicts policies, which is implicit in the requirement in Article 22(1) of Directive 2006/73/EC to maintain an effective conflicts of interest policy.

52. We consider, however, that the approach to disclosure of conflicts in the draft technical advice is too restrictive and goes further than Article 23 of MiFID II contemplates. Whilst accepting that there should not be an over-reliance upon disclosure, there are circumstances where disclosure, on an ad-hoc basis, may be an appropriate way to manage a conflict, particularly where other means of managing the conflict may be disproportionate. Additionally, the draft advice does not recognise that disclosure may be a more acceptable means of managing conflicts in the case of professional clients than retail clients and in

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relation to some asset classes than others. For these reasons, we do not consider that the 'last resort' approach adopted in the draft advice is appropriate.

53. Further, it seems not only unnecessary but wrong to prohibit disclosure in circumstances where it is used alongside other means of managing a conflict but is not relied upon as a means of managing the conflict. It is normal in private equity for agreements to impose positive obligations always to disclose material conflicts, whether or not the firm is managing those conflicts. Firms should be permitted to make disclosures to their clients of the types of conflict that may arise in the course of the firm's business. For this reason, notwithstanding the above comments, we consider that the word "used" in the second line of paragraph 2 of the draft advice should be replaced with the words "relied upon".

Q55: Do you consider that additional situations to those identified in Article 21 of the MiFID Implementing Directive should be mentioned in the measures implementing MiFID II? Please explain your rationale for any additional suggestions.

54. No.

Q56: Do you consider that the distinction between investment research and marketing communications drawn in Article 24 of the MiFID Implementing Directive is sufficient and sufficiently clear? If not, please suggest any improvements to the existing framework and the rationale for your proposals.

55. It would be helpful to provide greater clarity in relation to the meaning of Article 24(1)(b) of Directive 2006/73/EC. Since, in accordance with Article 52 of Directive 2006/73/EC a recommendation cannot be a personal recommendation if it is issued exclusively through distributions channels or to the public, the condition in Article 24(1)(b) has the appearance of being somewhat circular.

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V. Section 2.10 - Underwriting and placing

56. The proposed guidance should not apply to private equity firms. It is clearly drafted to apply to corporate finance providers providing placing services to the capital markets. Such providers are performing the MiFID activities of "placing of a financial instrument without a firm commitment" and/or "underwriting… and/or placing… on a firm commitment basis". These providers are service companies looking to raise finance by issuing securities on the capital markets. The corporate finance adviser advises the company on the terms of the issue and identifies potential investors, accompanies the issuer on road-shows describing the company to potential investors, determines how to price the issue of securities and who to place the securities with. The corporate finance adviser may also participate in underwriting.

57. This is of potential relevance to private equity firms only when using corporate finance firms to assist in selling a privately held company, in particular as part of an initial public offering. In this context, a private equity fund manager could be a client of a corporate finance house who provides primary market services when the private equity investment is sold by the private equity fund to third party investors through an IPO.

58. The above activity should certainly not be confused with the totally distinct activity of marketing a private equity fund. There should be little risk of confusion because the fund marketing service (in relation to a typical private equity fund structured as a limited partnership) is completely different from the typical scenario of an independent financial institution performing placing activities for an issuer under MiFID, as described above. AIF marketing involves introducing fund managers (AIFMs) to potential investors, with whom the private equity AIFM may then negotiate an investment into the fund. As a limited partnership AIF does not issue shares, there is no "pricing" of AIF interests, fund interests are not underwritten, there is no book building, the fund marketer does not allocate interests like a capital markets placing etc. The service is essentially an introduction service. The reason why the concept of fund marketing may be confused with the MiFID service described above is that marketing an AIF is defined in AIFMD as involving "offering or placing" the fund. However, none of MiFID, MiFID II nor the AIFM Directive state that AIF marketing involves performing either placing activity under MiFID II.

59. Our reading of the proposed ESMA guidance relating to underwriting and placing is that this is not intended to apply to fund marketing activity. It is important that competent authorities do not seek to apply these principles to a fund marketing context, because they have no relevance in the context of marketing a limited partnership AIF.

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Obligations rooted in the relationship between issuing client and investment firm

60. As stated above, we think this should not be relevant to private equity fund raising, in relation to which there is no placement activity.

Obligations rooted in the relationship between investment client and investment firm

61. As stated above, we think this should not be relevant to private equity fund raising, in relation to which there is no placement activity.

Advice

62. As stated above, we think this should not be relevant to private equity fund raising, in relation to which there is no placement activity.

Q58. Are there additional details or requirements you believe should be included?

63. N/A

Q59: Do you consider that investment firms should be required to discuss with the issuer client any hedging strategies they plan to undertake with respect to the offering, including how these strategies may impact the issuer client's interest? If not, please provide your views on possible alternative arrangements. In addition to stabilisation, what other trading strategies might the firm take in connection with the offering that would impact the issuer?

64. N/A

Q60: Have you already put in place organisational arrangements that comply with these requirements?

65. N/A

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Q61: How would you need to change your processes to meet the requirements?

66. N/A

Q62: What costs would you incur in order to meet these requirements?

67. N/A

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VI. Section 2.11 - Remuneration

Q63: Do you agree with the definition of the scope of the requirements as proposed? If not, why not?

68. Generally we think that affiliates of PE/VC AIFMs should not be subject to stricter rules than the remuneration rules under AIFMD. Compliance with AIFMD remuneration rules should be sufficient to evidence compliance with MiFID requirements and vice versa. This is particularly important for groups which have staff working on AIFs when operating in MiFID firms, for instance under delegation.

69. We assume that the definition of relevant persons in the future delegated act will be the same as the current definition of that term in Directive 2006/73/EC. We note that the draft definition of scope includes career progression as a type of remuneration. We do not think that this can be correct and this approach is not consistent with the CRD IV and AIFMD remuneration provisions. Given that firms may be subject to MiFID remuneration provisions as well as the CRD IV and/or AIFMD remuneration provisions, we think that it is important to have consistency in relation to this basic concept in order to avoid undue complexity. Moreover, we do not consider that it is practical to deal with career progression in a remuneration policy or by applying remuneration principles. Any conflicts arising in relation to incentives relating to career progression should fall to be addressed under the wider ambit of Article 23(1) of MiFID II.

70. It would be helpful for the limited application of the remuneration provisions of MiFID II to alternative investment fund managers (AIFMs) to be clarified. We note that, although Article 24(10) of MiFID II applies to AIFMs which are authorised under the AIFMD to carry on the

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activities referred to in Article 6(4) of the AIFMD, such AIFMs will not be subject to Article 9(3)(c) of MiFID II. Further, such firms may well be required to apply the requirements of Article 24(10) to staff who are also subject to the AIFMD remuneration provisions because such staff are involved in the management of AIFs as well as the provision of Article 6(4) investment services to non-AIF clients of the AIFM. In order to avoid undue complexity, we consider that it will be important that, where staff of an AIFM are subject to the AIFMD remuneration provisions, remuneration of those staff by the AIFM in compliance with those provisions will satisfy the obligations relating to remuneration under MiFID II (in particular, those under Article 24(10), where those MiFID II obligations are also applicable to such staff).

Q64: Do you agree with the proposal with respect to variable remuneration and similar incentives? If not, why not?

71. We support the proposal that commercial criteria should not be permitted to incentivise staff to act against the interests of their clients or breach regulatory requirements. We have some suggestions as to how the proposed guidance might be amended to achieve this. Ultimately financial services firms can only pay remuneration from their revenue, which typically consists of fees and commissions they generate from servicing clients. As with any other commercial organisation, remuneration is always based on commercial criteria; we believe the key issue is that these criteria should not operate in a manner which incentivises improper behaviour. We suggest amending the first part of the proposed guidelines in paragraph 6 to say:

    "Remuneration and similar incentives must include criteria designed to ensure that staff are not incentivised to prioritise commercial criteria over compliance with the applicable regulations, the fair treatment of clients and the quality of services provided to clients…".

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VII. Section 2.12 - Fair, clear and not misleading information

Q65: Do you agree that the information to retail clients should be up-to-date, consistently presented in the same language, and in the same font size in order to be fair, clear and not misleading?

72. While we agree that information provided to retail clients should be up-to-date as far as practicable at the time it is provided, continuous updating is not always possible. For example, valuations of illiquid investments such as private equity and venture capital cannot be undertaken with the same frequency as valuations of actively traded listed investments. Under the AIFMD it is recognised that the assets of a closed-ended fund may be valued only once a year. We suggest that it will often be more appropriate, both in client reporting and in marketing communications, to state the date as at which the information is given. We agree that in the case of marketing communications if the firm becomes aware of a material change while the marketing communication is still being used then the updated information should be communicated, either in an amended version of the original communication or a supplement or other updating communication.

73. It would be helpful to clarify what is meant by saying that information shall be consistently presented in the same language throughout all forms of information and marketing material provided to a client. Does the reference to “the same language” refer to using a single language to communicate with each client (e.g. French, German, Italian, English)? That will often be appropriate, particularly with a monolingual client, but may sometimes not be necessary (e.g. when a multilingual client communicates with offices of the same firm in a number of jurisdictions he may receive communications from them in different languages).

74. Or does it mean that exactly the same words must be used in each communication when providing a particular piece of information or risk warning? If the latter is intended then it may not be appropriate. Generally shorter wording is appropriate for shorter communications. Using identical wording for all communications increases the risk that a client will ignore or skip reading what he regards as repetitive “boilerplate”.

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Q66: Do you agree that the information about future performance should be provided under different performance scenarios in order to illustrate the potential functioning of financial instruments?

75. Our understanding is that this requirement will apply only to communications with retail clients but we suggest this should be clarified.

76. Whether future performance information should be provided under different performance scenarios depends on the nature of the instrument and the context of the communication. In the professional context a communication containing advice or responses to specific due diligence enquiries given by an advisory firm to the general partner or manager of a private equity fund should normally address the specific information or requests raised, rather than address different performance scenarios which have not been requested.

77. If projections of future performance were to be made in general marketing materials addressed to retail clients then it might be appropriate to give alternative performance scenarios. In relation to some types of product outside the private equity sphere, such as structured products, which are marketed by reference to future performance it may be necessary to give alternative performance scenarios in order to give a fair view of the produce without misleading the investor.

Q67: Do you agree that the information to professional clients should comply with the proposed conditions in order to be fair, clear and not misleading? Do you consider that the information to professional clients should meet any of the other conditions proposed for retail clients?

78. Although we do not think the changes are necessary we have no objection to the proposed conditions in paragraph 4 of the draft technical advice except for the general point that consideration should be given to the context of the communication. Accordingly when an adviser is responding to specific information requests from the manager or general partner of a fund, or indeed from investors or potential investors, it may be appropriate to address the specific point raised without repeating risk warnings given separately.

79. We do not consider that information provided to professional clients should meet any of the other conditions proposed for retail clients.

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VIII. Section 2.13 - Information to clients about investment advice and financial instruments

80. The distinction between independent and non-independent advice should not be pertinent for managers/advisors in private equity fund structures. Advisors in a PE/VC structure may not be strictly speaking “assessing a diversified range of financial instruments […] and implementing a selection process that fosters a fair and appropriate comparison of different financial instruments” (ESMA/in 8 and 9 of the Analysis in §2.16). Fund documents will typically regulate conflict of interest issues, which are also referred to in the definition of independent advice (that the advisor not limit their offer to their own products).

81. Clarification is also needed as to whether the ban on accepting fees by a third party in relation to the provision of services would apply to fees for services rendered by an advisor, for example, transaction/arrangement/finder’s fees in relation to a portfolio investment.

82. We have no particular comments on the proposal to further specify information provided to clients on financial information and their risks. It seems that, broadly speaking, this information, to the extent that it is pertinent, is already in the disclosure and marketing documents that are typically prepared when marketing private funds.

Q68. Do you agree with the objective of the above proposals to clarify the distinction between independent and non-independent advice for investors?

83. N/A

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IX. Section 2.14 - Information to clients on costs and charges

Q71. Do you agree with the proposal to fully apply requirements on information to clients on costs and charges to professional clients and eligible counterparties and to allow these clients to opt-out from the application of these requirements in certain circumstances?

84. Again, as set out above, we do not think that these rules should be relevant to PE/VC firms marketing AIFs managed by an AIFM within their group. This being said, we also do not agree with ESMA's proposal to fully apply requirements on information to clients about costs and charges also to professional clients and eligible counterparties. At least in a private equity context, professional clients and eligible counterparties will be involved in detailed and lengthy negotiations with the fund manager or its affiliates about a number of issues, including costs and charges. Such clients do not, therefore, need to be subject to the same information requirements as retail clients who are unlikely to be involved in discussions with a fund manager or investment adviser in the same way.

85. If such requirements are to be applied across all client types, we consider that professional clients and eligible counterparties should be allowed to opt out from the application of these requirements in all (not only certain) circumstances. It is unclear to us why such clients are unable to opt out of these requirements when the services of investment advice or portfolio management are provided. We do not agree that, in such a scenario, the "*nature of the services provided or the financial instruments concerned justifies the full application of the requirements, including in the relationship with non-retail clients*". Our response to Question 72 below explains why we take the view that certain of these requirements are inappropriate in the context of discretionary portfolio management services.

Q72. Do you agree with the scope of the point of sale information requirements?

86. We consider that ESMA's proposed point of sale disclosure of information requirements will not be appropriate or proportionate in many private equity situations. Indeed where the product concerned is a fund or where the service provided is discretionary portfolio management they may be impossible to apply.

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87. The point of sale information disclosures required should depend upon: the nature of the service provided; the relevant market; the agreement with the client; and the client's status. The proposed disclosure requirements seem to us to be appropriate only in the context of the retail markets where such disclosures are necessary to enable the client to make an informed decision.

88. In this regard, we disagree with ESMA's interpretation of the reference in Article 24(4)(c) of the MiFID II Directive of the phrase "*financial instrument recommended or marketed to the client*". At paragraph 18 of section 2.14 of the Consultation Paper, ESMA expresses the view that this wording should be interpreted broadly so as to cover the investment service of portfolio management, but we consider that this may have unfortunate and unduly burdensome unintended consequences. The activity of discretionary portfolio management will, by definition, involve the client deliberately appointing the investment manager to make decisions on an ongoing basis in relation to which financial instruments should be held in the client's portfolio so as to best achieve the relevant investment strategy. As part of that process, the investment manager will perform its own analysis of the costs involved in acquiring, holding and realising individual investments in the portfolio as part of calculating the expected return on those investments. The investment manager's skill at selecting investments whose associated costs are outweighed by their ultimate performance is one of the fundamental reasons why the client would be engaging the investment manager to perform portfolio management services in the first place.

89. If the reference to "*financial instrument recommended or marketed*" is interpreted as ESMA proposes, this would appear to have the effect that the investment manager would need to disclose to clients the costs involved with each individual investment decision in connection with the portfolio (or at least, with any new financial instrument in respect of which the relevant costs and charges had not previously been disclosed), since this information must be provided "*on a regular basis*". As already noted we think this is unnecessary, but in any event we cannot see how this can be complied with. The acquisition and divestments of investments under a discretionary management mandate is a continuing process and by definition at the time that the service commences the manager will not know what the particular costs will be in relation to any particular decision.

90. In our view, the reference to "*financial instrument recommended or marketed to the client*" in Article 24(4)(c) should be understood to relate to a personal recommendation or a specific promotion of a particular investment made by a firm to a client. In this context (and subject to the point we make above about the varying information requirements of different categories of

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clients), ex ante disclosures of costs and charges at the point of sale have a clear rationale in ensuring that the investor can make an informed choice about whether or not to enter into the investment transaction. Where the decision in relation to that investment transaction will be, or has already been, delegated by the client to a discretionary investment manager, we fail to understand the policy objective behind the apparent requirement to disclose information to the client about costs and charges on an instrument-by-instrument basis. However even in such a case it must be borne in mind that where the product is a unit in a fund, whilst the basis of calculation for some costs and charges can be disclosed, by definition, costs and charges associated with investments to be made/divested in the future will be unknown at the time that a fund is marketed, and cannot therefore be disclosed.

91. We would support further tailoring of the point of sale information requirements to reflect the financial instruments concerned, the services provided and the nature of the clients.

Q73. Do you agree that post-sale information should be provided where the investment firm has established a continuing relationship with the client?

92. We agree that post-sale information should be provided where the investment firm has established a continuing relationship with the client. There is no need for this to be personalised where there is no difference as to the position of individual clients in relation to the information.

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X. Section 2.15 - The legitimacy of inducements paid to/by a third person

93. We are concerned by the requirement in ESMA's draft technical advice for independent investment advisers and portfolio managers to return to all clients as soon as possible after receipt any third party payments received in relation to the services provided to that client.

94. We consider that where a client, particularly a professional client, has contractually agreed that the third party payment received by the firm can be set off against amounts which would otherwise be owed to the firm by the client, there should be no requirement to return such third party payments to the client provided that set-off will occur within a reasonable timeframe.

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95. If ESMA's technical advice is adopted as currently drafted, it will affect existing contractual arrangements which have been freely adopted and in operation for some considerable time and are frequently positively required by the relevant clients or investors.

96. Separately, we are also concerned by ESMA's statement at paragraph 16 of section 2.15 of the Consultation Paper which suggests that the Commission should consider aligning the relevant MiFID II inducement provisions with the AIFMD implementing provisions. We consider that such recommendation both exceeds the scope of ESMA's mandate and that such alignment would be fundamentally inappropriate in the professional investor context (where, as noted above, financial arrangements are negotiated with investors. In the context of a private equity fund it is normal for investors to negotiate the set off of any fees received by the AIFM and its group members. Rebates would be regarded as much less desirable because they would involve a number of very small credits to investors causing them significant administrative difficulties in monitoring these and establishing the correct accounting and tax treatment of each, rather than the whole exercise being dealt with on a transparent basis as a single set-off which is easy to assess).

Q79. Do you agree with the proposed exhaustive list of minor non-monetary benefits that are acceptable? Should any other benefits be included on the list? If so, please explain.

97. For the reasons set out below, we disagree in principle with there being an exhaustive list of non-monetary benefits which may be deemed to be 'minor' and acceptable.

98. We do not consider that the preparation of any such list is within the scope of ESMA's mandate from the Commission or required by the Level 1 Directive.

99. Further, we consider that determining what is an acceptable minor non-monetary benefit is a qualitative process which can only be undertaken by an individual firm when taking into account the types of services it provides and the types of clients to whom it provides those services. A non-monetary benefit could feasibly be 'minor' and acceptable in the context of, for instance, a private equity firm with sophisticated professional clients but not so in the context of a retail fund manager. An exhaustive list which takes no account of the type of firm or client seems to us to be wholly inappropriate.

100. In addition, if an exhaustive list is adopted, there is a risk that certain types of non-monetary benefit which would be permitted under the Directive's criteria will be omitted without there being any convenient means by which the list can be amended.

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101. We therefore consider that a non-exhaustive list of potentially acceptable types of minor non-monetary benefits would be more appropriate and would help firms to make informed decisions about permitted types of such payments. We consider that such a list could include those items already included in ESMA's draft technical advice.

Q80. Do you agree with the proposed approach for the disclosure of monetary and nonmonetary benefits, in relation to investment services other than portfolio management and advice on an independent basis?

102. We do not agree with ESMA's proposal at paragraph 7(ii) of its draft technical advice. This is partly because we consider that it goes beyond what is required by Article 24(9) of the Level 1 Directive but also because we consider it to be overly burdensome on investment firms without offering any commensurate increase in investor protection.

103. We consider that where a firm discloses the method of calculating, but not the exact amount of, a payment prior to proving an investment or ancillary service to a client, the firm should not be required to provide all clients with information on the exact amount of the inducement received on an ex-post basis but should instead undertake to provide further details on request (i.e. we do not consider there should be any change to the current position under Article 26 of the MiFID implementing regulation).

104. In our opinion, ex-post disclosures of inducements will be difficult for firms to make and of limited relevance to many investors. In particular, as inducements can only be accepted where they are of benefit to the investor, it is important that such benefit is not lost in the costs to the client of additional ex-post reporting requirements.

Q81. Do you agree with the non-exhaustive list of circumstances and situations that NCAs should consider in determining when the quality enhancement test is not met? If not, please explain and provide examples of circumstances and situations where you believe the enhancement test is met. Should any other circumstances and/or situations be included in the list? If so, please explain.

105. We agree in principle that, if there is to be any such list of circumstances and situations to which NCAs should have regard when determining whether the quality enhancement test is met, it should be non-exhaustive. We are, however, concerned that as currently drafted the

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list is insufficiently clear and is therefore likely to limit the ability of NCAs to apply the test appropriately. In particular, we do not understand limb (ii) which provides that the fee, commission or non-monetary benefit may not generally be regarded as 'designed to enhance the quality of the relevant service to the client' if, "*it does not provide for an additional or higher quality service above the regulatory requirements provided to the end user client*". We would suggest that this limb should either be deleted or clarified.

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XI. Section 2.16 - Investment advice on independent basis

106. See comments under Section 2.13.

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XII. Section 2.20 - Reporting to clients

Q96. Do you agree that the content of reports for professional clients, both for portfolio management and execution of orders, should be aligned to the content applicable for retail clients?

107. No, we do not. Professional clients frequently have very specific reporting requirements which must be followed. These may also vary by reference to the asset class so that, for example, private equity reporting normally requires the IRR (internal rate of return) and sometimes also the exit multiple. To impose a requirement that the content of reports to professional clients must be aligned to retail reporting (most of the requirements for which have in practice been established for reporting on liquid securities portfolios and some of which are inappropriate for long-term investment in private equity) will require the generation of information and reports which are not required by the professional clients and in practice have to be produced in addition to the reports specifically required by and agreed with the professional clients concerned.

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Q97. Should investment firms providing portfolio management or operating a retail client account that includes leveraged financial instruments or other contingent liability transactions be required to agree on a threshold with retail clients that should at least be equal to 10% (and relevant multiples) of the initial investments (or the value of the investment at the beginning of each year)?

108. No comment. EVCA's members do not generally provide such services to retail clients.

Q98. Do you agree that Article 43 of the MiFID Implementing Directive should be updated to specify that the content of statements is to include the market or estimated value of the financial instruments included in the statement with a clear indication of the fact that the absence of a market price is likely to be indicative of a lack of liquidity?

109. While we have no objection to including indications of a lack of liquidity in private equity investments we think it important that no obligation should be imposed to value investments at unrealistically frequent intervals. As noted above, the AIFMD only requires illiquid assets such as private equity to be valued at least annually.

Q99. Do you consider that it would be beneficial to clients to not only provide details of those financial instruments that are subject to TTCA at the point in time of the statement, but also details of those financial instruments that have been subject to TTCA during the reporting period?

110. No comment.

Q100. What other changes to the MiFID Implementing Directive in relation to reporting to clients should ESMA consider advising the Commission on?

111. We do not consider further reporting requirements are required. As noted above, some of the existing reporting requirements are not well suited to long-term illiquid assets.

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XIII. Section 6.1 – SME Growth Markets

112. We are in general agreement with ESMA on this matter. Due to the differences between different member states (size of market, corporate structures, corporate ownership, sizes and sectors etc.) we support the preservation of an appropriate degree of flexibility for the different market operators under the supervision of their respective national competent authorities. The same goes for the choice of operating model.

113. However, there is one matter where general guidance should be given. In view of the international nature of many new SMEs (markets, products/services, customers, composition of board, management and key personnel as well as potential investor base) and hence their choice of English as working language, the use of English language is encouraged, alongside local language, in the admission documents as well as for the on-going reporting. Therefore, English should always be an accepted language for the prospectus as well as reporting requirements (with local language summaries of key data for the benefit of retail investors).

50% Criterion

"Article 33(3)(a) of MiFID II requires that at least 50% of the issuers whose financial instruments are admitted to trading on the MTF registered as an SME Growth Market are small and medium-sized enterprises at the time when the MTF is registered as an SME Growth Market and in any calendar year thereafter.

SMEs are defined as companies with an average market capitalisation of less than €200m on the basis of end-year quotes for the previous three calendar years in Article 4(1)(13) of MiFID II."

114. We support the view that the 50% criterion to be considered an SME Growth Market should be based on the number of issuers only and an assessment done on an annual basis, based on an average of each month of the calendar year.

115. When an SME Growth Market falls below the 50% mark we agree there should be flexibility in deciding when it should deregister. This period should be 2 to 3 years. Regardless of the time chosen, we agree that during this period it should not be made public that the Growth Market is below the 50%.

116. Regarding the application of the 50% criterion to non-equity issuers, we support that they should also be taken into account for the 50% mark. If shares are quoted, then it is that market cap. Otherwise, if debt only, if the overall outstanding nominal value of the debt

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securities issued by the issuer does not exceed €200 million, then it should be acceptable to be considered [an SME].

Responsibility for an admission document

117. The responsibility for the accuracy of what is in the admission document should rest unequivocally with the issuer (i.e. typically the board) irrespective of whether or not each market operator decides to carry out a review to ensure the correctness of admission documents.

Periodic financial reporting

118. We agree that issuers on SME Growth Markets should publish annual and half-yearly reports but not quarterly. (Also, there should be no requirement to impose IFRS.)

119. We also agree with the timeframes foreseen for making annual and half-yearly reports/financial statements public (i.e. within 6 and 4 months should be fine).

120. There should be no additional specifications outside those already contained in MAD/MAR and MiFID II.

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XIV. Section 6.2 - Suspension and removal of financial instruments from trading

121. A distinction should be made as to whether the problem lies with the issuer or the market. If the problem lies with the issuer, then it should be removed from trading on all markets. If the problem is market-specific, trading in other markets should be allowed to continue.

122. In order to facilitate the decisions by market operators, we support ESMA's approach for a non-exhaustive list of examples rather than pre-specifying all possible circumstances.

123. Knock-on effects of the removal or suspension, on derivatives, underlying indices etc. need to be taken into account.

Co-operation agreements

124. We also support ESMA's view that co-operation agreements are not automatically triggered in the case of small and therefore economically not highly significant MTFS and OTFS.

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Otherwise it will lead to excessive burdens for small and non-significant trading venues if national competent authorities are bound by an excessive number of co-operation agreements.

125. A point that one may want to underline as well is that an issuer on an SME Growth Market should not, without consent, be subject to having its shares traded on any other SME Growth Market (affects liquidity and transparency) even if not subjected to additional reporting etc. requirements. That would be unjust.

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Specific Response to Sections and Questions of the Consultation Paper

XV. Section 2.1 - Authorisation of investment firms

1. The information requested is detailed to the point that it will take a firm (and its advisers) considerable time, effort and expense to collate into the form requested. The information is far more detailed than that required for an AIFMD application. Particular areas of concern are the sections on information on the capital, shareholders, management body and organisation. The burden of complying with these information requirements may in itself pose an entry barrier to the market and result in diminished competition.

2. Moreover, the question can be raised of whether regulators will have the resources required to process the information supplied in a timely manner, or if this will result in undue delays.

3. It would seem appropriate to take into consideration a principle of proportionality, such as the one mentioned in ESMA's consultation paper on draft RTS on information requirements for assessment of acquisitions and increases in holdings to investment firms (one of the reference materials cited by ESMA). This consultation paper contains a special regime dealing with acquisitions where the proposed acquirer is an EU-regulated entity and the proposed acquisition is in a small, non-complex investment firm. Given the analogy between the supervisory control of acquirers of investment firms and that of the identity of shareholders/officers/managers of new investment firms to be authorised, a similar, simplified procedure could be contemplated in this case.

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About EVCA

The EVCA is the voice of European private equity.

Our membership covers the full range of private equity activity, from early-stage venture capital to the largest private equity firms, investors such as pension funds, insurance companies, fund-of-funds and family offices and associate members from related professions. We represent 650 member firms and 500 affiliate members.

The EVCA shapes the future direction of the industry, while promoting it to stakeholders such as entrepreneurs, business owners and employee representatives.

We explain private equity to the public and help shape public policy, so that our members can conduct their business effectively.

The EVCA is responsible for the industry's professional standards, demanding accountability, good governance and transparency from our members and spreading best practice through our training courses.

We have the facts when it comes to European private equity, thanks to our trusted and authoritative research and analysis.

The EVCA has 25 dedicated staff working in Brussels to make sure that our industry is heard.