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Financial Conduct Authority
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25 September 2020

Dear Colleagues,

**BVCA response to FCA DP 20/ 2 A new UK Prudential regime for MiFID investment firms**

We are writing on behalf of the British Private Equity and Venture Capital Association (BVCA), the industry body and public policy advocate for the venture capital and private equity industry ("PE/VC") in the UK. We represent the vast majority of all UK-based firms (over 700), as well as their investors and professional advisers. The UK has a dynamic and PE/VC ecosystem which continues to be the second biggest hub worldwide. PE/VC will play a significant role in the recovery of the UK economy, backing entrepreneurs and management teams across all the nations and regions in the UK to grow innovative businesses, support employment, expand internationally and boost UK productivity. BVCA members invested over £43bn into 3,230 UK businesses from 2015-2019, the majority being SMEs. Companies backed by PE/VC currently employ 972,000 people in the UK.

**Summary Feedback**

We are extremely grateful to the FCA and HMT teams who are working on implementing this mandate for the time they have taken to engage with us prior to publication of DP 20/2. We look forward to continuing positive engagement in order to support the FCA's stated objective of avoiding an inappropriate or excessive regime that does not align with actual business models, or address the risk the firms pose.

The directive and regulation establishing a new prudential regime for investment firms ("IFR") will result in significant changes to the capital, liquidity and remuneration requirements applicable to investment firms. Depending on the outcome of Brexit, BVCA member firms could be amongst those most affected by IFR, despite the negligible level of systemic risk they pose.

**We have set out our detailed responses to the questions posed in the Discussion Paper in Appendix 1 to this letter.**

Below is an explanation of which firms are affected (Section 1) and a list of our members' key concerns (Section 2). Further data from our member survey is included in Appendix 2.

**1. Which venture capital and private equity firms does IFR affect?**

- IFR will directly affect MiFID firms that carry out:
  - Advising on and arranging deals in investments ("adviser/arrangers" or Exempt-CAD firms). Typically, these are PE/VC firms based in the UK that provide fund advisory and deal services to a fund manager in the same group that itself is based and regulated outside the EU, often in the US or the Channel Islands or inside the EU and regulated as an AIFM, typically in Luxembourg or Ireland. This might be an attractive approach where the firm pursues global fundraising and investment strategies. Adviser arranger structures are also used by some smaller venture capital fund managers, in particular those managing VCTs.
  - Portfolio management ("portfolio managers"). These are typically venture capital or private equity firms based in the UK to which portfolio management activity has been delegated by a fund manager in the same group that itself is based and regulated **inside** the EU as an AIFM, usually in Luxembourg or Ireland. This might be an attractive approach where a larger amount of the firm's fundraising and investment activity is in the EU.
- Sub-threshold AIFMs with a MiFID permission will also be affected. This will apply to some venture capital firms. In particular, some of these firms have permission to hold client money in connection with their non-MiFID business. IFR should only apply to the MiFID-related business in these firms, which is the UK's current approach.
- ***The position of CPMI firms:*** We welcome the proposal that to the extent IFR applies at all to AIFMs and UCITS firms with a MiFID top-up, it will only apply to the MiFID-related business of these firms. We understand this reflects the UK's current approach to the predecessor legislation. However, we understand a number of EU member states do not apply MiFID standards or related prudential standards to AIFMs and UCITs firms at all and are unlikely to apply IFR to such firms. There is therefore a risk that the UK's position on these issues may become uncompetitive. We accordingly request the FCA reviews its proposed approach of applying IFR provisions to AIFMs and UCITS firms. Given that AIFMs and UCITS firms are regulated comprehensively by rules covering the same areas as IFR, this would be a proportionate outcome.
- Many PE/VC firms are small owner-managed businesses and the costs of setting up the firm are borne by the individual executives. A significant outlay for these executives will be the regulatory capital that will need to be funded when the fund manager becomes regulated by the FCA (under directives such as AIFMD and MiFID). The level of regulatory capital needs to reflect the risks posed by the firm's activities, but if the requirements are not appropriately calibrated, it can act as a barrier to setting up a firm if the costs of doing so are excessive.

**2. Key areas of concern for venture capital and private equity**

**2.1 More onerous treatment in UK than in the European Union?**

- We are concerned that there is a material risk of the UK applying the regime in a way which is more onerous than the EU. This would be a very odd result in the context of Brexit.
- We do not agree that it makes sense to impose regulatory capital requirements on an adviser/arranger whose sole role is to provide services to a fund manager affiliate beyond a

basic requirement, currently €50,000 (or potentially a higher flat requirement of say €100,000).

- Many UK adviser/arranger firms are regulated as MiFID firms, whereas we understand that equivalent firms established in EU jurisdictions are not. The current impact of this difference is limited by the €50,000 capital requirement imposed on these firms. With the imposition of a ¼ fixed overheads requirement, or an even higher capital requirement under ICARA, that would change materially. In addition, there is no maximum limit on the capital requirements under IFR, in comparison to the €10 million maximum that exists under AIFMD.

- We would like to meet with you to explore the possibility of the UK aligning its approach to the EU approach, to ensure a level playing field between the firms located in the UK and firms located in the EU. The way the regime is implemented in the UK could be regarded as a downside to locating firms in the UK. We are keen to find ways to prevent this from happening wherever possible. We set out more detail about this in our answer to Q34 in Appendix 1.

- More broadly we consider that the UK should keep its implementation of IFD/IFR under review compared to EU implementation, to ensure that the UK's position is not uncompetitive.

**2.2. Need for an Exempt CAD transitional period**

- A wide-ranging transitional period allowing firms to adjust to the new requirements in IFR is of particular importance to PE/VC firms.

- For most venture capital and private equity businesses which are UK MiFID firms, the fixed overhead requirement (or potentially the ICARA) is likely to determine the capital requirement, rather than a K-factor calculation.

- This will result in a very significant increase in regulatory capital for firms that are currently subject to a flat requirement of €50,000. The total regulatory capital in the financial system for the 16 firms surveyed by the BVCA would **increase from €900,000 to an estimated £139.7million**. Such increases would cause particular challenges for smaller firms as these are owner-managed with few partners. Further information from our member survey is also provided in Appendix 2.

- The proposed regulatory capital increases are also fundamentally out of proportion to the risk that Exempt CAD firms that are sub-advisors pose. As they have no investment discretion and can relatively easily be replaced by the investment managers that have appointed them, the potential risks to these firms' clients are very limited.

- The IFR contains transitional provisions intended to smooth the impact on firms by allowing them to build up the new required amounts of capital over a longer period. In our view, the transitional arrangements apply on a broad basis to all capital requirements.

- The transitional provision needs to be available for Exempt CAD firms, including small AIFMs with a MiFID top-up which are Exempt CAD firms.

- We have set out our suggestions for a transitional period in our response to Q33 in Appendix 1.

### 2.3. Observations on the application of the requirements

- Assets under ongoing advice
  - We consider that advice provided by adviser/arrangers to PE/VC fund managers will fall outside the definition of "investment advice of an ongoing nature". We set out our reasoning below.
  - We note that PE/VC adviser/arranger services may fall outside the definition of MiFID investment advice altogether.
  - Even if such services fall within MiFID advice, they should not be considered "arrangements constituting investment advice of an ongoing nature". The advice given relates to specific potential transactions. It does not involve the sort of ongoing responsibility for monitoring a client's portfolio of the kind contemplated, which role will be performed by the AIFM or portfolio manager which receives the advice. There is generally no "continuous or periodic assessment and monitoring or review".
  - This is relevant both to the calculation of K-AUM and the SNI test.

### 2.4 Areas where the UK should exercise its national discretion

- We welcome the proposal to introduce a Group Capital Test regime as an alternative to prudential consolidation. We believe that private equity and venture capital fund manager group structures generally fall within the scope of this discretion and that they should have the option to apply for the discretion to be exercised.

- Delegation
  - Contrary to the EBA's view stated in its consultation paper, delegation of management and ongoing investment advice should be treated in the same way for the purposes of K-AUM calculations, to avoid double counting.
  - Where a fund manager appoints an affiliate to provide adviser/arranger services, the investor's relationship is with the fund manager. The investor would deal with the fund manager in the event of an issue arising. The relationship between manager and adviser/arranger is purely intra-group.
  - We are particularly concerned that the UK may become disadvantaged where non-UK managers are considering the location of deal teams. If the UK has higher regulatory capital requirements than other jurisdictions, this will be a disincentive to locating teams in the UK.
  - Where investors have specifically appointed a non-EU manager, i.e. where the substance of the arrangement is structured outside the EU, it would be disproportionate to apply UK prudential requirements to a firm that is merely acting as an adviser to the manager and does not have the ability to take any investment decisions.

- Remuneration requirements
  - Firms which are not SNIs and meet the relevant thresholds will also be required to apply IFR's remuneration rules on both a solo and group basis (except where the Group Capital Test applies). We are particularly concerned about the rules on variable remuneration and disclosure.
  - IFR requires 50% of variable remuneration to be paid effectively in shares and 40-60% of it to be deferred for up to five years. This does not make sense in the venture capital and private equity model, where in most cases executives are already required to wait until investments are profitably realised before receiving carried interest, as a means of incentivising and rewarding long-term performance. We would suggest that the FCA maintain the same approach to carried interest under IFR that it takes now under AIFMD. In addition, we believe that IFR's remuneration disclosure requirements are both inappropriate and poorly calibrated for venture capital and private equity.
  - We believe these issues further demonstrate the case for the vast majority of UK venture capital and private equity firms to be treated as SNIs. The UK's approach to PE/VC firms under the AIFMD is more logical and proportionate, and we would welcome the FCA using its discretion to take a similar approach under IFR.
- Liquidity requirements
  - The IFR liquidity requirement is likely to result in many firms having to hold cash (effectively one month's fixed overheads) on short-term deposit with a bank.
  - National regulators have discretion to exempt SNIs from this rule, and we would urge the UK to consider this in the case of venture capital and private equity fund managers. Amongst other reasons, this is because adviser/arrangers in respect of closed-ended funds pose little if any liquidity risk.
- ICARA
  - The ICARA will be new for adviser/arrangers. The supervisory review can be hugely burdensome for PE/VC firms and unnecessary given the nature of the risks to which these firms are exposed. We would strongly encourage HMT and FCA to make clear that PE/VC firms would not generally be expected to be subject to the ICARA or SREP process.
- CPMI firms
  - We welcome the FCA's stated position that the IFR requirements should only apply in respect of the MiFID activities of CPMIs. In our view this principle should also apply when determining a group's consolidated capital and liquidity requirements, so that non-MiFID activities are discounted for these purposes. We understand that this would be a change from the FCA's current treatment of CPMI firms, but we believe this would be justified in order not to extend the scope of the UK implementation of IFR disproportionately in comparison with other EU jurisdictions.

We would be happy to discuss the contents of this letter with you; please contact Tim Lewis at tim.lewis@traverssmith.com and Tom Taylor (ttaylor@bvca.co.uk).
Yours faithfully,

Tim Lewis
Chair, BVCA Regulatory Committee

**Appendix 1: Answers to specific questions**

**Q1. What are your views on the instruments or funds used by non-joint stock investment firms that should count as CET1 capital? Please give specific examples**

Many PE/VC firms are structured as Limited Liability Partnerships, i.e. bodies corporate with legal personality but not joint stock companies. It is vital that the current rules and guidance on Eligible LLP Members Capital are preserved. Impacted LLPs will need to be able to count relevant capital contributions as core equity tier one capital in order to be able to comply with the rules.

**Q4. Do you have any comments on delegation from or to another financial entity when calculating K-AUM?**

***1. Delegation – assets under ongoing advice***

When calculating K-AUM, a firm must include assets where management is formally delegated to another financial entity but may exclude assets where management is formally delegated by another financial entity.

Although the relevant provision only refers to "management", in our view, this approach should also be taken when an adviser is providing MiFID Investment Advice to a portfolio manager or AIFM. This would avoid inconsistent treatment between portfolio managers and advisers and also double counting of the same assets (i.e. by having to be included in the AUM for both the investment manager and the adviser).

Therefore, where an adviser is providing MiFID Investment Advice to a portfolio manager in respect of assets managed by that portfolio manager, the adviser should not be required to include those assets in its K-AUM.

It is particularly important that this approach is adopted in respect of intra-group advisory arrangements. In those cases, including intra-group investment advice in K-AUM calculations would result in double counting of the same assets within the same group, and may in some cases have the perverse result of requiring the firm providing advice to hold more regulatory capital than the discretionary manager in respect of the same AUM. This would be contrary to the FCA's stated intention at paragraph 7.30 of the Discussion Paper: "*The intention is that only the total of assets managed on behalf of clients that are external to the consolidation group need to be captured to calculate a consolidated K-AUM*".

We note that the EBA has taken an opposing view in its consultation in June. This appears to be on the basis that advice is a different activity legally from asset management. From a risk to client perspective, there is no basis for drawing this distinction. It means that where manager A delegates management to B, B is not required to hold capital, even though B's actions as discretionary manager bind A and A's underlying clients. This contrasts with the situation where adviser C advises manager A. Here, manager A is not obliged to follow C's advice and yet on the EBA's proposals, C must hold capital, thus duplicating the amount of capital in the regulatory system even though the risks posed by the adviser are lower than those which would be posed by a sub-manager. This cannot be the intended outcome of the rules.

***2. Definition of "financial entity"***

We note the EBA's view expressed in its consultation paper that the term "financial entity" in this context should only apply to EU regulated entities or other entities with an AUM-based capital requirement. Our view is that this an excessively narrow definition, and that it should instead be left broad enough include other entities such as fund or investment managers established outside the EU. This would allow UK firms acting as delegates of such non-EU financial entities (including those providing investment advice as described above) to exclude the relevant AUM under those mandates from their K-AUM calculation.

We believe this would be an appropriate result. Investors or clients of the relevant non-EU entity are facing that entity in the knowledge that it is not regulated in the UK or EU. It would be disproportionate to apply UK prudential regulation to arrangements whose substance is outside the UK/EU, particularly where the UK entity's role is solely as an adviser, without the ability to take binding investment decisions. Again, this is particularly important where the UK adviser is a member of the same group as the non-UK manager. There is a risk that taking another approach will disincentivise groups from locating their deal teams in the UK.

**Q13: What are your views on the conditions, both of which must be met, before an investment firm group may be given permission to use the GCT?**

We welcome the FCA's decision to exercise this discretion. We believe the majority of PE/VC firms will be able to use the GCT, as their group structures are simple and pose a low risk to clients and the market.

As a matter of urgency, we request that the FCA clarifies whether the UK will treat the topmost parent undertaking for prudential purposes (under consolidation or GCT) as the topmost UK entity, or may look to EU entities instead. In other words, we request clarification on whether EU will be treated as a third country for the purposes of UK implementation of the rules.

**Q16: What are your views on the structure and content of the elements being covered in the proposed new 'Pillar 2' framework.**

We do not think the UK should go beyond the IFR requirements and apply these to SNIs. The ICARA process would be disproportionately burdensome for those firms, and we believe it would be largely unnecessary. Our expectation is that the results of the ICARA process for the vast majority of adviser/arrangers would show that these firms pose very little risk to their clients and to the market.

**Q20: What are your views on the scope and application of a new remuneration code?**

We would request clarification on the following points:

- Since staff performance periods for remuneration purposes tend to follow the calendar year, we would ask the FCA to confirm that the new remuneration code will be applied in respect of the first full performance year following introduction of the rules (i.e. the year beginning 1 January 2022 for most firms).

- IFD requires firms to reduce individuals' variable remuneration by up to 100% in certain circumstances, but only where the financial performance of the firm is subdued or negative. However, this initial requirement for the firm to have poor financial performance is not mentioned in the DP's discussion of the criteria for applying malus and clawback arrangements. Our view is that it would be unnecessary gold-plating of the IFD rules at this stage to apply malus and clawback irrespective of the firm's financial performance where, for example, an individual's conduct has caused them to no longer be considered fit and proper. We would also note that this is intended to be a prudential regime, rather than a conduct regime, and so the remuneration rules should be applied primarily on the basis of financial performance.

**Q21: Do you think it would be appropriate for us to include in a new remuneration code a general proportionality rule similar to that contained in the IFD?**

Yes.

**Q25. Do you agree with our intended future treatment of CPMIs?**

We consider it important that:

- It is clear that the application of the rules to CPMIs is limited to their MiFID business only, in line with the UK's current approach.

- CPMIs have the benefit of a transitional provision, in the same way as investment firms.

- The remuneration rules are clarified so that compliance with the AIFMD rules will be deemed to constitute compliance with the IFD/IFR rules, as per SYSC 19C.1.1A G. It is important that CPMI firms are not subjected to overlapping and sometimes contradictory remuneration rules. This appears to be the FCA's intention, as stated in paragraph 13.5 of the Discussion Paper.

- The SNI test will apply to the MiFID part of a CPMI's business only. CPMI firms will not maintain separate accounts relating to their MiFID and non-MiFID businesses from a statutory accounting perspective.

- Firms should be permitted to prepare an approximate apportionment of their MiFID and non-MiFID businesses for the purposes of the calculation of regulatory capital requirements (including calculation of the firm's fixed overheads requirement on a consolidated group basis, which should be restricted to the overheads attributable to firm's MiFID business only).

We consider that the UK should keep under review its approach of applying MiFID and IFR provisions to AIFMs and UCITS firms. A number of EU member states do not do this currently, and if this remains the case there is a risk that the UK's position on these issues may become uncompetitive.

**Q33: Can you identify any other scenarios that are not covered by IFR transitional provisions?**

Most adviser/arrangers are currently exempt CAD firms and therefore outside the scope of CRR. The FCA has explained at para 19.10 of the DP that it interprets the relevant transitional provision as applying only to the permanent minimum requirement. The effect of this is that adviser/arrangers in existence prior to 26 June 2021 are unable to rely on a transitional provision in relation to all of the new substantive requirements (such as FOR, liquidity, ICARA and remuneration) which would apply by default under IFR. Whilst adviser/arrangers established after this date may rely on another transitional provision (Art 57(3)(b)), this merely caps FOR at ½ of fixed overheads. This may not be of practical use to many firms. A transitional period is essential for such firms so that so that more information on the impact of IFR can be collated by regulators and policymakers before the main changes are introduced and firms become subject to the full regime.

The size of the change in regulatory capital requirement for adviser/arranger firms is potentially enormous. Appendix 2 sets out the results of the BVCA survey on the potential impact on PE/VC adviser/arranger firms.

We note that the provisions in article 57(3) and (4) work on the basis of a 5-year transitional period. We propose that:

(a) a 5-year transitional period is introduced in relation to the fixed overheads requirement for adviser/arranger firms and that this allow adviser/arranger firms to build up their regulatory capital over the 5 years on a straight-line basis;

(b) the imposition of the additional new requirements (the ICARA, liquidity requirements and remuneration requirements) be postponed for five years to allow further work to be carried out regarding the proportionality of the impact of these on adviser/arranger firms. For the ICARA in particular, affected firms will require the time to properly consider their approach to the new rules and subject the ICARA document to the necessary level of internal scrutiny.

**Q29:** **Do you agree with our intended approach to remuneration exemptions for smaller non-SNI investment firms and individuals?**

We welcome the proposal not to apply the remuneration requirements to smaller non-SNI firms. We also welcome the FCA's stated intention of increasing the threshold for the application of the formal pay-out process rules from €100 million in average on-and off-balance sheet assets to €300 million, and would ask the FCA to consider using its discretion to increase this threshold yet further.

**Q34:** **Do you have any other comments on the content of a new prudential regime for investment firms as described in this DP?**

***1. Classification of adviser/arranger firms as within the scope of MiFID***

Most of the inappropriate and negative effects on our industry of the IFR rules stem from the fact that MiFID is designed for investment firms that deal with financial instruments that are tradable on organised trading venues, not for collective institutional investment in unlisted equity in partnership with a professional fund manager.

This is particularly evident in the fact that while IFR is intended and likely to produce a more proportionate prudential regime for most investment firms than CRD/CRR, it has created a disproportionate regime for PE/VC firms that are adviser/arrangers.

We would like to explore how this UK classification of adviser/arrangers can be changed. This is particularly important given that firms carrying out similar activities are generally not regulated under MiFID in any other EU member state.

A number of significant European and global - and well known - private equity firms fall under this category as they are using a UK regulated firm as their European hub to advise fund managers based in the US, Channel Islands, etc. If the adviser's appointment is terminated the private equity fund manager can simply continue to run the fund without receiving advice, without waiting for or being dependent on any steps in the winding up of the previous adviser. The failure of such an adviser would have no impact on investors or the wider financial market.

The UK's approach to implementing this part of EU law to date will put the UK at a significant disadvantage to our EU peers at a time when we are already facing significant competition from EU (and international jurisdictions).

PE/VC fund managers are not limited in their choice of jurisdiction for setting up and managing a fund, or setting up an adviser/arranger entity in which the deal team is housed, as this does not necessarily depend on where their investors are located, where the fund is expected to invest geographically, or where the PE/VC executives are based, although, the latter is likely to influence their decision.

The UK hosts the most important PE/VC ecosystem outside the USA and 50% of the European market. This generates significant numbers of highly-skilled jobs – both within the PE/VC industry and the supporting professional services community - and adds a significant dimension to the country's global importance as a financial services hub. However, in an ever-complex operating environment, the tax, legal and regulatory advantages of establishing a PE/VC fund and/or manager in the UK have been eroded as overseas jurisdictions have developed more favourable regimes (such as Luxembourg or Ireland) and the UK has not kept pace with these developments.

There are plenty of jurisdictions that, particularly in light of Brexit, continue to evolve and strengthen their operating frameworks to ensure their country remains competitive with the UK. For example, to ensure continued access to EU investors, firms (notably larger firms with the resources to contingency plan), have been and are looking to countries such as Luxembourg to set up EU AIFMs. This, alongside tax changes, is causing some movement or loss of jobs in the UK and over time this could lead to significant leakage/increasing loss of jobs, particularly if the regulatory and tax regime in the UK increases the costs of doing business here.

One of the reasons the PE/VC industry has thrived in the UK over the past thirty years is because of its tax and legal environment, including certainty of limited liability for investors and a proportionate regime for regulating fund managers and advisor/arrangers. As the set-up costs for a fund manager and fund are significant, the PE/VC executives need to be comfortable that they will not face material new hurdles when establishing a fund and/or a fund manager and/or adviser/arranger entity in a jurisdiction in the long-term. Since the financial crisis, a number of complex and fundamental changes have been introduced in the UK covering the regulation and taxation of fund managers and the cumulative effect of these on our members has been significant. We have worked closely with HMT, HMRC and the FCA over the past few years and we appreciate this ongoing collaboration, but believe the Government can go further to implement regulation and tax policy in a more proportionate manner.

As the UK leaves the EU, it will also be important for the country to continue to attract the best international talent and our policy framework must encourage this. The introduction of significantly higher capital requirements and unworkable remuneration requirements could lead to global firms moving their UK adviser/arranger firms to the EU instead.

### *2. Application of "assets under advice" to adviser/arranger firms*

The IFR includes in its definition of "AUM" or "assets under management" assets under "arrangements constituting investment advice of an ongoing nature".

***MiFID investment advice only:*** We agree with the EBA consultation which indicates that the advisory activities of firms which are not MiFID Investment Advice should not be considered "investment advice" under the IFR definition of “AUM” or “assets under management” and therefore do not need to be taken into account by firms when calculating K-AUM under Article 17 IFR.

***PE/VC advisory services may not be MiFID investment advice:*** For certain PE/VC arrangements, the related advisory activities may not constitute the investment service of "investment advice" under Section A of Annex I of MiFID as defined in Article 4(1)(4) of MiFID ("MiFID Investment Advice"). This would be the case where such advice will be provided for entrepreneurial purposes and in connection with an industrial strategy rather than a pure financial return and therefore will be corporate finance advice rather than MiFID Investment Advice. The draft RTS published by the EBA specifically notes that such activities should not be included within the calculation of a firm's K-AUM. This reflects the guidance issued by the Committee of European Securities Regulators in 2010. We understand that a number of EU jurisdictions take the view that this is how PE/VC firm advisory activities should be classified generally and that such firms are not required to be regulated under MiFID.

***PE/VC advisory services are not "ongoing" advice:*** Some PE/VC firms will currently be considered to be providing MiFID Investment Advice to the managers of the funds which own portfolio companies. This might be provided on the limited occasions when those funds decide to buy or sell a portfolio company. However, we believe that even in those cases the relevant arrangements are unlikely to constitute "investment advice of an ongoing nature" under the IFR definition of AUM, and so should not be included in the firm's K-AUM calculations in any event. We understand the purpose of the provisions is to capture non-discretionary investment management. We understand this to cover for example the advisory and execution services of certain wealth managers. These involve the advisory firm reviewing the entirety of a portfolio on an ongoing and continuous basis, making trading recommendations to the client and then (if so instructed), executing the transaction. The nature of monitoring services provided by PE/VC firms is different. It involves working with portfolio companies to support their growth strategies and reporting on this to the fund manager. Monitoring and providing reporting on the performance of portfolio companies should not be considered to be the same as monitoring and reviewing a client portfolio of financial instruments. PE/VC adviser arrangers also advise the fund manager on buying and selling portfolio companies, but this is on an ad hoc basis. Further, fund managers do not allocate a proportion of a fund to a PE/VC adviser arranger firm for ongoing monitoring. Instead, PE/VC adviser arrangers identify ad hoc opportunities and if appropriate, the fund manager may decide to follow the recommendations made to buy or sell.

*3. SNI calculation*

It is likely that many MiFID firms in the venture capital and private equity industry will not qualify as either small and non-interconnected firms (SNIs) or large/systemically important firms, and so the full IFR will apply to them.

However, the draft legislation contains uncertainties as to how firms should determine whether they qualify as a SNI, which is important because SNIs are subject to a lighter regime, particularly as regards the IFR remuneration requirements.

In particular, AUM, COH, on-and-off-balance sheet total and total annual gross revenue (Article 12 IFR) will apply on "a combined basis for all investment firms that are part of a group". Our understanding is that this combination applies only to investment firms authorised under MiFID and which are included in the group. We would welcome the FCA's confirmation of this in order to avoid any alternative interpretation that this "combination" applies on a worldwide basis, potentially including both non-EU firms and EU firms which meet the core MiFID definition of "investment firm" but are excluded from the application of MiFID under the exclusions within MiFID.

**Q35: Are there any specific areas where you believe that the requirements could be made even more appropriate for investment firms?**

In 2007 the FCA published guidance regarding the application of capital requirements for MiFID investment firms which were authorised as collective investment scheme operators. This made clear that the part of the firm's business relating to its CIS operating activities falls outside of MiFID. This treatment has been preserved following AIFMD.

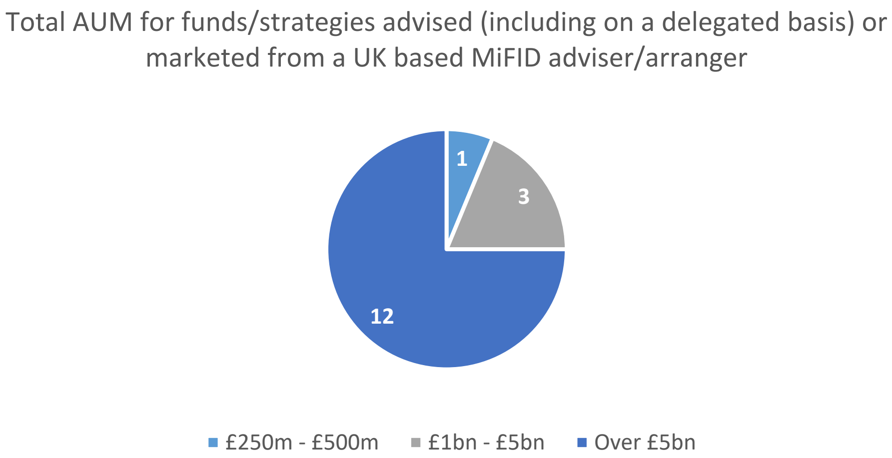
The FCA's discussion paper covers the treatment of CPMIs but not small AIFMs with a MiFID top-up. It would be helpful if the FCA could confirm the continuation of the current treatment and that only that part of a small AIFM's business which is covered by MiFID will be subject to the new IFR requirements.

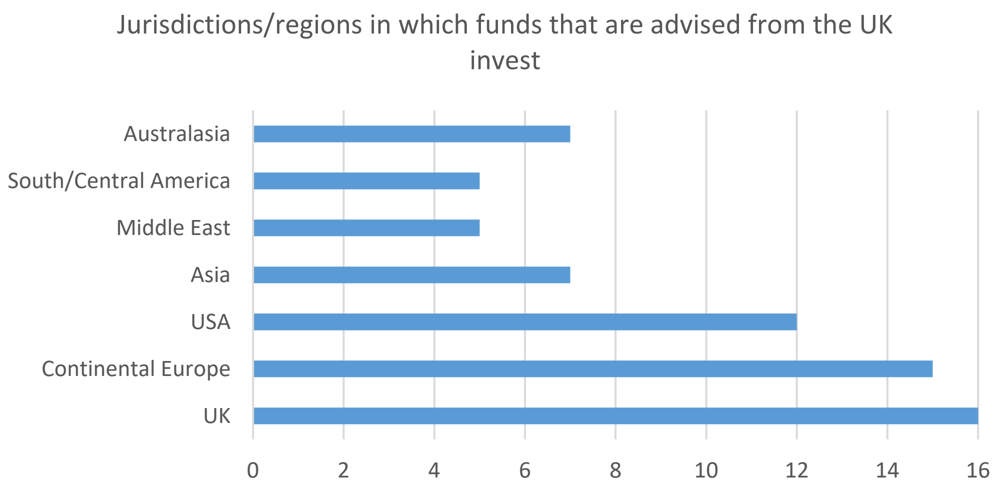
## Appendix 2 – BVCA member survey

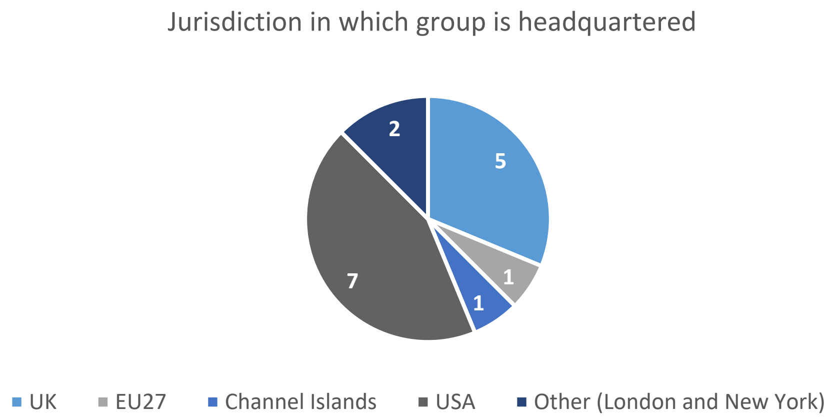
- 16 adviser/arranger (Exempt-CAD) firms completed the survey and their feedback informed the detailed feedback provided above. In summary, this included concerns about the lack of a transitional period, and the need for further clarity or tailoring to the UK market in respect of remuneration, liquidity, capital and consolidation requirements.

- The firms currently typically have a capital requirement of €50,000. Under IFR, each firm's capital requirement will increase as it moves to a Fixed Overhead Requirement. Based on this measure, **the total regulatory capital in the financial system will increase from €900,000 to £139.7 million**. This increase of 16920% is difficult to understand or to justify given the minimal level of risk posed by these firms.

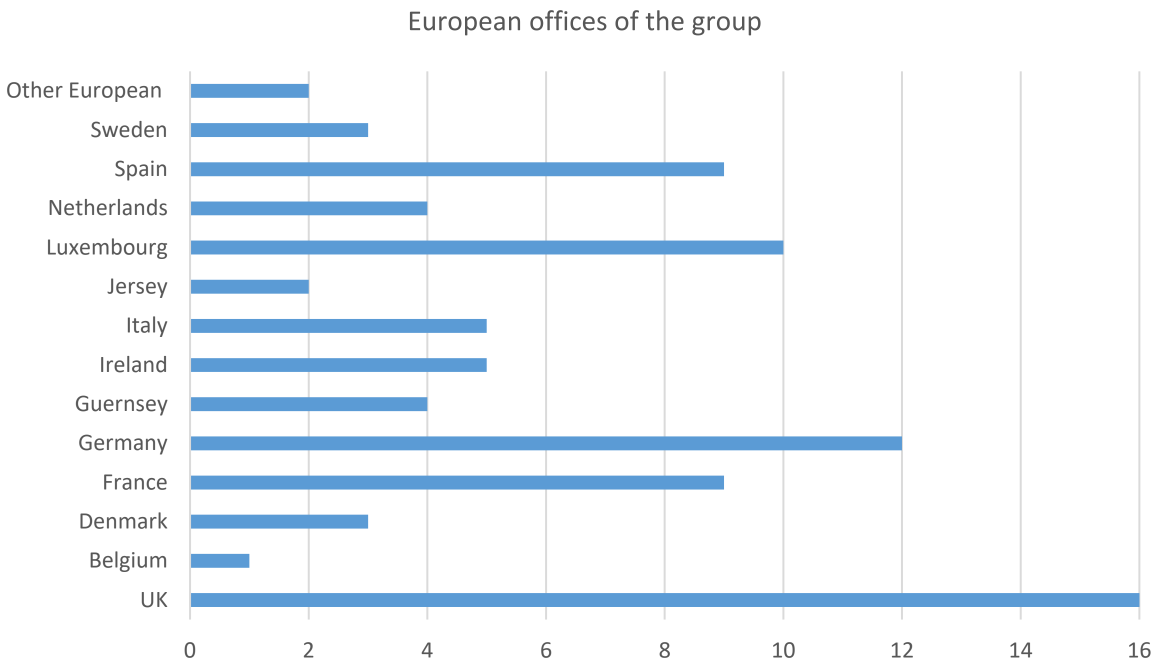
- The firms that responded to the survey were large and the results demonstrated that the UK is a base for international investment activity, although the most significant investment continues to be in the UK and continental Europe. This activity supports the broader PE/VC and professional services ecosystem in the UK and the IFR must be implemented in a measured and proportionate way to ensure the UK stays an attractive hub. The charts below highlight these attributes as well as the increased important links with the EU due to new structures being set up in Luxembourg and Ireland as a consequence of Brexit. MiFID passports are currently being exercised by these firms.



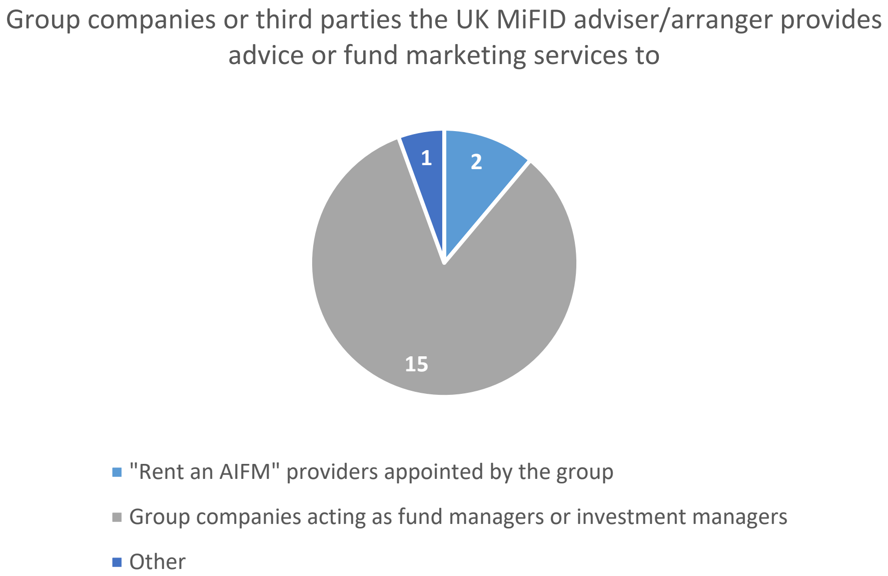





Jurisdiction in which group is headquartered
5
1
1
7
2
UK
EU27
Channel Islands
USA
Other (London and New York)

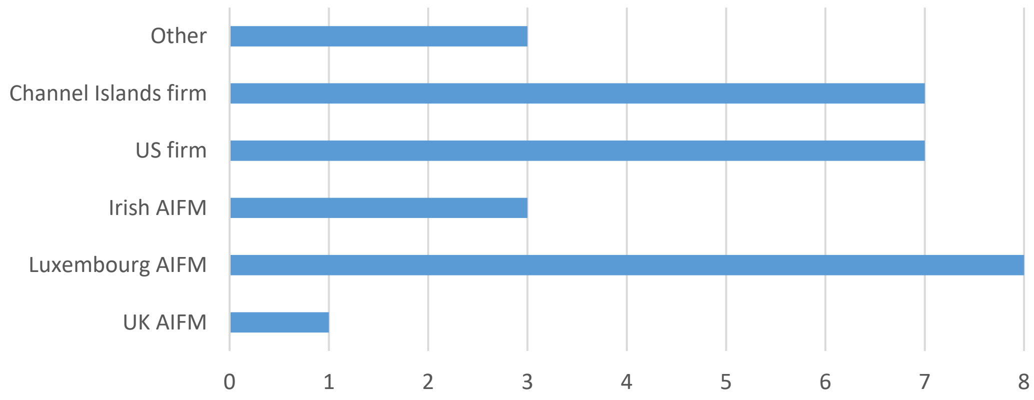



European offices of the group
Other European
Sweden
Spain
Netherlands
Luxembourg
Jersey
Italy
Ireland
Guernsey
Germany
France
Denmark
Belgium
UK
0
2
4
6
8
10
12
14
16

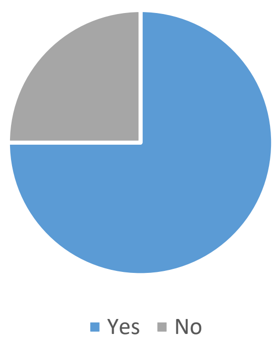



Group companies or third parties the UK MiFID adviser/arranger provides advice or fund marketing services to
2
15
1
"Rent an AIFM" providers appointed by the group
Group companies acting as fund managers or investment managers
Other

Location of entity(ies) the UK MiFID adviser/arranger provides advice or fund marketing services to




Do you currently (i.e. until the end of the transitional period) exercise the MiFID passports available for your MiFID adviser arranger/CAD-exempt entity?




Types of fund/strategy the UK MiFID adviser/arranger advises (including on a delegated basis) or markets from the UK