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Response

Commission's Call for Evidence

Regarding Private Placement Regimes in Europe

05/07/07

I. EXECUTIVE SUMMARY

1. The Federation of European Securities Exchanges (FESE) is a not-for-profit international association (AISBL), representing the operators of the European regulated markets and other market segments, comprising the markets for not only stocks and bonds, but also financial, energy and commodity derivatives. Established in 1974 as a small forum of stock exchanges in Europe, FESE today has 24 Full Members representing close to 40 securities exchanges from all the countries of the EU and Iceland, Norway, and Switzerland, as well as several corresponding members from other non-EU countries.
2. We understand that the Call for Evidence arises from the White Paper and primarily in relation to investment funds (e.g. private equity funds, hedge funds). However, the Call for Evidence is very broad in scope and extends well beyond investment funds into securities markets more generally. We are not aware of any significant problems or market failures as a result of there not being a private placement regime in European securities markets. Therefore, our initial view is that there does not appear to be a need to create a European private placement regime at this point. Any specific problems identified in relation to investment funds should be dealt with specifically in that context.
3. Moreover, many types of investment funds are already subject to PD, MiFID as well as the Market Abuse and Transparency Obligations Directives. The biggest bulk of the primary and secondary market rules applicable to investment funds already take into account the special case of 'sophisticated' investors who are the target of a private placement regime.
4. The PD provides a clear framework for when a prospectus is required for a public offer. An exemption from the requirement to produce a prospectus under this Directive constitutes a private placement regime for all the securities subject to this Directive. Any new rule contemplated for certain types of investment funds should be designed carefully so as not impinge on this important exemption which is already well established and recognised in the market.
5. Similarly, MiFID differentiates the application of conduct of business rules (information requirements, suitability/appropriateness/execution-only and best execution) by investor type (retail or professional investor and eligible counterparty). Any proposal to amend MiFID in any way that would alter the application of these rules to any of these investor categories would be greatly unwelcome for the market. In fact, any current problems in relation to investment funds may well be alleviated by the introduction of MiFID In November 2007 (after which intermediaries would have a clear passport based on a single set of conduct of business rules and unified investor classification).
6. We understand that there is a concern that distributors of certain funds (such as private equity funds and hedge funds) currently have to comply with retail type disclosure requirements even when they are seeking to sell only to professional clients. Many of these problems may well be resolved once MiFID enters into force. However, in order to resolve any residual issues, it would be preferable to address these issues in their own right rather than through the creation of a new regime which potentially could affect a broader spectrum of securities which currently operate smoothly in the market and for which there is no need for a private placement regime.
7. If the outcome of the Call for Evidence suggests that some type of private placement regime is necessary, it is extremely important that the scope of such a regime be defined carefully in order to avoid unintended consequences for securities and funds operating efficiently in the market. We consider it absolutely essential that the scope of any private placement regime does not covers securities or funds that are admitted to trading on Regulated Markets and on MTFs.
8. The concepts of qualified investor in the PD and professional investor in MiFID are different. However, this reflects the fact that the regimes were created for different purposes. Although defined

differently, in practice, the two concepts can work smoothly side by side, and we believe that they will once the MiFID regime is in place. In fact, when PD entered into force, the CESR Guidance on Client Categorisation (2002), which is based on the same classification as MiFID, was already place; the experience based on the functioning of these two regimes does not suggest any problems. In any event, we understand that the ESME Group is examining inconsistencies between various FSAP Directives to determine if amendments need to be made to diverging definitions, and we understand that preliminary discussions indicate that these two definitions do not have to be aligned.

9. Although the Call for Evidence states up-front that this is a fact-finding exercise, it sets out general proposals in relation to the possible creation of some type of regime for private placement. We are of the view that the status quo is an equally viable option and in our opinion should be given serious consideration by the Commission.

II. DETAILED ANSWERS TO THE QUESTIONS:

Questions 1a: Is private placement a useful concept in national laws? What is the **size and structure** of the business that developed under the national regimes (geographical and product breakdown, dominant players etc.)?

Questions 1b: Does the absence of a common understanding of private placement result in a **single market failure**? Do differences between national regimes, i.e. the absence of an EU private placement approach prevent or discourage possible cross-border investment transactions? Are any sections particularly affected? How do problems manifest themselves?

10. **1a:** We think that for all instruments covered by the PD, there already is a well-functioning private placement regime. This regime is defined as the reverse of the Art 3 Para 2 exemptions from the obligation to publish a prospectus.

11. **1b:** In general, we are not aware of a Singe Market failure arising because of the lack of a common understanding of private placement.

12. However, in relation to certain types of funds such as hedge funds and private equity funds, there may be a need for measures to facilitate cross-border transactions (if not already addressed by MiFID). If such action were necessary, we caution the Commission to look at the required scope very carefully and not to introduce a blanket regime for all investment funds.

Questions 2: How can the **borderline** between **private placement** and **public offering** best be defined? What should be the legal consequences of **leakage of private deals** into the public sphere (including any liability for the original issuer/placement agent)?

13. 'Public offer' is clearly defined in the PD. Article 3(2) clearly sets out exemptions from the obligation to produce a prospectus, which constitutes a private placement regime for all instruments subject to the PD. Thus we see the line between **a public offer requiring a prospectus** and **a private placement** as very clearly defined by Article 3 (2).

14. For instruments not subject to PD, the lack of harmonization in terms of disclosure requirements is more than compensated by harmonized conduct of business rules under MiFID, which set out the information that the intermediary needs to provide to the client, the conditions under which the intermediary needs to assess the suitability or appropriateness of the product and the application of best execution rules. All of these rules are differentiated by investor type which should allow the intermediary to sell such products cross-border to professional investors and eligible counterparties even if the disclosure requirements are not harmonized.

15. Moreover, in many circumstances, the securities outside the scope of the PD may only be offered domestically and there may be no need to facilitate cross-border transactions. Furthermore, the combination of PD and MiFID provides adequate protection for all investor categories, both retail and professional. For products that are sold in the primary market without a prospectus (pursuant to Article 3(2) of PD), their being offered to retail and professional clients will nonetheless be subject to

MiFID COB rules. For retail as well as professional clients, the intermediary will have to assume the responsibility of selling such a product under the very clear rules of MiFID, depending on the service being provided to the client. If the client is receiving investment advice (Article 19(4)) or an appropriateness assessment (Article 19(5)), the product will be sold only if it suitable or appropriate, respectively, as defined by the Directive. If the client is using the execution-only service (Article 19(6) of MiFID), then the product can only be sold subject to a number of conditions set out in the Directive (eg that it be non-complex, that the service be initiated by the client, etc). This multi-layer regime under MiFID is designed to address the full range of situations that might arise, and are adaptable to all situations, both when the product has been offered with a prospectus and without one.

Questions 3: Are there some types of **investment products** which could benefit in particular from private placement; e.g. closed **ended funds or non-harmonised open ended funds**? Does it make sense to develop a private placement regime exclusively for some designated products? Or should we build a framework that is open to any types of security? Please give reasons.

16. To the extent that the need for a regime is justified by evidence, we would expect there to be no need to apply it to any instrument covered either by PD or MiFID as well as instruments admitted to trading on a RM and MTF. This is because securities admitted to trading are already subject to a disclosure regime (i.e. the relevant provisions as foreseen by the Prospectus, Market Abuse and Transparency Obligations Directives), and there is no need to further regulate them. The European economy derives significant benefit from the complementary functioning of RMs and MTFs, both of which are subject to clear and transparent rules aimed at protecting investors and enhancing market integrity.
17. We recognise that there may be benefits in having an exclusive open ended fund regime that is harmonised across Europe. Any such framework should be on a designated product basis only. Once the need for action is identified, the Commission should look into a broad range of options to deliver the desired outcome (which could also involve self-regulatory means).

Questions 4: What **investors** should be eligible counterparties under private placement (i.e. capable of being approached on a private basis with a view to possible investment)? Should eligibility be defined following the definition of "eligible counterparty" or of "professional clients" in MIFID, or following the definition of a "qualified investor" of the Prospectus Directive? Or would you suggest an alternative definition?

18. The investor type eligible to be approached without disclosure should be defined by reference to ´qualified investors´ in the PD.
19. The definitions in PD and MiFID should be retained without amendment. The concepts of qualified investor in the PD and professional investor in MiFID are different (and arguably eligible counterparty is an entirely separate concept which does not have any bearing on the present discussion). However, this divergence reflects the fact that the two regimes were created for different purposes: primary market and secondary market. Although defined differently, in practice, the two concepts can work smoothly side by side, and we believe that they will once the MiFID regime is in place. In fact, when PD entered into force, the CESR Guidance on Client Categorisation (2002), which is based on the same classification as MiFID, was already place; the experience based on the functioning of these two regimes does not suggest any problems. In any event, we understand that the ESME Group is examining inconsistencies between various FSAP Directives to determine if amendments need to be made to diverging definitions, and we understand that preliminary discussions indicate that these two definitions do not have to be aligned.

Questions 5: How should the **supply side** of a private placement be regulated? Is there a need for additional rules or would the respective prudential requirements for the specific market player suffice? Should financial institutions from some/all third countries be recognised?

20. We are not aware of any deficiency in this area which would require regulation.

Question 6: Despite being limited to a (to be defined) set of sophisticated investors, would there still be a need for **investor protection** rules? Is there a need to include rules regarding the eligibility of certain players the owners/unit holders/participants of which might be more vulnerable (e.g. pension funds)?

21. We consider that MiFID provides sufficient investor protection for both retail and professional investors. Detailed consideration both at Level 1 and Level 2 was given to the different needs of clients in terms of protection and the COB rules were designed to ensure that those needs are met. MiFID rules would form a useful building block for the design of investor protection rules for any securities that fall outside the scope of MiFID.

Questions 7: Which kind of **restrictions/requirements** would need to be deactivated for a private placement regime to deliver significant benefits? Which would be seen as excessive? How much discretion can be left to local authorities in defining these rules without risking a minimum level of harmonisation?

22. The answer to this question depends on the scope of securities or funds that could potentially fall within a private placement regime. Thus we are unable to answer this question at this early stage.

Question 8: What would you consider **best practice** at national level among the existing private placement regimes: with respect to purely domestic private placements and with respect to private placements across borders?

23. We consider the functioning of the PP regime implicit in the Prospectus Directive to be best practice.

Question 9: Are there **any other** relevant issues to be analysed that have not been addressed in this note?

24. To the extent that a private placement regime is deemed necessary to address identified market failures, we would stress the importance of setting an appropriate scope and in particular the need to **exclude** those funds and securities subject to either **PD or MiFID** or **admitted to trading on a RM or MTF.**

Questions 10:

a) Is there a risk that the diverging definitions of eligible investors will create problems in their application? If yes, please describe these problems and their impacts.

b) Could the private placement features of the directives with respect to

- disclosure

- conduct of business

- information requirements

- suitability and appropriateness tests for investors

be regarded as sufficient and appropriate for an EU private placement regime? If not, how should these provisions be amended?

c) Are any other elements missing that would be regarded as crucial for an effective EU private placement regime?

25. Our response to these questions is as follows:

    a) No, there is no such risk. The definitions differ between PD and MiFID but this does not create problems because the definitions were created for different purposes (please see our response to question 4 for more detail).

    b) It is not possible to answer without knowing what type of securities are concerned. Moreover, it is not clear from the question whether `the private placement features of the directives´ would be used for any new PP regime for funds outside the scope of these directives, or whether these features would be amended within the PD and MiFID. We would not support any amendment to existing directives for the purposes of creating a PP regime.

    c) We have no comments here.

Question 11: In the event that the provisions for cross-border private placement in the EU needed to be improved: Would this require new rules (e.g. a directive) or could existing EU law be used to shape an EU regime, or would even a light approach, e.g. harmonisation of national rules combined with mutual recognition suffice to establish an effective regime?

26. Although the Call for Evidence states up-front that this is a fact-finding exercise, it sets out general proposals in relation to the possible creation of some type of regime for private placement. We are of the view that the status quo is an equally viable option and in our opinion should be given serious consideration by the Commission.

27. Such an approach is also consistent with the Commission´s overall Post-FSAP strategy and its wider commitment to better regulation principles.

III. CONCLUSION

28. As the current response indicates, we do not see any need to introduce a private placement regime for any security or fund subject to the PD or MiFID, or for instruments or funds admitted to trading on a RM or MTF. We thus ask the Commission to exercise caution when assessing the potential need for such a regime in other areas not covered by these cases, and, if the need for legislation is established, to design its scope very carefully so as to avoid any damage to the functioning of these two Directives and the current regime applicable to admissions to RMs or MTFs. It should be noted that the European economy derives significant benefit from the complementary functioning of RMs and MTFs, both of which are subject to clear and transparent rules aimed at protecting investors and enhancing market integrity. If the Commission establishes any benefit in having an exclusive open-ended fund regime that is harmonised across Europe, any such framework should be on a designated product basis only. Once the need for action is identified, the Commission should look into a broad range of options to deliver the desired outcome, including self-regulatory means.