bvca The voice of long-term investment

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9 December 2010

Dear Ms Ho,

FSA CP 10/27: Implementing CRD3 requirements on the disclosure of remuneration

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 (**"PE/VC firms"**).

In order to focus our response appropriately we have answered only those questions in the consultation which we think raise issues relevant to the private equity and venture capital industry. We have also considered the consultation with a view to similar issues which will arise on implementation of the Alternative Investment Fund Managers Directive (**"AIFMD"**).

General comments

We welcome the FSA's approach to proportionality in implementing the CRD3 remuneration disclosure requirements. From a PE/VC firm perspective, we consider that the division of disclosure obligations between the four groups of firms (or "tiers") is broadly appropriate. The BVCA considers that it would be logical, appropriate and proportionate for the four-tier system to be applied in the same way throughout the revised Remuneration Code, including the framework for certain firms to justify non-compliance with certain principles, under the "comply or explain" approach proposed in FSA CP10/19: Revising The Remuneration Code.

In this response we outline our concerns surrounding the potential impact of the disclosure requirements on smaller PE/VC firms, since it is these firms that are most likely to be disproportionately negatively affected.

Smaller PE/VC firm's tend to have fewer staff then larger firms. The requirement to disclose aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on risk are highly problematic in this context for two key reasons. First, this level of granularity is disproportionately onerous for smaller PE/VC firms to achieve. Second, where the aggregated information relates to few staff it may be relatively simple for stakeholders (including staff) to discern the remuneration of particular individuals. This undermines the purpose of the aggregation and could create issues and tensions which run contrary to the interests of the individuals and firms concerned, their funds and investors as well as their portfolio companies. In this context it is hard to see which stakeholders will actually benefit from this level of transparency. We would therefore propose that disclosure by such firms should be limited to a summary of their governance and controls around remuneration, with a focus on conflicts of interest management.

The FSA's remuneration rules will also be relevant when considering Level II implementing measures for the AIFMD requirements. The AIFMD contains remuneration related provisions broadly similar to those contained in CRD3. It would be appropriate, therefore, for the FSA to establish rules which could eventually be appropriate for the implementation of both Directives. In view of this, it is important that the rules are proportionate and do not overly burden smaller firms.

Q.1 Do you agree with our proposed approach to implement the disclosure requirements of CRD 3?

We consider that the FSA's approach to the disclosure of remuneration requirements under CRD3 firms to be reasonable and clear. We note below those concerns which we consider most relevant to the UK private equity and venture capital industry.

Q.2 Do you agree with our proposed requirements in terms of frequency and form of disclosure, as set out in paragraph 4.3 and 4.7?

We agree that the required disclosures could sensibly be included in firms' disclosures made under BIPRU 11.3.10. This will have the additional benefit of allowing a smooth transition to the disclosure of remuneration requirements under the AIFMD which also envisages disclosure through a firm's annual accounts.

In line with the FSA's recognition that the disclosure will be an "onerous new requirement" (paragraph 4.4) we suggest extending the deadline for the first disclosure from 31 December 2011 to mid-2012. This will permit those firms with a financial year end in the last quarter of 2011 sufficient time to incorporate their first disclosure into their annual accounts. A related issue, on which further clarity would be extremely helpful, relates to the period for which disclosures must be made if the firm's financial year end does not fall on 31 December 2011. Should such firms made disclosures in their own accounts in respect of the

period running from 1 January 2011 to the date of their financial year end? To require disclosures in respect of the calendar year would give rise to confusing inconsistency, whilst requiring disclosure for the entire financial year would give retroactive effect to the rules for the period predating 1 January 2011.

Q.3 Do you think that there would be any meaningful disadvantage in extending the scope of our disclosure requirements to third country BIPRU firms in relation to their activities carried on from establishments in the United Kingdom?

In requiring third country BIPRU firms to disclose remuneration information, where no equivalent or comparable obligation is in place in the rest of the EU, the FSA would be placing the UK at a significant competitive disadvantage. The additional regulatory burden may encourage firms to divert employees and activities away from the UK without bringing any compensatory benefit.

Q.5 Do you agree with our proposed application of the principle of proportionality to institutions as set out in paragraphs 4.18 to 4.20?

We consider that the proposed division of disclosure requirements into the four tiers to be a sensible and clear way of applying proportionality to the disclosure of remuneration rules. The vast majority (if not all) of PE/VC firms represented by the BVCA will fall into Tier 4. We agree with this implied recognition of the fact that PE/VC firms do not pose systemic risk and we therefore suggest that the FSA extends the four-tier proportionality bandings to all of the remuneration rules.

Our key concern relates to the information PE/VC firms are required to disclose. The obligation to disclose 'aggregate quantitative information on remuneration, broken down by senior management and members of staff whose actions have a material impact on the risk profile of the credit institution...' (Annex 3(g)) could lead to an overly burdensome disclosure requirement on small PE/VC firms. The vast majority of PE/VC firms are very small when compared to other securities market participants, including deposit-takers, investment banks and many securities dealers. The smallest have only two principals and a few junior executives. To that end, we suggest that it would be disproportionate to require any public disclosure of substantive remuneration arrangements by investment management firms, and that disclosure by such firms should be limited to a summary of their governance and controls around remuneration, with a focus on conflicts of interest management. To the extent that any quantitative data is required to be published (no matter how anonymised) it will otherwise be very easy to work out the remuneration packages of particular individuals. This would be a perverse outcome, given that Tier 1 firms are only required to publish aggregate quantitative information at the level of directors. As we noted above, this also undermines the purpose of the aggregation and could create issues and tensions which run contrary to the interests of the individuals and firms concerned, their funds and investors as well as their portfolio companies. In this context it is hard to see which stakeholders will actually benefit from this level of transparency.

As far as disclosure in groups containing more than one FSA regulated firm is concerned, we consider that it would be against the principles of proportionality to require Tier 4 firms to adhere to more stringent disclosure requirements than their risk profile merits, simply because they are in the same corporate group

as a higher tiered firm. The division of disclosure requirements on the basis of a firm's nature, size and risk profile is a sensible and proportionate approach to the remuneration rules. It does not follow that a Tier 4 firm poses a higher risk, or is somehow altered in its nature, simply by virtue of being in the same group as e.g. a Tier 2 firm. As each individual firm will remain subject to the disclosure requirements, it would be overly burdensome, and of no additional benefit to stakeholders, to require firms within a group to adhere to the rules of the highest tiered firm.

We would be happy to discuss these issues with you if that would be helpful. In the first instance please contact Margaret Chamberlain, chairman of the Regulatory Committee, on 020 7295 3233 or margaret.chamberlain@traverssmith.com.

Yours sincerely,

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Chair - BVCA Regulatory Committee

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