

Submission

European Private Equity & Venture Capital Association
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CREATING LASTING VALUE

On behalf of the Public Affairs Executive (PAE) of the EUROPEAN PRIVATE EQUITY AND VENTURE CAPITAL INDUSTRY

September 30, 2013

To EBA

Re Response to

EBA Consultation on draft Regulatory Technical Standards on own funds requirements for investment firms based on fixed overheads (EBA/CP/2013/30)

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Introduction

1. We write on behalf of the representative national and supranational European private equity and venture capital (“PE/VC”) bodies. Our members cover the whole investment spectrum, including the institutional investors investing in a broad range of PE/VC funds, as well as the PE/VC firms raising such funds, who 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, and 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 the EBA’s consultation concerning its Regulatory Technical Standards on own funds requirements for investment firms based on fixed overheads under Article 97(4) of Regulation 575/2013 (the “RTS”). We stand ready to provide whatever further contribution to this work the EBA might find helpful, including attending meetings and contributing further materials in writing.
3. We set out below answers to the EBA’s questions relevant to the PE/VC industry.
4. We note that as drafted there is a potential conflict in application between Article 36(5) (audited financial year not 12 months) and Article 36b (use of projected data).

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Specific Response to Questions

Q1: Do you agree with the subtractive approach proposed in Article 36(1)?

5. We support the use of this approach. We believe that the majority of European AIFMs and investment firms by size and funds under management are currently subject to rules using this approach. We believe that this approach should give greater consistency of treatment across firms around the European Union given the differences in accounting standards to which they are subject.
6. We note the RTS assumes firms' accounts are audited. We suggest that for any firms which are not required to publish audited accounts, the requirement be based on the 12 month financial year end data.

Q2: If yes, do you agree with the list of items? What items should be added or deleted?

7. The most important item in the entire list is the final "sweeper" item. This should be phrased in a way which makes it clear that all variable expenditure should be deducted in order to arrive at fixed expenditure. In order to achieve this we would prefer the formulation "all other variable expenditure" to the formulation "extraordinary non-recurring expenses", in order to avoid the possibility that in some jurisdictions "extraordinary expenses" or "non-recurring expenses" or "extraordinary non-recurring expenses", coincides with a narrower concept under local generally accepted accounting principles.

Alternatively, if the EBA wishes to continue to use the phrase "extraordinary non-recurring expenses" in the main text, it would be helpful for firms if the recital could make clear that this phrase effectively refers to "all other variable expenditure".

8. It would be helpful to make clear to firms that where national implementing measures currently include items which are not set out in the RTS, firms will still be able to treat those items as variable expenditure provided they fall into the "sweeper" provision. In other words, the absence of a particular item from the list should not be regarded as determinative. The determinative test is whether the item is in fact "variable expenditure".
9. Other items which are currently included in the list of variable expenditure in at least one EU jurisdiction are:
 - interest paid to counterparties;
 - interest charges in respect of borrowings made to finance the acquisition of a fund's tradable investments;
 - foreign exchange losses.
10. Theoretically the subtractive and additive approaches should result in approximately the same result and thus the overall capital requirements for investment firms should ceteris paribus not be materially different. In order to ensure no material shifts in capital requirements due to a switch to the subtractive approach, the EBA may take the opportunity to revisit the application

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of recurring “non-cash” expenses such as depreciation and amortization, which may be excluded from the fixed overhead base.

Q3: In case you prefer the additive approach, please elaborate on the advantages of using such an approach and on how to minimise the risk of faulty classification.

11. We do not support the use of the additive approach. We are concerned that this would be insufficiently flexible to take account of differences between Member States, differences between accounting standards, development of accounting standards and business development.

Q4: Do you agree with the inclusion of tied agents as set out in Article 36(4)? If not what alternative do you suggest?

12. We do not agree with this inclusion. Either an expense is an expense of the investment firm or it is not. The anti-avoidance provision in Article 36(3) already allocates to an investment firm the fixed expenses of a third party which have been incurred on behalf of the investment firm. This applies equally to expenses incurred by a tied agent on behalf of an investment firm.

Q6: Currently a 35% share is proposed of the proportion of costs to be included for tied agents. Do you believe this is adequate?

13. We do not believe it is appropriate to allocate a pre-determined share to the investment firm in this way, because it may have no correspondence to the fixed expenditure effectively incurred for the investment firm. Where a tied agent is paid a percentage of commissions earned (so that if no commissions are earned, nothing is paid), the draft rule would artificially inflate the investment firm’s fixed overhead. Conversely where the tied agent is effectively a salaried employee of the investment firm and represents a fixed overhead, 35% could underestimate the fixed overhead. The rule should be designed to reflect the actual expenses incurred through a particular business arrangement rather than applying a notional value to all such arrangements.

Q7: Do you agree with the proposed 20% threshold in Article 36a? Please provide evidence of the potential impact of this threshold.

14. The impact of the threshold depends on a number of factors.

15. First, the impact is determined by how competent authorities exercise their discretion to vary the standard capital requirement from one-quarter of fixed overheads of the preceding year. We assume the intention is that the capital calculations should be recalculated on the one-quarter fixed overheads basis to take account of the increased capital requirement arising from the material change. It would be helpful if EBA could indicate that this is the intention in order to ensure common treatment across the EU.

16. Second, the impact is determined by the timing of the assessment and any notifications to be made by the firm relating to the assessment. It is implied from the RTS that firms should notify a 20% projected change to the CA, following which the CA may vary the requirement. For a small firm in a volatile business environment, that could require frequent notifications.

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We believe a percentage threshold is a more flexible and proportionate metric than an absolute number. We would suggest 33% rather than 20%, in particular to reduce the burden on smaller firms.

Q8: Do you consider it necessary to set a *de minimis* amount for small investment firms, as set out in Article 36a(5)? If yes what should the amount be?

17. We note that no *de minimis* has been proposed. We would suggest a *de minimis* of €250,000 (being the total capital requirement). We note that for an AIFM, the minimum initial capital requirement is €125,000. Setting a *de minimis* total capital amount of €250,000 before changes need to be considered by the regulator effectively means that such changes would only need to be considered for firms with at least €1 million of annual fixed expenditure.

Q9: Do you agree with the introduction of the €2 million absolute threshold? If not what should the amount be?

18. We do not believe there should be a minimum threshold.

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About the PAE

The Public Affairs Executive (PAE) consists of representatives from the venture capital, mid-market and large buyout parts of the private equity industry, as well as institutional investors and representatives of national private equity associations (NVCAs). The PAE represents the views of this industry in EU-level public affairs and aims to improve the understanding of its activities and its importance for the European economy.

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.

