Mr Greg Sachrajda
Cross-Cutting Policy and Strategy, Supervision, Policy and Competition
Financial Conduct Authority
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By email: ifprquery@fca.org.uk

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Dear Mr Sachrajda

Enhancing proportionality for small investment firms

The BVCA is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of around 650 firms, we represent the vast majority of all UK based private capital firms, as well as their professional advisers and investors. In 2022, £27.5bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized businesses.

The UK is the world's second largest hub for the private capital fund management industry, but this position depends on the UK maintaining a robust tax, legal and regulatory environment that is internationally competitive and an attractive place to establish private capital firms, raise capital and invest.

Now that regulators have a new secondary competitiveness and growth objective, we are pleased to see that the PRA and FCA have jointly announced in PS 23/17 enhancements to the proportionality of the prudential regime for banks. We believe there are similar opportunities for the FCA to make enhancements of the UK's prudential regime for investment firms.

We make several recommendations below, including replicating the PRA's proposal on malus and clawback provisions for small firms, and to revisit decisions to "gold-plate" EU-derived prudential requirements, which put UK private capital firms at a competitive disadvantage compared to their EU counterparts.

We hope these recommendations are helpful and would like to discuss them in more detail at your earliest convenience.

Remuneration requirements: Enhancing proportionality for small firms

Under the new rules, smaller banks will no longer need to include malus and clawback provisions in the bonus pay-out arrangements for key staff members. This is on the basis that maintaining malus and clawback regimes is disproportionately expensive for smaller firms, who often lack the size of Human Resource departments at larger banks. The PRA also proposed to amend its definition of a 'small CRR firm' to increase total asset thresholds to £4bn (and £20bn for firms that meet the 'Simpler-regime criteria'). The proposed increase in thresholds will allow much larger firms to benefit from a less costly and burdensome remuneration regime.

We consider that the same arguments are applicable to non-SNI MiFID firms.

Malus and clawback provisions were introduced for private capital firms (and other MIFID firms) as part of the FCA's remuneration code for MiFID investment firms for performance periods beginning 1 January 2022, and forms part of the Investment Firm Prudential Regime (IFPR).

Under IFPR, private capital firms which are non-SNI MIFID firms must apply the standard or extended remuneration requirements, which include malus and clawback provisions. For remuneration purposes, a MiFID investment firm exceeding any of the following thresholds are subject to these rules:

- ≥ £1.2bn assets under management
- ≥ £100m on- and off-balance sheet total assets
- ≥ £30m total annual gross revenue from investment services and activities
- Plus additional quantitative threshold criteria relating to client orders handled, assets safeguarded and administered and on client money held.

From recent survey data, 54%[1] of BVCA members who are private equity firms exceed the AuM threshold alone, so a large share of UK-based MiFID investment firms will be in scope of these rules. With this in mind, we strongly support the PRA's policy rationale behind enhancing proportionality in its remuneration regime. We agree with the PRA - and with the evidence it has collected - that the implementation of EU-derived prudential regimes has been costly and burdensome for some firms and that maintaining malus and clawback regimes is disproportionately expensive for smaller firms.

Noting that the FCA now has the very same new secondary competitiveness and growth objective, we would welcome an FCA review of IFPR to increase and simplify the quantitative threshold criteria and enhance proportionality for small investment firms. For example, we believe that excluding small non-SNI investment firms (i.e. those that are not large non-SNIs) from the malus and clawback provisions in IFPR will realise many benefits, including reduced costs for those firms, reduced administrative burden on those firms and the FCA, enhanced competitiveness of the UK as a place to establish a private capital firm and help UK firms to attract new staff. This will improve the position of the UK as a great place to do business and support the UK Government's priority to grow the economy.

<u>The Investment Firm Prudential Regime: other areas where more proportionality could be introduced</u>

IFPR resulted in significant changes to the capital, liquidity, and remuneration requirements for investments firms, particularly for those previously classified as exempt CAD firms. BVCA member firms were amongst those most affected by increased compliance costs and burdens from IFPR, despite the negligible level of systemic risk they pose.

In private capital firms the assets of the manager and the fund are separated in different legal entities. Private capital funds are almost exclusively closed-ended, meaning there is an absence of liquidity risk. Investors in these funds typically commit their capital for a period of five to seven years, so it is not possible for managers to be unexpectedly faced with significant numbers of investor redemption requests – as has happened in open-ended funds.

We raised concerns at the IFPR consultation stage that the UK would be implementing IFPR in a way that was more onerous than the EU and individual Member States' approach to IFR/IFD. Now that the FCA has a new secondary competitiveness and growth objective, we would welcome a review of the following points:

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[1] The methodology involved gathering data from 137 active GPs in BVCA membership who are private equity as at 07/12/2023. Data sources include direct submissions from members, and supplementary data enriched with data from Preqin, Arx Origination, and firm websites. The collected data was validated, cleaned, and cross-referenced for consistency. The analysis relies on source data accuracy.

- The regime introduced pay rules for firms which were previously exempt CAD firms for the first time. We consider the relevant rules do not address any meaningful regulatory concern, but they do impose cost and business restriction. These should be reviewed with a view to enhancing proportionality for smaller firms and reducing cost and burden (see recommendation on malus and clawback provisions above).
- The overlap between the IFPR and AIFMD rules should be reduced as far as possible. We do not agree that it makes sense to impose regulatory capital requirements on an advisor/arranger whose sole role is to provide services to a full scope AIFM affiliate beyond a basic requirement of €50,000 (or potentially a higher flat requirement of say €100,000, see our response to the EBA's 2017 consultation for an explanation of the policy rationale for this). An alternative option to address the overlap might be to require a CPMI firm to comply with the greater of the AIFMD and IFPR capital and liquidity requirements only.
- The current rules require CPMI firms (subject to both AIFMD and MiFID remuneration requirements) to opt up to the MiFID requirements for its entire business, not just that related to MiFID business. This is particularly burdensome for firms with substantially more AIFMD AuM than IFPR AuM and should be reconsidered with a view to improving proportionality.
- This *de facto* gold-plating of EU standards arises in large part because many UK private capital advisor/arranger firms in the UK are regulated as MiFID firms, whereas we understand that equivalent advisor/arranger firms established in EU jurisdictions are typically not so regulated. We ask that the FCA consider aligning its approach to that of regulators in key EU jurisdictions.
- There is no maximum limit on the capital requirements under IFPR, in comparison to the €10m maximum that exists for the funds under management requirement under UK AIFMD. A suitable maximum capital requirement should be introduced under IFPR, as exists in UK AIFMD.
- From the 1 January 2022, UK MiFID investment firms which are SNIs have had to complete the Internal Capital and Risk Assessment (ICARA). The ICARA is resource intensive and presented affected private capital firms with significant challenges, requiring new processes, policies and procedures. The EU Directive does not require SNI firms to prepare ICARAs, so again UK-based SNI firms incur a much greater compliance cost and burden and are at a competitive disadvantage compared to their EU-based counterparts.

These recommendations would help to ensure a level playing field between adviser/arranger firms located in the UK and across the EU. They also support the FCA's new secondary objective for competitiveness and growth by reducing costs on investment firms, increasing the attractiveness of the UK as a base for firms, and reducing administrative burden on firms and the FCA.

Please let us know if you have any questions and we would welcome an opportunity to discuss this in more detail with you. Please contact Tom Taylor ttaylor@bvca.co.uk / Nick Chipperfield nchipperfield@bvca.co.uk).

Yours sincerely,

Tim Lewis
Chair, BVCA Regulatory Committee