Retail Investment and Distribution Policy
Financial Conduct Authority
12 Endeavour Square
London E20 1JN

By email: dp22-06@fca.org.uk

7 March 2023

Dear Retail Investment and Distribution Policy Team

Re: BVCA response to DP22/6 Future Disclosure Framework

The BVCA is the industry body and public policy advocate for the private equity and venture capital (PE/VC) industry in the UK. With a membership of over 700 firms, we represent the vast majority of all UK-based PE/VC firms, as well as their professional advisers and investors. Between 2017 and 2021, BVCA members invested over £57bn into around 3,900 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over two million people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

We have responded only to the consultation questions on which our members have specific views.

Q1: What are the benefits or drawbacks of the timing of disclosure being prescribed by the FCA? Or should it be left to firms to find the right time for their target consumer?

We believe that firms should be allowed to retain some flexibility in terms of the timing of disclosure for their target consumer. A general requirement on firms to provide "timely" disclosures for investment decision-making will enable firms to provide more relevant and engaging disclosures.

Q2: Will a durable medium requirement constrain your ability to deliver innovative disclosure? Are there any other rules that may constrain the medium in which information can be provided?

We consider that flexibility is key here. Firms should be able to determine the best method of disclosure for their clients / investor base, whilst remaining subject to over-arching duties that financial promotions must be clear, fair and not misleading and the principles of treating customers fairly. This type of approach is also technology and format-neutral, which greatly assists with future-proofing disclosure requirements.

Q3: Do you agree that we should future proof the disclosure requirements? How else can we do this? Do you have any views or evidence on the merits and drawbacks of different approaches to future-proofing?

We agree with the need to provide for a degree of flexibility now and going forward. We welcome a technologically neutral approach that enables the use of new technology, but does not mandate the use of particular systems. Only a principle based-approach can be truly future-proof as it allows firms to evolve with the needs of their customers / investors and developing technology (some of which may not even be foreseeable as yet).

Q4: How do you envision the distribution of retail disclosure changing over the next 5-10 years?

Please refer to our response to Q3.

Q6: How should it be determined that a product is suitable for the retail market and therefore that regulated disclosure should be produced? Does this need to be balanced with choice for retail investors?

This question requires some reflection on the definition of the 'retail market'. We would also like to stress the distinction between genuine retail investors and others. The new regime should not, for instance, mandate disclosures to executives at the investment manager who participate in co-investment arrangements or to sophisticated investors that narrowly do not satisfy the requirements of MiFID's professional client test due to a technicality.

These nuances should be considered as far as possible. In general, we would support an approach that places the onus on firms to ensure that their disclosures are appropriate for the audience for which they are intended, consistent with duties for financial promotions to be fair, clear and not misleading and to treat customers fairly.

<u>MiFID professional client definition</u>

The MiFID elective professional client tests are calibrated for investment services provided in relation to liquid assets, such as listed and regularly traded shares. Because they were designed with liquid assets in mind, the tests are extremely difficult to satisfy by individuals who invest in illiquid products like PE/VC funds, regardless of their wealth, sophistication, or experience. Even the largest institutional investors make relatively few investments in PE/VC funds each year, so retail investors will rarely, if ever, meet the quantity test. Tying relevant experience to "financial services" rather than broader business experience can make it difficult to opt-up other types of investor with relevant experience in business and familiarity with running privately owned companies of the type owned by private equity funds, e.g. as entrepreneurs.

As a result, our members often find that sophisticated and high-net-worth investors, certain family offices, entrepreneurs, academic endowments, executives, and directors must be treated as retail investors under the MIFID test, despite meeting or surpassing the level of experience and expertise of institutional investors in this context. There are wide implications of falling under the current regime, including the requirement to produce a PRIIPs KID for investors who do not meet the MiFID professional client definition.

We would urge HMT and the FCA not to use the MiFID professional client concept when defining 'retail' for the purposes of these principles, but instead apply a broader concept reflecting the long-standing UK domestic approach to elective professional clients.

<u>Co-investment arrangements</u>

In addition, institutional and professional investors investing in PE/VC funds will typically insist that senior executives of the fund manager invest in the funds whose portfolio company investments the firm is responsible for selecting, executing and supporting over three-to-seven-year holding periods. This is a long-standing practice that helps to ensure there is long-term alignment of interest between the fund's portfolio companies, the firm's investment team and investors in the fund (colloquially known as "skin in the game"). These arrangements are often achieved through co-investment vehicles. Under the PRIIPs regime, there was a risk that co-investment by the firm and its affiliates required firms to produce a PRIIPs KID, imposing unnecessary administrative cost and burdens on firms to produce retail disclosures, effectively for their own consumption.

Co-investment arrangements in these circumstances are only open to members of the firm and its affiliates, whose roles in relation to the fund mean that they are sufficiently knowledgeable and experienced to understand the investment proposition. These arrangements are not made widely available to retail investors; however, the PRIIPs rules effectively mean that a firm can be required to prepare retail disclosures 'for itself' (i.e. a PRIIPS disclosure which goes to the executives who run the fund). In policymaker acknowledgement that this outcome would be nonsensical, we received informal guidance from the European Commission that a PRIIPs KID is not required to be produced by firms in these circumstances. We strongly recommend that HMT and the FCA make this clear in the rules when designing a new retail disclosure regime. This is needed to reflect the commercial reality of these arrangements and ensure the UK regime is not unduly burdensome on PE/VC firms.

Noting the FCA's incoming secondary objective of international competitiveness, the European Commission's proposal to revise the ELTIF framework, a European investment vehicle designed for long-term investments, provided a similar exemption for executives involved in the management of ELTIFs. It said that suitability assessments would not be required where the retail investor is a member of senior staff, portfolio manager, director, officer, agent or employee of the manager or of an affiliate of the manager and has sufficient knowledge about the fund concerned. We strongly recommend a similar approach is taken for the requirement to produce retail disclosures under a new UK regime.

Q7: Do you agree with these principles [plain language, the prominent display of key information, and the inclusion of images and graphics] for effective disclosure design? Are there any other principles we should assess?

We agree with the principle of encouraging the use of plain language and avoiding overly technical language in retail-focussed disclosures. We consider that the best way of achieving this is by applying a general requirement to use the clearest possible language in the circumstances to explain terms in retail-facing disclosures. The exact scope of what this means will be very situation and product specific and being more prescriptive than this would only risk the challenges that have arisen with the PRIIPs regime occurring again.

Q9: Evidence suggests that layering in retail disclosure can improve consumer understanding. Do you agree with this and can layering also reduce the burden on firms? Are there any challenges we should consider?

We agree that firms should be encouraged to provide concise executive summaries of retail facing disclosures. However, the precise format and contents of these should be left to firms to determine on a situation-specific basis, subject to the duties of ensuring financial promotions are fair, clear and not misleading and treating customers fairly. An overly prescriptive approach to this issue risks mandating meaningless standard form documents that risk the same challenges as under PRIIPs.

Q10: Are there other interactive disclosure approaches we should evaluate?

In relation to Q9 and Q10, we are generally in favour of these changes but would caution against mandating specifics. For example, we would recommend that the FCA does not mandate the use of particular images or graphics.

More generally, we agree with HMT's dismissal of the need to strive for comparability between investments in their consultation paper on PRIIPs and UK Retail Disclosure. As such, we would advise against specifying detailed requirements in terms of disclosure design. We believe disclosure is most likely to be effective when managers are given the flexibility to decide what is appropriate for their clients / products.

Q11: How can disclosure requirements facilitate firms to use plain language to further consumer understanding while balancing accuracy, particularly with complex products?

Accuracy should take precedence, as it is at the heart of investors' (whether retail or non-retail) expectations of firms in the disclosures that they receive. If a retail client receives a disclosure they do not understand, they can ask for further information or seek independent advice. However, if a client receives *inaccurate* information they may not know that it is inaccurate. So simplicity should not be mandated at the price of disclosures becoming inaccurate or misleading. Again, we consider that the best practical approach here is to allow firms to determine the most appropriate disclosure format and content for their clients / investors, having regard to general guidelines and their duties to ensure financial promotions are fair, clear and not misleading and treat customers fairly.

Q12: What do you consider the appropriate balance between flexibility and prescription in disclosure? Does comparison feature in this balance?

We are very strongly in favour of flexibility as opposed to prescription for the reasons articulated above.

Q13: What information, if any, should be comparable? Do you have evidence to support or refute comparability between similar product types?

As evidenced by PRIIPs, we do not consider that there is merit in seeking to prescribe comparability in this way as the universe of possible investment products is simply too broad to achieve this across the industry. Instead, a principles-based approach should be adopted.

Q14: What level of prescription should be involved in the calculation of costs to ensure clarity and consistency for consumers while also prioritising the need for accuracy?

Please see our response to Q16.

Q15: What are the pros and cons of presenting cost as single figure, with more detailed information layered in disclosure?

We consider that a single cost figure risks being seriously misleading and potentially inaccurate.

Q16: What level of flexibility should there be in the calculation and presentation of risks?

We are generally in favour of allowing managers the flexibility. Where costs are prescribed, it should be for unlisted mass-market retail products.

It is worth noting that listed investment companies / investment trusts are already subject to extensive disclosure requirements as listed companies and a duplication of disclosure requirements could lead to confusion. In particular, the UK's changes to the prospectus regime should cover listed investment vehicles. If there are deficiencies in disclosure requirements that apply to listed vehicles, then they should be changed by amendment of the prospectus regime.

Q17: What is the purpose of performance disclosure?

The purpose of performance disclosure is to give investors an indication of the types of return that may have been achieved in relation to a particular investment product. However, the detail of that disclosure will vary significantly between product types. For the reasons outlined above, we consider that a principles-based approach should be adopted and prescriptive rules relating to particular formats of performance disclosure should be avoided in order to mitigate the risk of providing misleading information to investors.

Q18: To what extent should the FCA prescribe the performance information to be provided to retail investors? Should the FCA categorise products for the purpose of performance disclosure?

Please see response to Q17 above.

Q19: Would tailoring or flexibility promote accuracy and enhance consumer engagement?

We believe that flexibility is most likely to promote accuracy and enhance consumer engagement.

Q20: Are there other content requirements that should be included in regulated disclosure? Should this content be disclosed alongside product information?

Again, we consider that prescriptive content requirements are not helpful to retail investors or the wider market.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor ttaylor@bvca.co.uk / Nick Chipperfield nchipperfield@bvca.co.uk).

Yours faithfully,

Tim Lewis, Chair, BVCA Regulatory Committee