



THE VOICE OF  
PRIVATE CAPITAL  
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INFRASTRUCTURE  
LONG TERM INVESTORS

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

## **Response to the ESMA Consultation Paper on Integrating sustainability risks and factors in MiFID II**

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## 1. INTRODUCTION

The European private equity<sup>1</sup> industry supports the EU's work on Financing Sustainable Growth and has also responded to the [ESMA consultation paper on integrating sustainability risks and factors in the UCITS Directive and AIFMD](#). Please refer to that submission for a detailed explanation of the private equity industry's approach to ESG as only key points related to private equity firms' MiFID activities are covered below.

While private equity fund managers are typically regulated under the Alternative Investment Fund Managers Directive (AIFMD), some private equity businesses or sub-businesses might also operate under a MiFID licence. Private equity firms holding a MiFID licence, in the vast majority of cases, provide only a few limited investment services, such as the reception and transmission of orders and investment advice. They cannot hold client money or securities, they do not generally need to deal or take portfolio management decisions and their clients' investments are not likely to be affected by short-term market movements. Concretely, such firms include:

- **Adviser/arranger firms:** The majority of private equity firms holding a MiFID licence will fall in this category. To the extent that they perform investment services, those services are limited to the reception and transmission of orders and investment advice. They assist private equity funds and their managers to invest into companies and may assist third parties to invest in private equity funds. They therefore typically have a limited number of exclusively professional clients (for example, only the manager of the private equity fund would be the client, and that manager will usually be another company in the same group as (or the holding entity or subsidiary of) the adviser/arranger). These firms do not hold client money or assets. Where the adviser/arranger is acting as a distributor for MiFID II purposes, the manufacturer of the relevant fund would generally be a fund manager/AIFM.
- **MiFID managers with limited authorisations to provide investment services:** These firms perform portfolio management for the purposes of MiFID but will not have permission for "placing" and will not hold money or assets. They differ significantly from other types of investment firms, as they typically do not deal on own account or underwrite and do not hold client money or assets in connection with investment services.
- **AIFMD firms with "top-up" permissions under Article 6(4) AIFMD permitting them to provide limited investment services:** These firms have top-up permissions principally in order to give investment advice and/or to receive and transmit orders in a manner similar to the adviser/arrangers described above.
- **MiFID firms currently subject to CRD IV requirements:** This category includes an extremely limited number of private equity firms, which hold a "placing without a firm commitment" permission.

Private equity firms that hold a MiFID licence are generally smaller firms when compared to other investment firms as they typically have a very small number of professional advisory clients (which, as noted above, could just be a fund manager in the same group as the adviser/arranger). This is in contrast to investment firms with a large number of retail clients. It is therefore essential to ensure that:

- (i) the final legislation is fit for purpose, practical and workable for all parties and financial market participants, irrespective of the size of either the investment firms or the companies and other assets into which they are investing, and their level of experience in dealing with sustainability factors; and

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<sup>1</sup> For the purpose of this consultation response, "private equity" is used as a generic term to refer to and to encompass both private equity and venture capital.

- (ii) there is sufficient flexibility for financial market participants to design a programme, which best aligns with their business needs and supports the needs of their individual portfolio companies.

Against this backdrop, we very much welcome the high-level principles-based approach proposed in the consultation paper. We prefer such an approach to one that is overly prescriptive (and, as suggested by ESMA, could increase the risk of regulatory arbitrage).

We also support ESMA's recognition that any changes introduced should be applied by firms with the proportionality principle in mind, taking into account the size, nature, scale and complexity of their activities.

Private equity firms have already incorporated ESG considerations into many aspects of their business models and reporting to investors. These additional sustainability requirements should not add to the overall regulatory compliance burden experienced by the smaller firms in our industry (relative to other types of investment firms). It would be counterproductive to the overall aims of the EU's work if the proposals resulted in resources being allocated to additional bureaucratic processes rather than the existing activities being undertaken by private equity firms to create sustainable value in their investments.

Implementing the proposals proportionately, and only where relevant to the firms' activities, would be a more productive use of firms' resources. This approach is substantiated by the fact (and acknowledged by ESMA) that the EU's taxonomy will not be ready until 2022 and that this is an evolving industry. Too much regulation could (i) hamper EU firms' ability to create and market suitable funds compared to their global peers, (ii) increase barriers to entry for new firms, and (iii) generally stifle innovation.

## 2. ORGANISATIONAL REQUIREMENTS

**Question 1 - Do you agree with the suggested approach and the changes to Article 21 of the MiFID II Delegated Regulation on ‘general organisational requirements’? Please state the reasons for your answer.**

Answer:

Yes, to the extent the approach states that ESG considerations should be taken into account where relevant for the provision of services. The section also includes the proportionality principle.

However, we are concerned about some of the detailed explanations that precede the proposed amendments. We believe these go too far and therefore it will be crucial to ensure that they do not serve as an inspiration or guide to impose much more detailed requirements on firms, without reference to the proportionality principle (i.e. mandate ESG considerations and specialised resources when not relevant to the firms’ activities).

Our response to the ESMA consultation paper on the UCITS Directive and AIFMD includes a more expansive explanation (Question 2), which is not replicated here.

**Question 2 - Do you agree with the suggested approach and the changes to Article 23 of the MiFID II Delegated Regulation on ‘risk management’? Please state the reasons for your answer.**

Answer:

No. Given our introductory comments about proportionality and the types of activities performed by MiFID firms in the private equity industry, the text should be amended as shown below in bold. This would mirror the approach proposed by ESMA elsewhere in the paper.

“Investment firms shall take the following actions relating to risk management:

(a) establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the firm’s activities, processes and systems, and where appropriate, set the level of risk tolerated by the firm. In doing so, investment firms shall take into account environmental, social and governance factors (where relevant).

[...]”

For the reason noted in our response to Question 1, we are concerned about the expectations placed on compliance staff.

**Question 3 - Do you agree with the suggested approach and the new recital on 'conflicts of interest'? Please state the reasons for your answer. What would be specific examples of conflicts of interests that might arise in relation to sustainability considerations?**

Answer:

No, for the reasons set out in our response to Question 2.

The recital should be amended to clarify that the arrangements should only apply to the extent relevant.

**Question 4 - Do you think that on the topic of 'organisational requirements' other amendments should be made to the MiFID II Delegated Regulation in order to incorporate sustainability risks and factors? If yes, which ones? Please state the reasons for your answer.**

Answer:

No. Please refer to our introductory comments.

### 3. PRODUCT GOVERNANCE

**Question 5 - Which existing market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or “labels”? Please describe.**

Answer:

This question may be less relevant to private equity firms given our explanation in the introduction on the types of MiFID activities performed. Where this is relevant, firms should have flexibility to explain their approach as it is an evolving industry.

**Question 6 - Do you agree with the suggested approach and the proposed amendments to the MiFID II Delegated Directive Articles on ‘product governance’? If not, please explain.**

Answer:

Yes, as they make it clear that ESG characteristics and preferences are considered where relevant.

It is important that this is not interpreted to mean that a detailed assessment of ESG factors must be carried out as this may not be applicable. These requirements should be implemented in a proportionate manner because the clients in question are generally not retail investors.

**Question 7 - Do you agree with the proposed changes to the ESMA Guidelines on MiFID II product governance requirements and the addition of an additional case study? If not, please explain what changes should be made and why.**

Answer:

See answer to Question 6.

**Question 8 - Do you think extra guidance is needed on the elements listed in paragraph 15 above? If yes, please provide details.**

Answer:

Our key point is that any guidance should not be interpreted as a prescriptive list of procedures to follow and assessments to undertake. This would result in an unnecessary burden for firms.

Firms should have the flexibility to approach their assessment based on their activities and the needs and types of clients they have.

**Question 9 - Please specify any approach you see to identify environmental, social and governance criteria separately from each other or as a single indicator. Please explain how the criteria would interact with each other and how the target market assessment and matching would be performed in such cases.**

Answer:

Any approach proposed must be flexible to the firms' activities and their clients. This is an area where over-engineering an approach might actually become counter-productive given the nature of the client.

## 4. SUITABILITY

**Question 10 - What current market standards or “labels” are you intending to take into account or already taking into account for the consideration of ESG factors? Do you see any issues when relying on current market standards or “labels”? Please describe.**

Answer:

See answer to Question 5.

**Question 11 - Do you agree with the suggested approach and the amendments to paragraph 28 of the suitability guidelines? If not, do you have any suggestions for developing a more detailed approach with regard to (a) the collection of information from clients and (b) the assessment of ESG preferences with the assessment of suitability?**

Answer:

This approach must remain principles-based, leaving it up to the firm to decide the level of information and type of assessment required. It must be flexible to reflect the type of clients the firm is providing services to as they are generally not retail. A more detailed proposal would not be suitable as it could be interpreted to be a mandatory requirement. This would be inappropriate and unnecessarily prescriptive.

**Question 12 - Please specify any approach you see to assess environmental, social and governance criteria separately from each other or as single preferences. Please explain how the criteria would interact with each other and how the suitability assessment would be performed in such cases.**

Answer:

See answer to Question 9.

**Question 13 - Do you agree with the suggested approach and the amendments to paragraph 70 of the suitability guidelines?**

Answer:

Yes. See answer to Question 6.

## 5. COST-BENEFIT ANALYSIS

**Question 14 - What level of resources (financial and other) would be required to implement and comply with the proposed changes (risk-management arrangements, market researches and analyses, organisational costs, IT costs, training costs, staff costs, etc., differentiated between one off and ongoing costs)? When answering this question, please also provide information about the size, internal organisation and the nature, scale and complexity of the activities of your institution, where relevant.**

Answer:

Invest Europe represents over 600 members that vary significantly in terms of their size and other characteristics. As such, we are not in a position to answer this question.

It is reasonable to assume that there will be additional costs, but hopefully also benefits of incorporating sustainability (e.g. better risk management and additional value creation).

The overall balance is difficult to estimate. To a large extent this will depend on ESMA's and local regulators' views on whether incorporating sustainability requires many additional resources/policies or whether these can be included in existing risk management policies and can be picked up by existing resources. In the latter case, there will probably only be incremental training/IT/staff costs. In the former case, the costs can be significantly more substantial.

Information requested	Firm response
Firm size (annual turnover in euro)	N/A
Number of employees	N/A
Firm complexity (low/medium/high)	N/A
Expected costs from market research related to ESG factors (in euro)	N/A
Expected IT costs related to ESG factors, initial and on-going (in euro)	Initial: N/A
	On-going: N/A
Expected training costs related to ESG factors (in euro)	Initial: N/A
	On-going: N/A
Other expected organisational costs related to ESG factors (in euro) - <i>please describe</i>	Initial: N/A
	On-going: N/A



### **Contact**

Thank you in advance for taking account of our feedback as part of the consultation process. We would be delighted to discuss any of the comments made in this paper in further detail.

For further information, please contact Erika Blanckaert ([erika.blanckaert@investeurope.eu](mailto:erika.blanckaert@investeurope.eu)) at Invest Europe.

## 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 Invest Europe

Invest Europe is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.  
For more information please visit [www.investeurope.eu](http://www.investeurope.eu).

