Via electronic submission:

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To Sven Gentner
Head of UnitC4 – Asset management
DG Financial Stability, Financial Services and Capital Markets Union
European Commission

Response to the European Commission's public consultation on cross-border distribution of investment funds.

Dear Sir/Madam,

Introduction

The Institutional Limited Partners Association (ILPA) appreciates the opportunity to respond to the public consultation issued by the Commission on 2 June 2016 as part of the Capital Markets Union (CMU) Action Plan, in order to make the investment environment more effective in the EU.

About the ILPA

The ILPA is a global organisation dedicated to the interests of institutional investors into private equity (PE) funds worldwide (known as Limited Partners). ILPA's membership comprises more than 10,000 investment professionals from 32 countries around the world across more than 380 organisations, ranging from insurance companies, pension funds, public sector funds, foundations and endowments, collectively representing more than €1 trillion in private equity assets under management globally. More than 15% of ILPA's member organisations are headquartered in Europe, including a number of well-known European pension plans, insurance companies and endowments across 11 countries. In addition, many of ILPA's non-EU member organisations operate European investment portfolios managed or advised by satellite offices in the EU.

General overview

We will not address each and every question posed by the Commission in this consultation, instead providing a tailored response on the main barriers to cross-border distribution of funds in Europe, and focussing on the key issues and areas of improvement as we see them for the ILPA membership.

Please also note that the elements mentioned in this response are complementary to the response we provided at the beginning of the year to the European Commission's Call for Evidence on the EU Regulatory Framework for Financial Services, in order to promote private equity as a vital source of long-term financing for businesses across Europe through a regulatory framework that is appropriately calibrated.

Our comments will be divided in two categories: the regulatory barriers to the cross-border distribution of funds (covering some of the questions as regards marketing requirements, costs, regulatory fees or administrative arrangements), and the taxation aspects that limit such funds from accessing all European markets.

Main barriers to the cross-border distribution of funds

ILPA believes that the framework established in the EU following implementation of the Alternative Investment Funds Managers Directive (AIFMD) serves as an effective illustration of how a common set of rules can be implemented in an inconsistent way across Member States, generating numerous unintended consequences.

First, ILPA surveys of our members based in the EU indicates that these institutional investors have seen their access to non-EU managers curtailed since the implementation of the AIFMD, notably due to presence of unnecessary requirements placed on fund managers. By way of example, the requirement to register with multiple national authorities has proved particularly troublesome for ILPA members, in that non-EU AIFMs have elected to cease or at minimum limit their marketing of funds to EU-based investors. Also, the additional requirements periodically imposed by Member States on top of the standard AIFMD provisions have exacerbated this decrease in non-EU AIFMs' marketing of funds in the EU. This has a chilling effect on third country investor appetite to allocate into the EU, as well as restricting the ability of such actors to diversify their portfolios.

Limiting business opportunities for both EU and third country LPs risks curtailing capital flows exactly at the moment when are they most needed to kick start economic growth in the region. The introduction of new layers of complexity in the regulation of cross-border investment, alongside the related costs and uncertainty this generates can serve as a significant disincentive for ILPA members when they consider investing in the region. This contradicts the main objective of the CMU initiative, namely to channel greater capital flows into the European real economy. Therefore, ILPA calls for the terms of the AIFMD to be tailored, principally with the objective of establishing a workable and proportionate passporting system for both EU and non-EU AIFMs, one which ensures a real level playing field for investors globally.

Moreover, the differences between Member States in regards to the implementation of the AIFMD, and more specifically the diverging definitions of marketing and pre-marketing between Member States, generate confusion and ambiguity for both managers and investors. In particular, the fact that some Member States do not recognize the existence of a pre-marketing phase can create uncertainties

for both managers and institutional investors, and thus reduce the investment opportunities for EU investors, and consequently their ability to invest in projects useful for the real economy. Such inconsistency between national approaches and definitions should be streamlined in order to bring more clarity.

Importance of the taxation environment

Private equity (PE) funds exist to provide patient capital committed for the long term (the average holding period of a standard PE-backed portfolio company is usually between three and seven years), which complements the availability of debt finance typically offered by banks in the economy. This supports economic growth, financial stability, and security for those businesses and individuals who rely on a steady income stream, particularly retirees holding policies with pension funds or insurers providing an annuity.

In order to achieve this, PE funds channel institutional money – whether it is coming from potentially tax-exempt Limited Partners such as pension funds, charities etc, or those that are subject to domestic tax such as insurers or family offices – into growing companies that in turn generate for investors and their ultimate beneficiaries a meaningful return. As of March 31 2016, PE and venture capital (VC) investments into European privately held companies generated for institutional investors 10-year returns of 11.46% on average, compared with 4.3% and 2.7% returned in the public markets over the same period, according to the MSCI World and MSCI Europe indices respectively.

As ILPA mentioned in its recent response to the Organisation for Economic Cooperation and Development's (OECD) consultation on the treaty entitlement of non-CIV funds, it is not the purpose of non-CIVs to provide treaty benefits to those investors who are not eligible to receive them. It is rather to provide a mode for investors to channel capital into undervalued and/or high growing companies in Europe and elsewhere, regardless of where that individual investor may sit, in a way that maximizes the return on their investment, and preferably without adding undue tax liability beyond which they are not otherwise subject in their home jurisdictions.

In this respect, the ILPA warns against any measure that would represent a considerable burden of compliance for non-CIV managers – any additional cost being inevitably passed on to institutional investors and their ultimate beneficiaries. As a matter of fact, any excessively restrictive approach in this field could have an extremely detrimental effect on the attractiveness of PE as an asset class for international Limited Partners, and have a chilling effect on international flows of investment. The commensurate reduction in capital flows could have significant knock-on effects for both the companies that rely on such equity investment, and for example, individuals that hold policies with institutional investors such as pension funds and insurers. The ILPA's members in these two categories manage invested capital totalling EUR575 billion in private equity backed companies globally, EUR100 billion of which has been invested by European insurers and pension funds.

Overall, policies in this field should prevent institutional investors from being placed in a competitively worse-off position from a tax perspective when allocating to a PE fund, than if they had invested directly in its underlying assets.

Conclusion

Overall, the ILPA is supportive of any effort from the Commission to knock down any existing barrier to the cross-border distribution of funds across the EU, and of every initiative that will lead, in the context of the CMU initiative, to a better environment for institutional investors operating in the EU. This would ultimately be to the benefit of the end recipients of private equity investment: European SMEs.

For this reason, one of the main barriers to investment into European cross-border funds identified by ILPA members would be the progressive phasing out of national private placement regimes. The removal of this “optionality” for managers could jeopardize the attractiveness of the marketing passport in the EU, and would create needless uncertainty for both managers and investors.

Finally, we would be very pleased to elaborate on the views mentioned in this response, given the importance of such issues to our members. We look forward to playing a constructive role in this process going forward and to discussing ILPA’s submission in greater detail.

Kind regards,

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