bvca The voice of long-term investment

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CEBS Secretariat
Tower 42 (level 18)
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16 September 2010

Dear Sirs,

CEBS CP04 (Revised 2): Consultation paper on the amendments to the Guidelines on Common Reporting (COREP)

This response is made by the Regulatory Committee of the British Private Equity and Venture Capital Association ("BVCA"). The BVCA represents the overwhelming majority of UK-based private equity and venture capital firms. This letter sets out our comments in relation to the above consultation paper ("CP04").

Background

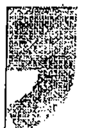
CP04 is relevant to those private equity and venture capital firms that fall within the scope of Directive 2006/49/EC ("CAD"). Most commonly, these firms are investment managers who will fall within Article 20(2) of CAD. We believe the UK has the highest concentration of private equity firms falling within Article 20(2) of any EU member state. For background we set out the reporting requirements currently applied to these firms by the UK Financial Services Authority, which due to the concentration of firms probably has the most experience of dealing with them.

FSA Rules require Article 20(2) firms (in UK FSA terminology, "BIPRU limited licence firms") to submit the FSA's capital adequacy return (FSA003). These firms must also submit:

- the FSA's credit risk return (FSA004) if, in both of its last two capital adequacy returns (or only one, if the firm submitted a credit risk return during its last accounting year), the firm's total credit risk capital component exceeded £10m (or its currency equivalent); and
- the FSA's market risk return (FSA005) if, in both of its last two capital adequacy returns (or only one, if the firm submitted a market risk return during its last accounting year), the firm's total market risk capital requirement exceeded £50m (or its currency equivalent).

Each of the returns described above must currently be submitted:

- on a quarterly basis, for firms falling within Article 5(1) of CAD. (The FSA refers to these types of firm as BIPRU €125k firms); and
- on a half-yearly basis, for firms falling within Article 5(3) of CAD (The FSA refers to these types of firm as BIPRU €50k firms).



Key observations

It is important that measures made under CRD which are primarily designed for banks and investment banks are appropriately tailored for any non-banks to which they apply, or allow sufficient flexibility for tailoring. We are concerned that the CEBS proposals do not meet this criterion. Private equity firms do not pose the same policy issues as banks. Effective regulatory policy must distinguish between these two sectors. This is expressly recognised by the European Commission in their development of a draft Alternative Investment Managers Directive tailored to the private equity and venture capital industry. We ask CEBS to be mindful that a "one size fits all" approach would impose significant and disproportionate cost and other burdens on firms that (as a result of their nature and their more limited size and scope of activity) do not pose the same policy issues as banks. We welcome CEBS's proposal to limit the number of returns which Article 20(2) firms must submit, but are concerned that the current proposals do not contain sufficient flexibility or tailoring for these firms.

Legal structures other than listed public companies

The rules appear designed primarily for listed public companies. The vast majority of UK private equity and venture capital firms are private companies, limited liability partnerships or privately owned organisations, owned and run by their executives. Other legal forms of privately owned organisation are used as the legal form of undertaking by Article 20(2) firms in other EU member states. Regulators need sufficient flexibility to design forms to enable the different types of organisation subject to CRD to complete them easily. For instance, it is important that regulators are not required to refer only to "ordinary shares" in their reporting forms, as some types of Article 20(2) firm do not issue shares.

Which returns?

We understand Article 20(2) firms must submit the basic capital adequacy return. We also understand they must submit credit risk and/or market risk returns in certain circumstances, but it is not clear to us when this requirement is triggered. We expect that supervisors will not gain any benefit from receiving credit and market risk returns for the vast majority of Article 20(2) firms. The default position should be that credit and market risk returns are only required by exception in circumstances determined by the local supervisor. As noted above, this is currently the case in the UK.

Frequency

CP04 requires that capital adequacy, credit risk and market risk returns should be submitted quarterly by all firms falling within Articles 5(1) or (3) of CAD. This would represent a significant increase in reporting frequency for UK firms falling within Article 5(3) of CAD who, under current FSA rules, submit these returns on a half-yearly basis. We see no policy justification for this change. Private equity and venture capital investment management firms have predictable costs and expenses because of the illiquid nature of the investments they manage (which means that investors are committed for the medium term at least, so are committed to paying management fees for the medium term). They have stable balance sheets and cashflow. Any unexpected material change to financial status occurring between reporting periods must be reported to the FSA. We see no supervisory benefit in requiring such firms to report on a quarterly basis rather than a semi-annual basis. (Indeed a semi-annual basis is in our view too frequent; annual notification would be more appropriate.)

The British Private Equity and Venture Capital Association
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We would be very happy to meet with you to discuss these issues in more detail, if that would be helpful. If you have any questions, please contact Tim Lewis in the first instance at tim.lewis@traverssmith.com on +44 (0)20 7295 3321.

Yours faithfully,

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Margaret Chamberlain
Chair – BVCA Regulatory Committee

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