FRANCE INVEST

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France Invest's comments on the European Commission's
Proposal for a Directive as regards the Union retail investor protection rules

France Invest would like to thank the Commission for the opportunity to comment on its proposal for a Directive as regards the Union retail investor protection rules.

As explained in our response to the Commission's consultation on a retail investment strategy for Europe dated 30 July 2021, **France Invest fully supports the European Commission's objective to develop a coherent regulatory framework to empower consumers, enhance their participation in EU capital markets and help improved market outcomes**. It would be regretful if excessively strict rules striving to protect retail investors resulted in hindering fund producers and distributors from producing and distributing products aiming at them.

Traditionally, the venture capital and private equity (VC/PE) industry markets to investors that are either institutional (pension funds, insurers, banks, sovereign wealth funds, fund-of-funds…) or experienced (family offices, entrepreneurs…). Situations where VC/PE managers market to individuals committing smaller tickets - and which are objectively retail clients - are at this stage rather rare. Furthermore, most sales of VC/PE funds to retail investors are intermediated and/or in the form of a packaged product.

In order to make long-term and active investments into unlisted businesses that require time to grow and evolve, VC/PE funds typically structure themselves as closed-ended funds with no redemption rights, which favours illiquid and large commitments from investors who are in a position to make such investments. Nevertheless, open-ended "evergreen" funds are progressively emerging to provide retail investors with a more flexible and semi-liquid structure.

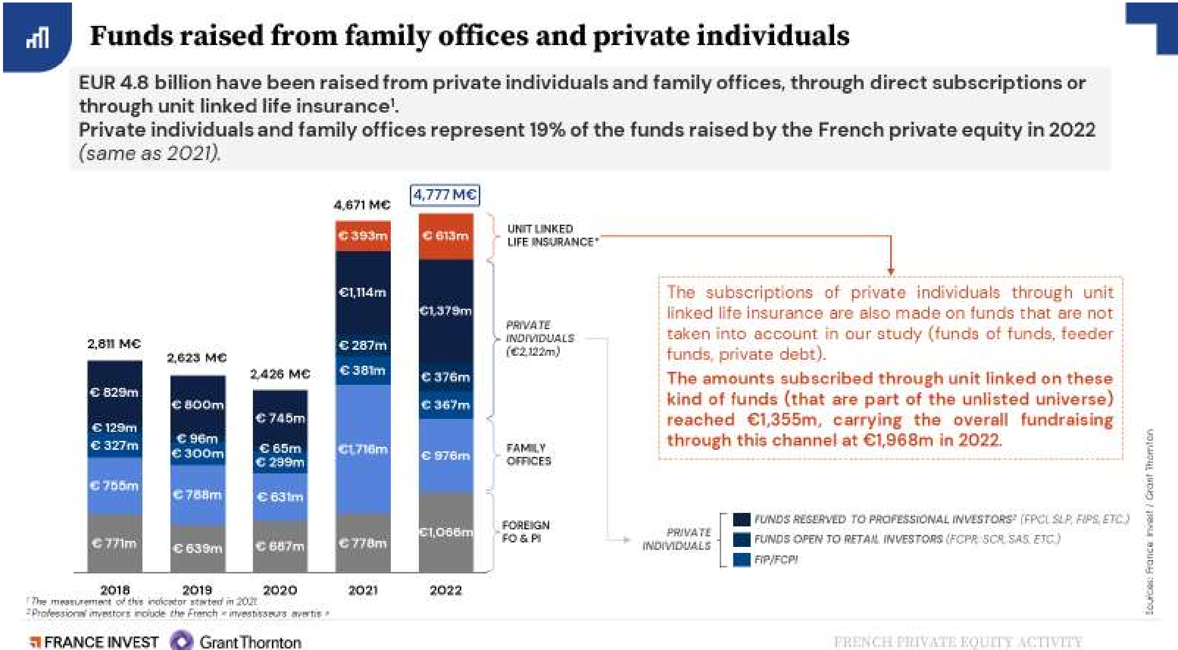
Currently, private equity in the broadest sense, including all non-listed assets excluding real estate, represents a tiny share of French people's wealth, whether directly or indirectly: the assets under management of France Invest members represent less than 0.1% of French households' financial wealth (Q3 2021)[1].

In France, FCPI ("fonds communs de placement dans l'innovation", introduced in 1997) and FIP ("fonds d'investissement de proximité", introduced in 2003) are close-ended funds aiming at retail investors. These funds can provide redemption rights in specific cases of misfortune (accidents in life such as

[1] https://www.franceinvest.eu/rendre-le-capital-investissement-accessible/

death, unemployment, illness…). Investors have been encouraged to invest in these vehicles mainly by the tax advantages they can derive from these investments. These funds are AIFs and as such do not benefit from a retail passport at EU level. In 2022, the total amount collected in these funds reached EUR 367 million from 53,000 subscribers. This amount corresponds exclusively to subscriptions allocated to the capital of SMEs which entitle subscribers to income tax reductions. It showed the attractiveness of innovation financing (70% of subscriptions were made in FCPI, and the remaining 30% in FIP)[2]. Before the removal of the wealth tax[3] in 2017, the funds raised reached EUR 1 billion.

This being said, the attractiveness of the VC/PE asset class, in particular in terms of performance, diversification and resilience, and the desire from some investors to commit capital into start-ups and scale-ups is driving **an increasing number of VC/PE managers to offer products (which do not offer tax incentive) that are directly available to retail clients**. In 2022, our members raised EUR 4.8 billion from family offices and retail investors, whether directly or through life-insurance contracts. Family offices and retail investors thus represented 19% of the capital raised by our members in 2022.



<u>France Invest's general comments on the proposed Directive</u>

In our view, ensuring the appropriate level of protection of retail investors is essential. **We support the three most central aspects of the Commission's proposed Directive** i.e.:

- ensuring good value for money for clients;
- addressing potential bias in the advice process;
- treating clients based on their characteristics.

This being said, there are four main reasons why we feel the current proposal should be improved:

- **managers marketing to professional-only clients should be more explicitly exempted from all rules set in the Retail Investment Strategy**, including rules on undue costs, product

[2] https://www.franceinvest.eu/fip-et-fcpi-des-levees-stables-en-2022/
[3] The wealth tax ("Impôt sur la fortune") applied for a net wealth of over 1.3 million euros and could be reduced by investing in FIP or FCPI

governance, information on costs, marketing and communications practices, professional requirements, suitability and appropriateness;

- the **proposed rules on undue costs** (in the context of a review of the AIFMD), designed for mass-market products, **would have far reaching consequences** on the way structures are distributed and ultimately on investors' choice;
- **the proposed rules on inducements would disrupt the existing distribution models** and the use of MiFID structures;
- even though the proposed review of **the categorization of investors** goes in the right direction, it **should be further enhanced**.

For the retail investment package not to seriously disrupt the EU financial services industry, it is essential to bring targeted changes to the well-intended proposals introduced by the European Commission.

I. France Invest's comments on the Commission's proposals on undue costs (article 2 of the proposed Directive modifying article 12, article 14, article 46 and article 56 of the AIFMD)

Preliminary remarks:

– We would like to underline that **a smooth articulation should be ensured** between the Commission's proposals to revise the AIFMD and its proposals regarding the review of the PRIIPs Regulation and of the MiFID, in particular with the Commission's proposed requirements on product governance.

– We fully support a high level of transparency on costs: investors need to have the relevant data in order to make well informed investment decisions. However, retail and professional investors do not need the same level of detail. **Professional investors should be left out of the scope of the RIS as they do not need the same level of protection as retail investors**. The AIFMD offers a passport for funds aimed at professional investors.

– **Our industry is already well regulated**, unlike other sectors which might not be as regulated yet. Safeguards are already in place regarding the costs that may be charged to AIFs and their investors. For instance, national competent authorities (NCAs) examine and approve the costs charged to a fund and its investors at the time of authorization of a new fund. We are not against a transfer of obligations from one level to another, as long as there is no change in their scope or reach.

– We do not share the general view that managers charge undue costs to AIFs and their investors. In our opinion, investors should generally be free to make their own investment decisions, on the basis of standardized, clear, accurate and fair information. Even though we agree that retail investors require an enhanced level of protection, **this does not justify a cap on the turnover of AIFMs or on the fees and expenses charged to funds**. For instance, we think that AIFMs should remain responsible for deciding on the staff required to manage a fund, the level of their remuneration and other expenses attached to the fund.

– We understand that ESMA's report on undue costs mainly focuses on UCITS, which are very different funds from VC/PE funds in terms of underlying assets and functioning. **The specificities of VC/PE funds need to be taken into account** when designing any rules on costs.

– It should be noted that **fees are not always possible to calculate prior to the fund marketing and not easily comparable from fund to fund**. This may be true for mass-marketed products,

such as mutual index-based, open-ended funds, but not necessarily applicable to long-term, closed-ended products. Indeed, these are products where the manager makes active investments in businesses – and where costs can greatly vary depending on fund size, macro-economic conditions, investment sector transactions structuring and are not easily calculated at the fund's onset.

– **It is of the utmost importance that costs are assessed in relation to benefits, volatility, investment strategy and expected net returns for investors**. Indeed, looking only at costs gives a partial view of a product and is misleading, in particular when comparing products.

  For instance, when focusing on costs, plain vanilla products and traditional funds (such as ETFs or UCITS) would probably compare more favorably against more sophisticated products, such as VC/PE funds, even though the latter may bring additional benefits to investors. In other words, **the costs attached to PE/VC funds should be assessed in relation to their higher performance and lower volatility as well as their benefits in terms of portfolio diversification and purpose** (they invest in and support SMEs). The management of VC/PE funds inherently implies higher costs: as these funds have larger teams to analyze and select potential targets and actively support portfolio companies, they require enhanced compliance, training and information effort for managers and distributors, etc.

  As a consequence, **taking only costs into account would shy retail investors away from more sophisticated products, such as VC/PE funds, and be counterproductive** with regards the Commission's objective to encourage the participation of retail investors to capital markets and finance European companies, and provide them with higher performance and more value.

– In a competitive environment, regulatory costs borne by the managers always end up being costs to the consumer. EU lawmakers should not underestimate the effect that a legislation aiming at a reduction in cost might eventually create additional costs for consumers. In any case, it should be noted that competition among market players prevents them from charging undue costs.

Specific comments:

– We support the Commission's aim to foster retail investors' participation in capital markets. In this context, it is key that **AIFs aimed at professional investors should be left out of scope** regarding undue costs, as professional investors are very well able to assess by themselves whether costs are excessive and inappropriate or not and to negotiate these costs.

  To this aim, we suggest clarifying the first sentence of article 12 paragraph 1a as follows:

  > For the purposes of paragraph 1, Member States shall require AIFMs to act in such a way as to prevent undue costs from being charged to the AIFs **made available to retail investors** and their unitholders.

– It is of utmost importance that **costs are assessed in relation to benefits**. The management of VC/PE funds inherently implies higher costs than other types of funds: as VC/PE funds apply an active management strategy, they require enhanced compliance, training and information effort for managers and distributors, etc. In other words, higher costs attached to some funds may be explained by the higher quality they deliver. We believe that costs should be rather disclosed, explained and justified.

  To this aim, we suggest rewording point b of article 12 paragraph 1a as follows:

The costs which **can be justified by the AIFM** ~~are necessary for the AIF~~ to operate in line with its investment strategy and objective **to increase value for investors** or to fulfil regulatory requirements.

– We do not share the general view that managers charge undue costs to AIFs and their investors. Conversely, we fully agree that an appropriate level of transparency should be applied. In addition, we would like to recall that the management of funds implies inherent costs, including compliance costs. In the same way, some IT and operational costs are incompressible. Technology might help reduce them but will not remove them completely. For instance, algorithms cannot invest in non-listed companies.

For these reasons, we suggest removing point a of article 12 paragraph 1b as follows:

~~**a) The costs are not undue;**~~

In addition, we suggest rewording point n of article 46 paragraph 2 as follows:

Require to compensate investors where ~~**undue**~~ **undisclosed and unjustified** costs have been charged to the AIF or its unit-holders.

Furthermore, we suggest rewording point b of article 12 paragraph 1b as follows:

The costs borne by retail investors are justified and proportionate, having regard to the characteristics of the AIF, including its investment objective, strategy, expected returns, level of risks, **regulatory requirements** and other relevant characteristics.

– **When assessing costs, the funds' specificities should be taken into account**:

  ○ Active and passive management should be distinguished. For example, the management of VC/PE funds implies higher costs (including a higher remuneration for highly skilled managers) than the management of ETFs.

  ○ The number of underlying portfolio companies in one specific fund should also be taken into account.

  ○ In its report, ESMA focuses on UCITS, which do not imply the same expenses as AIFs. For example, compliance costs are higher for VC/PE funds than for UCITS.

To this aim, we suggest rewording paragraph 1c of article 12 as follows:

Member States shall ensure that AIFMs are responsible for the effectiveness and quality of their pricing process. The pricing process shall be clearly documented, shall clearly set out the responsibilities of the management bodies of the AIFM in determining and reviewing the costs borne by investors, and shall be subject to periodic review. The assessment of costs shall be based on objective criteria and methodology, including a comparison to **national** market standards **specific to asset classes, management style and size of transactions**.

– In our opinion, **the methodology proposed for developing benchmarks should be clarified and adapted to the specificities of VC/PE funds**.

  ○ Delegated acts will set out how benchmarks will be developed, which at this stage gives **very limited visibility** on the methodology that will be used.

- Any delegated acts should be developed **well in advance** of the date of application of the Directive. It is crucial to give market players enough time to get familiar with the delegated acts and prepare for the implementation of the new rules.

- In any case, it is key that **professional associations are involved** in the development of the methodology underlying benchmarks.

- Also, the methodology should be made **public**.

- The disclosure of information to authorities in order to build benchmarks should not add to the reporting burden of managers.

For these reasons, we suggest rewording paragraph 1f of article 12 as follows:

> 1f. After having consulted EIOPA and competent authorities, ESMA shall, where appropriate, develop **in due time** and make publicly available benchmarks **and their methodologies, developed with the contribution of the relevant professional trade bodies,** to enable the comparative assessment of costs and performance of AIFs, or their share classes where they have different cost structures, to be used for the assessment set out in paragraph 1e.

- **It will be difficult to develop benchmarks which are relevant for comparing products**. For example, comparing costs may be unfavorable to smaller funds or funds which raise less capital than expected (and whose costs are fixed). In addition, direct fund strategies are not comparable to funds of funds strategies in terms of total direct and indirect costs.

- If based on the information included in the Key Information Document (PRIIPs KID), data available to build relevant benchmarks will not be sufficient. Indeed, the PRIIPs KID focuses on risks and costs but does not show the VC/PE category, nor does it specify the relevant strategy, management type, diversification, geography or target returns of the fund. In other words, it will not be possible to create consistent groups of PRIIPs based on the information included in the KID. In any case, these groups should not be defined on the basis of the synthetic risk indicator (SRI).

- **Data is not sufficient at this stage to allow for the development of meaningful benchmarks for VC/PE funds**:

    - It is key to have a sufficient number of comparable products available and with similar strategies to build pertinent samples and determine benchmarks.

    - In addition, in particular in the case of VC/PE funds, we would like to note the importance of **economic cycles**, which will have to be taken into account when developing benchmarks. Indeed, it will not be possible to compare costs against benchmarks built on the basis of data collected during a previous cycle, as they will no longer be relevant.

    - A level playing field should be ensured among PRIIPs and similar requirements applicable to similar PRIIPs. In the same way it will not be possible to develop benchmarks for structured products, **it will not be possible, at this stage, to develop benchmarks for VC/PE funds**.

  - Our industry is still young regarding retail markets and the **sample of funds currently available to retail investors will not allow to compute meaningful benchmarks for VC/PE funds**. The retailisation of VC/PE is quite recent and, at this stage, not enough data is available to build adequate standards. Only a handful of market players are active in the retail market, and they play in different sectors or strategies (private debt, funds of funds, direct funds, infrastructure…). **The development of benchmarks for VC/PE funds should be reconsidered at the occasion of the review of the Directive, in 5 years' time**, when more data is available.

- **The obligation to take corrective measures should not apply to funds which are no longer marketed**. Indeed, this would be of no use if investors can no longer invest into the fund.

- Regarding reporting to competent authorities, we are against increasing the burden on AIFMs and require them to disclose information on the costs borne by investors and performance of the AIF at the level of the AIF's share classes. Indeed, this burdensome requirement would in turn increase costs.

  For this reason, we suggest rewording point f of article 24 paragraph 2 as follows:

Information on the costs borne by investors and performance of the AIF, at the level of each AIF **~~or at the level of the AIF's share classes where those share classes have different cost structures.~~**

- A level playing field and **a harmonized implementation** of the rules should be ensured throughout the EU:

  - It should be clarified **what "deviates from the benchmark" means**. Indeed, the assessment of a "substantial" deviation from the benchmark is subjective. There is a risk of regulatory arbitrage and jurisdiction shopping if rules are not implemented in a harmonized way throughout the EU.

  - Also, in order to ensure a harmonized implementation of the rules at EU level, **NCAs should not be authorized to define on a case-by-case basis costs** that could be authorized under their jurisdiction and which are not included in the list of eligible costs. This could lead to distortions between the Member States.

    For this reason, we suggest rewording letter (ii) of article 12 paragraph 3 point a, as follows:

identifying which costs can be charged to the AIF and its unitholders taking into account the level of the costs and the nature of the costs by reference to a list of eligible costs that meet the conditions set out in paragraph 1a, points (b) and (c), **~~and the conditions under which competent authorities may authorise on a case-by-case basis costs which are not included in the list of eligible costs but that meet the conditions set out in paragraph 1a, points (b) and (c)~~;**

II. France Invest's comments on the proposed review of the inducement regime (through the introduction of article 24a in the MiFID and of article 29a in the IDD)

Preliminary remarks

- The Commission proposes the introduction of a ban on inducements for execution-only, where no advice relationship exists between the client and the investment firm. We are concerned that **the proposal leads to a lack of clarity as it was not drafted considering all parts of the financial services industry, including the VC/PE sector**. Execution-only sales/services could indeed unintentionality capture existing market practices, including placement fee arrangements where fees are received by distributors.

- We would like to highlight the **need for consistency** among the Commission's proposals and existing regulations. For instance, according to general rules in MiFID, payments to third parties should be made in an honest and fair manner. The duplication of requirements should be as far as possible avoided.

- In addition, we believe that **cultural differences** among the Member States should be taken into account when designing new rules. For instance, in the absence of pension funds, French savers invest a large part of their savings into life insurance products and their distribution networks have been articulated around the existence of inducements. Prohibiting them would have significant and detrimental consequences on our distribution model.

- The alignment of the inducement regime set out in the IDD on the regime set out in the MiFID will have a significant impact, considering that **advice is not as widespread in the case of the distribution of insurance products**. Indeed, investors are not in direct contact insurers but, rather, with their wealth management advisors.

- The UK example has shown that banning inducement can lead investment firms to focus on wealthy clients with a large volume of transactions, and leave alone less wealthy clients who, as a consequence, will never access sophisticated products with attractive returns. In the end, we believe that consequences are unfair. On the contrary, inducements provide sufficient remuneration to investment firms whatever the wealth of their clients[4].

Specific comments

- Commissions should not be paid in addition to other remunerations received from the client for the same service. **It is vital that investment firms can find a source of income, either commissions or other remunerations, in return for the services they provide, to make their business model viable**. For instance, insurance companies have high regulatory capital requirements for holding PE/VC assets on their balance sheet. Furthermore, the remuneration of the manager's staff should be comparable, whether they manage institutional or retail funds to ensure similar returns for similar strategies. If not, they would not be willing to provide the same quality of service to retail investors. If retail investors were to pay lower commissions, the quality of the service they receive would deteriorate. For example, there is a risk that they are no longer offered VC/PE funds because this activity would no longer be sustainable. Which would in turn make it difficult to meet the obligation for distributors to take into account the diversification of their clients' portfolios. This would more generally be contradictory with the Commission's objective of fostering retail investment in capital markets and our aim of making VC/PE more accessible to retail investors.

[4] Please refer to KPMG study on "Rémunération fondée sur les commissions ou sur les honoraires: y a-t-il un modèle plus pertinent pour les investisseurs de détail?" published in November 2021.

Furthermore, investment firms should be able to remunerate third parties for the service they provide e.g. business introducers. The commercial relationship between investment firm and its service providers does not create any conflicts of interests with investors. We are not aware of any study showing there might be an issue.

We therefore suggest clarifying paragraphs 1, 2 and 7 of the proposed new article 24a of the MiFID, as follows:

1. Member States shall ensure that investment firms, when providing portfolio management **for which they have already received a remuneration from the client for such service**, do not ~~**pay or**~~ receive any fee or commission, ~~**or provide**~~ or are provided with any non monetary benefit, in connection with the provision of such service, to or by any party except the client or a person on behalf of the client.

2. Member States shall ensure that investment firms, when providing reception and transmission of orders or execution of orders to or on behalf of retail clients, do not ~~**pay or**~~ receive any fee or commission, ~~or provide~~ or are provided with any non-monetary benefit in connection with the provision of such services, to or from any third-party responsible for the creation, development, issuance or design of any financial instrument on which the firm provides such execution or reception and transmission services, or any person acting on behalf of that third-party.

[…]

7. Where the investment firm is not prohibited from getting ~~**or paying**~~ fees or benefits, from or to a third-party, in connection with services provided to its clients, it shall ensure that the reception or payment of such fees or benefits does not impair compliance with the investment firm's duty to act honestly, fairly and professionally in accordance with the best interest of its clients. The existence, nature and amount of such third-party payment(s) shall be disclosed in accordance with Article 24b(1).

– It should be allowed for **two entities to agree on sharing the remuneration relating to a same transaction which remunerates the provision of the service of advice provided by one entity and the service of RTO provided by the other entity**, in the context of the global solution they offer to the client. For example, a client might receive advice from an advisor and have his or her transaction executed on a platform. In such instance, it should be possible for advisor and platform to agree on splitting the remuneration received for these services in relation to that transaction. This would ensure a level playing field between market players that provide their services as advisors in the context of open architecture and market players that provide their services as tied agents in the context of closed architecture.

We therefore suggest clarifying paragraph 3 of the proposed new article 24a of the MiFID, as follows:

3. Paragraph 2 shall not apply to investment firms, when providing investment advice on a non-independent basis relating to one or more transactions of that client covered by that advice. **It shall not apply to two entities, one providing the service of RTO attached to a transaction and the other providing the service of advice in relation to that same transaction, which have agreed to split the fee or commission received in relation to the global solution they offer.**

– In relation to **minor non-monetary benefits**, it should be clarified what the EUR 100 ceiling applies to and who is in charge of judging whether the benefits impair compliance with the firm's

duty to act in the best interest of the client. Indeed, this exemption, even though it might appear quite large, leaves room for interpretation and lacks clarity and it will be difficult to apply it in practice, as it will be difficult for the firm to prove that the benefits do not impair its compliance with its duty to act in the best interest of the client.

- The fees which remunerate **auditors** are necessary for the provision of investment services and by their nature cannot give rise to conflicts with the investment firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients. They should therefore not be subject to the obligations applicable to investment firms which are set out in the first subparagraph of the proposed paragraph 7.

  We therefore suggest explicitly including them in the examples set out in paragraph 7 of the proposed new article 24a of the MiFID, as follows:

7. The payment or benefit which enables or is necessary for the provision of investment services, such as custody costs, settlement and exchange fees, regulatory levies or legal fees, **auditors' fees**, and which by its nature cannot give rise to conflicts with the investment firm's duties to act honestly, fairly and professionally in accordance with the best interests of its clients, is not subject to the requirements set out in the first subparagraph.

- We support the Commission's assessing the effects of third-party payments on retail investors and the impact of the new measures which will be introduced as well as the Commission's proposing legislative amendments to correct any unsuitable impact. However, in our opinion, **three years will be too short a period to fully encompass the impact of the new measures**. Also, amending rules three years after their introduction will not ensure the appropriate level of legal stability and certainty that market players need to perform their activities.

  We therefore suggest amending paragraph 8 of the proposed new article 24a of the MiFID, as follows:

8. **~~Three~~ Five** years after the date of entry into force of Directive (EU) [OP Please introduce the number of the amending Directive] and after having consulted ESMA and EIOPA, the Commission shall assess the effects of third-party payments on retail investors, in particular in view of potential conflicts of interest and as regards the availability of independent advice, and shall evaluate the impact of the relevant provisions of Directive (EU) [OP Please introduce the number of the amending Directive] on it. If necessary to prevent consumer detriment, the Commission shall propose legislative amendments to the European Parliament and the Council.

  We also suggest amending paragraph 6 of the proposed new article 29a of the IDD, as follows:

6. **~~Three~~ Five** years after the date of entry into force of Directive (EU) [OP Please introduce the number of the amending Directive] and after having consulted ESMA and EIOPA, the Commission shall assess the effects of third-party payments on retail investors, in particular in view of potential conflicts of interest and as regards the availability of independent advice, and shall evaluate the impact of the relevant provisions of Directive (EU) [OP Please introduce the number of the amending Directive] on retail investors. If necessary to prevent consumer detriment, the Commission shall propose legislative amendments to the European Parliament and the Council.

- **The enhanced test on quality of advice should better take into account the specificities of VC/PE**:

- Not all funds that are not mutual funds are complex – although they are absolutely different. For example, venture capital products marketed to high-net-worth individuals may be riskier investments due to the underlying businesses they support and the long-term (and therefore illiquid) nature of their products – but they are by no means complex to understand (arguably they are more easily understandable than any mutual fund whose value derives from a basket of public securities).

- In our view, **it will be difficult for advisors to define a sufficiently wide product range including VC/PE products** and pick the most cost-efficient product.

- It should be kept in mind that, at this stage, VC/PE funds aimed at retail investors are still very few and that the retailisation of this asset class is still young. We propose that the **product range is defined taking into account the specificities (e.g. development stage) of the relevant sector**.

- Most importantly, **costs should be assessed and considered as regards the benefits derived from the product**, in particular in terms of time horizon, diversification, resilience, meaning, transaction size, volatility and performance.

III. France Invest's comments on the proposed review of the client classification regime (through a review of the annex of the MiFID)

- **We warmly welcome the Commission's proposal to review the classification of clients under the MiFID** and support the increased flexibility introduced in the fitness test, in particular through the addition of a fourth criterion. As explained in our response to the Commission's 2021 consultation, currently, **most investors classified as "retail" under EU law which commit capital to VC/PE funds are only qualified as such due to the inadequacies of the current MiFID investor categorisation**.

- However, we would like to suggest some further improvements to three of the four criteria and propose the introduction of a fifth alternative one, in place of the first and second criteria.

1/ In our opinion, the first criterion of the fitness test, set out in terms of number of transactions carried out by the client, should **take into account the type of fund**. For instance, **transactions are less frequent in relation to funds investing in non-listed assets** (due to the long-term nature of those investments) than in relation to funds investing in listed assets. In other words, an average frequency of 10 transactions over four consecutive quarters might be relevant for liquid funds but inadequate for less liquid funds. For example, the frequency criterion is not appropriate to the specificities of VC/PE funds. In average, a qualified investor that regularly invests in VC/PE fund makes a maximum of 2 to 3 transactions in those type of financial instruments per year and will not invest systematically each year. As a consequence, even members of the management team will not be able to meet the proposed criterion when investing on their own account.

We therefore suggest clarifying the first criterion of the fitness test set out in annex II.1 as follows:

the client has carried out transactions, in significant size, on the relevant **listed** market at an average frequency of 10 per quarter over the previous four quarters, **or for non-listed assets, at an average frequency of 1 per year over the previous four years**

2/ The second criterion of the fitness test, based on **the size of the client's financial wealth, should include the value of their financial instruments held directly and indirectly**. For instance, in France, households invest a large part of their savings in unit linked life insurance i.e. they hold financial instruments indirectly through these wrappers, which are not themselves considered as financial instruments. These instruments should be taken into account when considering their financial wealth.

Also, we believe that calculating the average size of the client's financial instruments over the previous 3 years would be too cumbersome and increase the administrative burden of investment firms, which would have to gather additional supporting documents on the patrimonial state of the client. It would also exclude clients who have recently increased their wealth, e.g. won the lottery or inherited. In other words, **the financial wealth of the client should be assessed at the time of the transaction**.

We therefore suggest enlarging the second criterion of the fitness test set out in annex II.1 as follows:

the size of the client's financial **instruments** ~~instrument portfolio~~, defined as including cash deposits and financial instruments, **held directly or indirectly, including through unit linked insurance contracts,** exceeds EUR 250 000 ~~on average during the last 3 years~~;

3/ We would like to underline that, if some clients may have acquired some experience in the relevant market as retail clients, **first investments in a different asset class, for example for diversification purposes, may remain difficult**. **We therefore propose introducing an additional criterion on the "size of commitment" (€100,000 threshold**, which defines what "sophisticated investors" are in Article 6 of EuVECA (Regulation) **which would be an alternative to criteria 1 and 2**. Many distribution firms impose concentration limits on client investments in a single issuer or product type (typically no more than 10% in a single issuer). For example, an investment minimum of €100 000 would imply a total portfolio level of EUR 1,000,000 which we believe provides sufficient comfort as to the client's sophistication and overall net worth without requiring additional criteria.

4/ **We support the wording proposed by the Commission for the third criterion**, relating to the professional experience of the client. Indeed, we understand that it covers relevant experience beyond the financial sector (e.g. in a finance department of a company) and that, in particular, it covers family offices, business angels and "serial entrepreneurs" as well as members of the management team (executives, directors or employees engaged in the management of the funds). Indeed, it does not make sense that a marketing director may be treated as a professional investor, but a chief financial officer may not.

5/ **We support the introduction of a fourth criterion**, which will be particularly relevant for the members of the management company's team. Nonetheless, it should be noted that it will not be generally relevant for all investors.

This being said, we suggest amending this criterion in order to **clarify that the justification of the client's recognised education or training is brought by the client himself or herself** and does not involve the investment firm.

We therefore suggest clarifying the fourth criterion of the fitness test set out in annex II.1 as follows:

the client can ~~provide the firm with proof of~~ **justify** a recognised education or training that evidences his/her understanding of the relevant transactions or services envisaged and his/her ability to evaluate adequately the risks.

Last, we believe that what matters is both the test and the way it is applied. Most markets only allow accreditation to be proven via client attestation. Under the proposal, nothing is done for the test to be done more easily by institutions other than investment firms. This is a big problem in a diverse CMU.

IV. France Invest strongly supports the Commission's proposal to improve financial literacy

In our opinion, financial literacy is an area which has a significant scope for improvement in order to increase the protection of investors and foster their participation in capital markets. More precisely, the education of investors on long term investments should be enhanced. Indeed, the lack of understanding from retail investors about VC/PE funds is a factor which might discourage or prevent them from investing. These products have specificities which require a minimum level of financial literacy. In 2022, France Invest released a report on how to make the VC/PE asset class more widely accessible[5]. Among the main conclusions drawn in this report, the training of distributors was highlighted as an area of improvement. To respond to this training need, France Invest developed 6 short videos explaining the asset class in an educational and recreational manner[6]. We are now also working on a specific training programme which aims at making our asset class better known and understood, by investors and distributors (it should be released this autumn).

For further information, please feel free to contact Carine Delfrayssi, European and Regulatory Affairs at France Invest, at c.delfrayssi@franceinvest.eu or +33(0)1 47 20 99 79.

[5] https://www.franceinvest.eu/rendre-le-capital-investissement-accessible/

[6] https://www.franceinvest.eu/boite-outils/epargnants-et-capital-investissement/comprendre-le-capital-investissement/

About France Invest

Established nearly 40 years ago, France Invest brings together venture capital, private equity, infrastructure and private debt teams based in France, as well as the associated professions which support them. Its membership currently counts roughly 400 management firms and 180 associate members.

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France Invest's members represent one of the main growth drivers for the French and European economy and support a significant portion of employment in France and Europe. In 2022, French private equity and infrastructure players invested €36 billion in 2,800 companies and infrastructure projects. They raised €42 billion from investors, half of which abroad (just under one third at EU level excluding France), which will be invested over the next 5 years[7]. In addition to that, in 2022, private debt players (structures financing companies and infrastructure projects) invested €19 billion in 449 transactions and raised €12 billion that will finance new transactions in the coming years[8]. European companies, in particular start-ups and SMEs, are the main recipients of our members' investments. Over the 2016-2021 period, over 280 000 jobs were created in companies backed by French venture capital and private equity[9].

In particular, during the pandemic, the venture capital and private equity industry has demonstrated its adaptability, supporting existing portfolio companies as and when needed, while continuing to invest in new businesses that require capital and operational expertise to grow.

7 www.franceinvest.eu/wp-content/uploads/2023/03/Etude-dactivite-2022_France-Invest_VDEF.pdf
8 https://www.franceinvest.eu/marche-de-la-dette-privee-en-2022/
9 www.franceinvest.eu/wp-content/uploads/2022/12/CP_FranceInvest_Etudes_Impact_et_Creation_Valeur_14122022_DEF-1.pdf

FRANCE INVEST

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France Invest's comments on the European Commission's proposed review of the PRIIPs Regulation

France Invest would like to thank the Commission for the opportunity to comment on its proposal for a review of the PRIIPs Regulation.

As explained in our response to the Commission's consultation on a retail investment strategy for Europe dated 30 July 2021, **France Invest fully supports the European Commission's objective to develop a coherent regulatory framework to empower consumers, enhance their participation in EU capital markets and help improved market outcomes**.

Traditionally, the venture capital and private equity (VC/PE) industry markets to investors that are either institutional (pension funds, insurers, banks, sovereign wealth funds, fund-of-funds) or experienced (family offices, entrepreneurs). Situations where VC/PE managers market to individuals committing smaller tickets - and which are objectively retail clients - are rather rare. Furthermore, most sales of VC/PE funds to retail investors are intermediated and/or in the form of a packaged product.

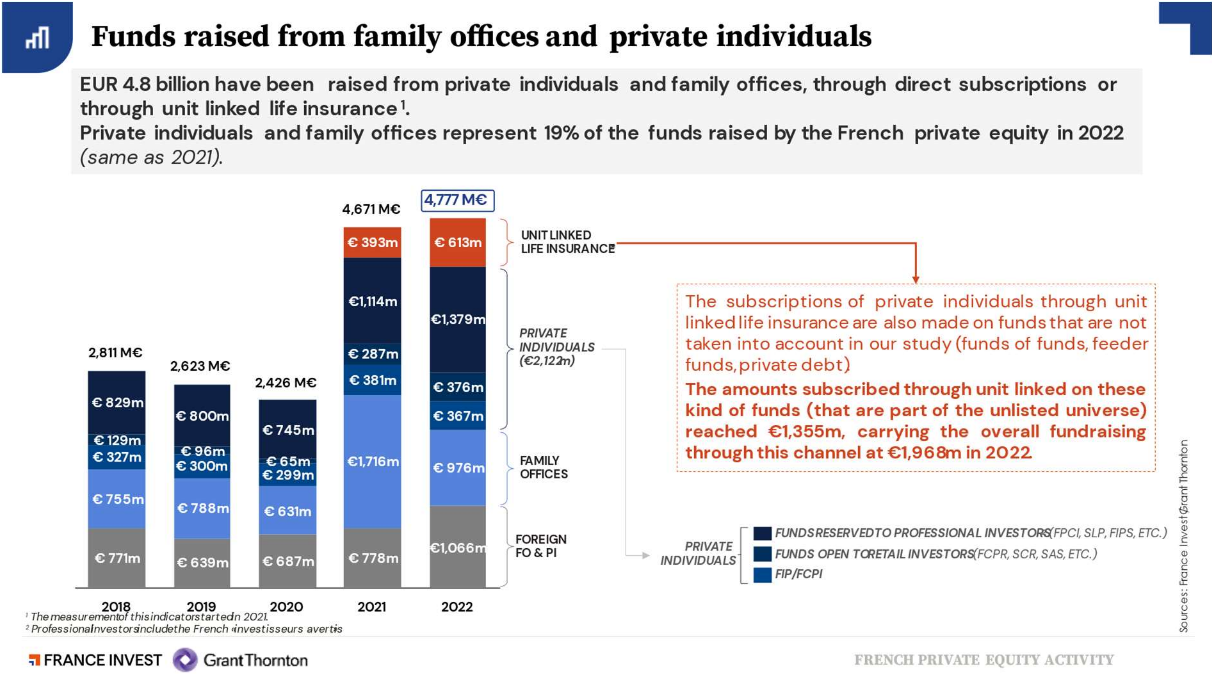
In order to make long-term and active investments into unlisted businesses that require time to grow and evolve, VC/PE funds typically structure themselves as closed-ended funds with no redemption rights, which favours illiquid and large commitments from investors who are in a position to make such investments.

For instance, private equity, in the broadest sense, including all non-listed players excluding real estate, represents a tiny share of French people's wealth, whether directly or indirectly: the assets under management of France Invest members represent less than 0.1% of French households' financial wealth (Q3 2021).

In France, FCPI ("fonds communs de placement dans l'innovation", introduced in 1997) and FIP ("fonds d'investissement de proximité", introduced in 2003) are funds aiming at retail investors. These funds can provide redemption rights in specific cases of misfortune ("accidents in life" such as death, unemployment, illness…). Investors have been encouraged to invest in these vehicles mainly by the tax advantages they can derive from these investments. These funds are AIFs and as such do not benefit from a retail passport at EU level. In 2022, the total amount collected in these funds reached EUR 367 million from 53,000 subscribers. This amount corresponds exclusively to subscriptions allocated to the capital of SMEs which entitle subscribers to income tax reductions. It showed the attractiveness of

innovation financing (70% of subscriptions were made in FCPI, and the remaining 30% in FIP)[1]. Before the removal of the wealth tax2 in 2017, the funds raised reached EUR 1 billion.

This being said, the attractiveness of the VC/PE asset class, in particular in terms of performance, diversification and resilience, and the desire from some investors to commit capital into start-ups and scale-ups is driving **an increasing number of VC/PE managers to offer products that are directly available to retail clients**. In 2022, our members raised EUR 4.8 billion from family offices and retail investors, whether directly or through life-insurance contracts. Family offices and retail investors thus represented 19% of the capital raised by our members in 2022.



In this context, it should be noted that, in France, all investment funds aiming at retail investors are required under national law to produce a KID.

France Invest's general comments on the proposed review of the PRIIPs Regulation

As explained in our response to the Commission's consultation on a retail investment strategy for Europe dated 30 July 2021, **we support the Commission's aim to improve the PRIIPs KID**. Indeed, **most retail investors do not understand the content of the KID properly and are overloaded with information that is not necessarily relevant to them**. In our opinion, the KID does not enable retail investors to compare different investment products in different asset classes or offered by different investment providers. Even though it probably does not require a complete overhaul, we believe that **the KID should be refined in order to better take into account the specificities of VC/PE funds**.

While we would welcome an improved KID, we would like to raise the Commission's attention on the **need for regulatory stability and legal certainty** and to warn against overly frequent updates of the document, for the following 3 main reasons:

– First, retail investors who are presented with a document which is repeatedly modified in its format and content might get confused. Indeed, individuals who are less familiar with financial

[1] https://www.franceinvest.eu/fip-et-fcpi-des-levees-stables-en-2022/

[2] The wealth tax (called ISF) applied for a net wealth over 1.3 million euros and could be reduced by investing in FIP or FCPI.

instruments and their related vocabulary might feel unsettled when provided with versions of a document which are similar but not identical. In the end, the document might appear less trustworthy if changed too frequently;

- Second, some distributors might also have difficulties with keeping up to date, understanding and then explaining to investors the differences between the successive versions of the document;

- Third, the costs implied for KID producers should be taken into account. We would like to highlight here the cost of manufacturing a single PRIIPs KID, which amounts to between EUR 5k and EUR 7k (plus induced costs of IT tools) and the cost of updating a KID, which ranges between EUR 4k and EUR 6k. Indeed, the process of producing a KIID is quite complex and requires producers to collect data which is first processed by a service provider. After this initial processing, producers carry out checks and then ask their accounting service providers to make the relevant calculations, which they check. The data is then checked by their compliance and legal departments so that the document can be considered as a final document.

For these main reasons, we would encourage the Commission to refrain from revising the Regulation again once the current review has been finalized.

France Invest's comments on the proposed new section titled "Product at a glance"

We would like to highlight that the KID itself is a summary of a PRIIP's key features. This additional section might appear as redundant and would necessarily increase the length of the KID. **The addition of any item in the document would make it extremely difficult to contain the KID on 2-3 pages**.

Most importantly, in our opinion, **this new section is not well balanced, as it focuses on the costs and risks of the PRIIP without showing any of its benefits for the investor and gives a partial view of the product to investors**. In particular, the costs and risks attached to PE/VC should be assessed in relation to their strategy, their diversification, their structure their higher performance and lower volatility.

France Invest's comments on the proposed new section titled "How environmentally sustainable is this product?"

First of all, we would like to insist on the **need for a smooth articulation** among the relevant regulatory requirements applicable and current practices of market players.

- We think that this additional section of the PRIIPs KID should include items that are relevant to retail investors' sustainability preferences, which refer to a definition of sustainable investment which is not necessarily defined as per the Taxonomy Regulation and, rather, uses Principal Adverse Impact (PAI) criteria. **The 3 items relating to sustainability preferences should show in the KID** in order to ensure consistency with the MiFID requirements. Furthermore, in the context of the review of the RTS relating to SFDR, the ESAs propose the introduction of a dashboard placed at the beginning of precontractual and periodic reporting templates for "article 8" and 'article 9" funds which would include the percentage of sustainable investments, the percentage of investments eligible as per the Taxonomy Regulation, if PAI criteria are taken into account, and whether the product has an objective of greenhouse gas emissions. **The review of the PRIIPs Regulation and the review of the SFDR RTS should be consistent**.

- Also, **the share of a product's investments which are aligned with the Taxonomy Regulation might be "nil"**, as long as fund managers have not full visibility of this regulation, which may confuse retail investors who are not fully familiar with European financial regulations.

The KID might actually deter these investors from investing altogether or, to the least, confuse them.

– It should also be noted that the Taxonomy Regulation is not stabilized nor complete yet (e.g. the list of eligible investments is still under construction) and that a Social Taxonomy may be developed in the future. This would imply additional updates of the KID.

– Besides, a smooth articulation between EU and national rules should be ensured. **Requirements at EU and national level should be compatible**.

– Furthermore, various sectors have already developed their own tools to assess sustainability in the products. For instance, insurance companies, which may invest in PE/VC products, use a European ESG Template ("EET") to collect information on the products they consider investing.

Second, we are of the opinion that **showing the expected greenhouse gas emissions intensity associated with the PRIIP pursuant to Delegated Regulation 2022/1288 would be particularly burdensome for PE/VC funds, which invest in unlisted assets** (as opposed to traditional UCITS funds which invest in listed assets). Moreover, it should be specified which greenhouse gas emissions are concerned (e.g. scope 2 or 3). Without mentioning that such emissions can only be determined after the subscription period for most VC/PE closed-ended funds, once the investment period is terminated and the portfolio has been built. Most importantly, the review of the PRIIPs Regulation and the review of the SFDR RTS should be consistent. The latter envisages to introduce a dedicated section on goals in terms of green gas emissions for certain products, which would show in a dashboard placed at the beginning of their reporting templates. **We would suggest replacing information on the expected greenhouse gas emissions intensity associated with the PRIIP by stating whether the product has a target in terms of greenhouse gas emissions**.

Last, we believe that **this new section of the KID should include two additional items** which would be meaningful for investors:

- whether the PRIIP is a "article 8" SFDR product which promotes environmental or social characteristics or a "article 9" SFDR product which has sustainable investment as its objective;

- if relevant, that the PRIIP benefits from a label defined by domestic legislation.

<u>France Invest's comments on the KID's review</u>

We welcome the Commission's proposal to develop RTS specifying the conditions under which the KID should be revised, distinguishing between PRIIPs that are still made available to retail investors and PRIIPs that are no longer made available.

In particular, we believe that **closed ended funds which are no longer open for subscriptions after an initial subscription period should not be required to update their PRIIPs KIDs**[3].

In addition, we think that, if a PRIIP is a long-term product, it should not necessarily have to be updated every year.

<u>France Invest's comments on the proposed new article 14</u>

- Electronic format

[3] Please refer to our response to the 2021 consultation for further detail.

We understand that the Commission proposes to prepare a multi-dimensional KID with a layered format. It will have to be ensured that information included in the different layers, and in particular in the new section titled “Product at a glance”, is **consistent.**

We would like to note that it should be allowed to make KIDs available on restricted access websites when the relevant PRIIPs are available to a limited investor base (e.g. “investisseurs avertis” or feeder funds). In other words, **KIDs should be made available only to relevant investors and should not be made widely available to anyone**.

- Personalization

We acknowledge the Commission’s aim to personalize the information contained in the KID. However, it would be difficult to decide the extent to which the document should be customized: **a balance needs to be found between personalization and comparability** (i.e. would a comparison of different PRIIPs based on their customized KIDs be sufficiently reliable?). From a general point of view, we believe that the KID should remain simple and efficient.

In our mind, interactivity should not necessarily imply the use of specific software which would be costly and possibly inadequate for readers but rather should be possible through **standard tools** (such as Excel spreadsheets).

In particular, while we praise the Commission’s objective to make information accessible to visually impaired readers, we believe that there might be other means for these investors to access the information contained in the KID, for example through specific reading apps.

In addition, it would have to be ensured that **customizations are allowed under national regulations** and articulate smoothly with domestic requirements.

- Accessibility & storage

It should be clarified how long a KID should be kept available. In any case, **this requirement should not exceed 10 years after the first publication of the document**. Moreover, it should be specified that **the KID does not need to be kept available after a fund has been liquidated**.

It should also be noted that distributors or advisors might not have a website. In our opinion, the requirement to keep KIDs should be limited to producers.

In our , **granting retail investors access to past versions of PRIIPs KIDs would confuse them**; retail investors only need relevant, up-to-date data and should not be overloaded with information.

France Invest’s comments on the entry into force and application of the revised Regulation (article 2)

We suggest introducing a grandfathering clause in the revised Regulation, so that the new rules only apply to new PRIIPs. In other words, **PRIIPs which are marketed at the time of entry into application of the revised Regulation should not have to comply with the obligation to have a new KID** produced according to the revised rules. Indeed, existing investors would feel puzzled if provided with a new version of a document they have become familiar with.

France Invest’s further proposals regarding the review of the PRIIPs Regulation

As explained in our contribution to the Commission’s 2021 consultation, we welcome a targeted review of the PRIIPs Regulation. Indeed, the current KID is not understandable and may in some instances be misleading for retail investors, in particular with respect to VC/PE funds, as it includes elements which are not relevant to them (in particular regarding fees and performance scenarios).

We strongly believe that the KID should be refined in order to better take into account the specificities of VC/PE funds. As explained previously, these funds are typically unlisted and closed-ended and invest for an average of 5 years in unlisted private companies. As a consequence, they cannot be treated in the same way as products that have daily price quotes. In particular, certain typical private equity features, such as the use of carried interest as a conditional pay-out mechanism, should not be presented in a standardised way, in order to avoid giving these investors inappropriate information. By trying to create a "one-size-fits-all", the KID may create false expectations – especially on products such as VC/PE where the ultimate success of the fund will depend less on past performance or market indexes than on the manager's ability to grow real businesses. In addition, we would like to underline the need for some flexibility/possibility to adapt/explain some key features which are specific to PE/VC products and for **more room for notes in the template designed by the ESAs**.

More specifically:

- The **level of detail on fees should be reduced**:
    - Investors are interested in the total cost of their investment, not necessarily in the breakdown of the different fees – in the same way as consumers are not necessarily interested in knowing how much money goes to the supermarket when they purchase yoghurts.
    - AIFMs and distributors receive a lot of queries about fees. Indeed, in most cases, investors are charged the full amount of their subscriptions at the time of their subscription and do not understand that fees are charged during the life of the fund. They think that it is an additional outflow.
- A **clear distinction should be made in the breakdown of costs between performance fees and carried interest.** Both are not certain and fully depend on the final performance of the fund. However, performance fees can be considered as a contingent management fee, while carried interest is a value sharing mechanism.
- **Performance scenarios are not helpful in the case of VC/PE funds**, (i) first of all because calendar references (one year and five years) are totally disconnected from the products, which are closed-end funds with a life of 10 years (generally), (ii) but also because most players use data provided by professional associations, which means that readers cannot make meaningful comparisons.
    - In addition, using past performance to project future returns can lead to fundamentally misleading results when the product is not exposed to volatility risk.
    - Past performance would for example not take into consideration the fact that the underlying businesses invested in by the previous funds managed by the same fund manager will be different from the investments that will be invested in by the fund currently being raised: the nature of private equity funds is that companies are invested in by the fund, held for a number of years while the fund manager assists the company management team in taking the business through a particular period of growth or redevelopment, then exits the investment, either through a sale of the business to another private buyer or trade buyer, or it is floated on the stock market. When the next fund is raised, it is typically unlikely that there would be an opportunity, or a reason, to seek to invest in these companies again. In the case in the fast-evolving arena of venture investing opportunities to create businesses in sectors often arise because of technological developments that make it possible to invest in areas that even a short time ago would not have existed and where, by definition, no track record exists.

- Relying too heavily on past performance information also carries the danger of over-emphasizing temporary depressed market conditions previous private equity funds have been exposed to at one stage of their lifetime, as well as being too optimistic during periods of market booms that are no longer indicative of a later exit environment.

- **It should be explicitly possible not to classify debt funds in category 1 and to show a SRI lower than 6**.

- VC/PE funds are **closed ended** and lock-up periods can go up to 10 years; in our opinion, this feature is not presented clearly enough in the KID. We feel that investors in VC/PE funds will be better informed of the limited liquidity of these products through **a clear disclaimer that there is no opportunity to redeem their commitment before the end of the life of the fund**. VC/PE funds are mainly closed ended and, as a consequence, investors are expected to invest over the long term (even though these funds may provide redemption rights in specific cases of misfortune such as death, unemployment or illness). In our opinion, retail investors should be made well aware of this feature.

- We believe **it would be more appropriate to give VC/PE fund managers the opportunity to only present a holding period that corresponds to the full life of the close-ended fund**. This would allow investors to have a more appropriate idea of the length of time they will have to hold their fund and avoid giving them the impression that there is an opportunity for them to dispose of their investments at some point before the end of the fund's stated lifespan.

- In our opinion, **information on the taxation applicable** to the investment and capital gains is essential to retail investors. This is particularly true in the case of VC/PE funds, whereby fiscal incentives may contribute to compensate for the additional risk attached to this asset class.

Last, we believe that **PRIIPs KIDs should not be required in the case of members of the management team when they invest into VC/PE funds managed by the management company that employ them**. Indeed, members of the management team have sufficient knowledge on the funds and do not need to receive the KID and should not be considered as "clients".

For further information, please feel free to contact Carine Delfrayssi, European and Regulatory Affairs at France Invest, at c.delfrayssi@franceinvest.eu or +33(0)1 47 20 99 79.

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