EUROPEAN COMMISSION

Internal Market and Services DG

Brussels, April 2007

CALL FOR EVIDENCE

REGARDING

PRIVATE PLACEMENT REGIMES IN THE EU

CALL FOR EVIDENCE REGARDING PRIVATE PLACEMENT REGIMES IN THE EU

I. INTRODUCTION AND PROCEDURE

In its White Paper on enhancing the single market framework for investment funds (COM (2006) 686 final) of November 2006 the European Commission committed to "undertake a systematic analysis of national barriers to private placement".

Proper arrangements for private placement could, for example, make an important contribution to the deepening of European markets for institutional products such as private equity investments. The lack of a European private placement regime is often perceived as creating legal uncertainty and hindering cross-border business. In its report the Expert Group on Private Equity considered these shortcomings as a factor that increases the costs of raising money, particularly by inflating legal and advisory fees. These higher organisational costs, in turn, impact negatively on the returns available to investors.

In preparation of the above-mentioned report the European Commission is currently gathering information and views as regards the necessity and feasibility of a European private placement regime. With this call for evidence interested parties are invited to express their views and to submit relevant evidence in this regard.

The call consists of three parts which are closely aligned to the structure of the Commission's impact assessment framework. Section II aims at singling out if there is a single market failure and putting the issue in an economic context. Section III focuses on the requirements of an 'ideal' private placement regime, thereby shaping the objectives which future action, if any, should seek to establish. Section IV shifts the spotlight at the EU level. It asks whether existing EU legislation provides an appropriate framework. If not, how should it be amended?

It would be helpful if replies to the questions in sections II and III could be supported by **examples of best practice** from national level within or outside the EU.

Reactions to this call for evidence should be sent to the following email address: markt-consult-PP@ec.europa.eu **by end June 2007** at the latest. Requests for clarification on specific questions should be sent to the same mailbox.

All replies will be made public via the European Commission website: http://ec.europa.eu/internal_market/securities/ucits/index_en.htm. Respondents that do not want their reply to be published are asked to state this clearly in their reply.

The issue will also be discussed in a panel at the occasion of an open hearing on UCITS legislative amendments that will take place 26 April 2007. Further debates will be held in the relevant forae.

On the basis of these inputs, taking account of Member States' replies to a questionnaire on the national regulatory frameworks and other material, the Commission will prepare a report on the options to establish a European private placement regime by the end of the year. This report will serve as a basis for considering whether further action in this area will be needed.

II. PROBLEM DEFINITION

This section aims at taking stock of the current situation at national level in EU Member States, but also in third countries. It should

- *clarify national concepts of private placement schemes,*
- *provide information about the structure of the relevant market in terms of key players, products sold, etc. and*
- *highlight potential single market failures resulting from the diversity of national regimes.*

Following the logic of the Commission's impact assessment approach replies should help identifying whether there are significant distortions that deserve further analysis and might eventually require action at EU level.

a) Definition of private placement

Private placement is usually understood as a specific sales method for investment products. It is a (non-)regulated space where buyer and seller can conduct transactions if they, their transaction and possibly the object of the deal comply with certain conditions. This is in principle independent of the investment products concerned.

The regime itself then consists of a set of conditions market participants have to fulfil in order to benefit from waiver of the requirements and rules that would apply in the event of public offerings.

A private placement regime would reduce many of the restrictions that are imposed in the event of marketing to the public, like availability/provision of mandatory disclosure documents and conduct of business rules.

It has to be stressed, however, that exceptions to the rules that apply to public marketing/ general solicitation will not touch upon regulatory restrictions on the buy-side, like limits on institutional investors investing in certain products.

b) Economic relevance of private placement

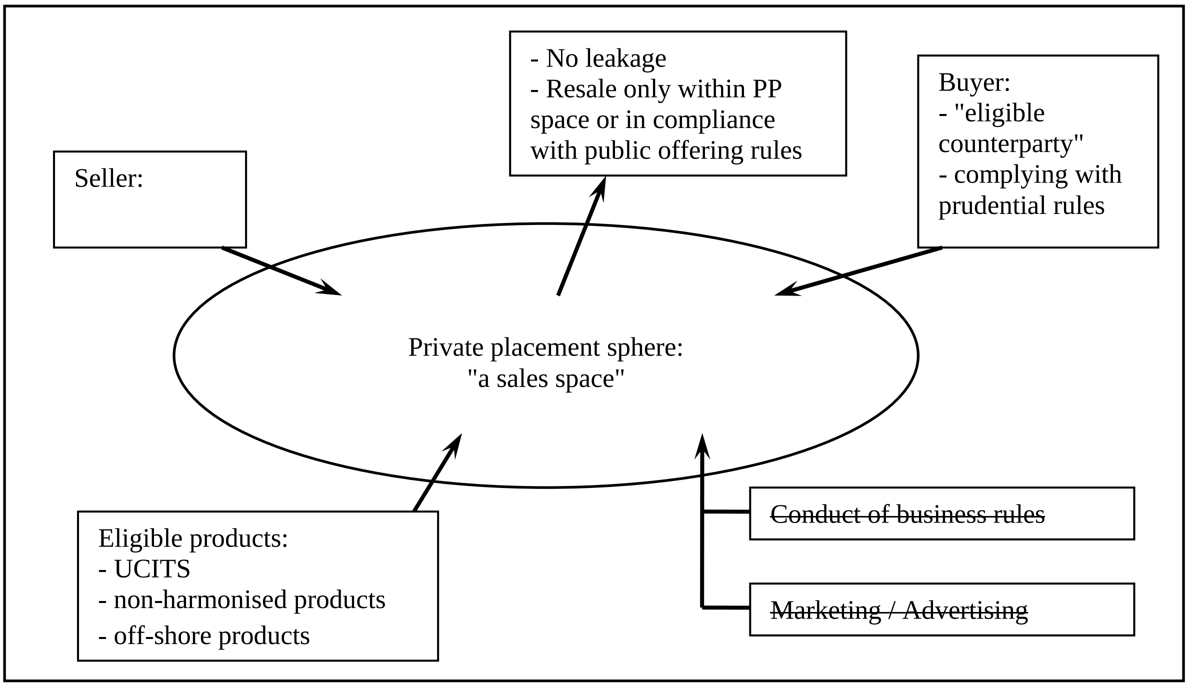
At the moment, no comprehensive private placement regime exists at EU level. To see whether there is a case for such a European regime, it would be helpful to know how useful and economically relevant national arrangements are. How widely are they used? What is the total market size in terms of volume and number of deals per year? What financial instruments or products are particularly affected?

c) Impact of market fragmentation for private placements

Existing national private placement regimes differ in many respects. There is no a common basic understanding of 'private placement'. The consequences of operating inside national private placement regimes also differ. In some countries, the national regime may be limited to a waiver from the obligation to publish prospectus or other mandatory disclosures. Compliance with certain promotion rules (such as marketing techniques) could still be required. Product registration with the local authority may in some cases be demanded. To learn more about whether and in which way Member States provide exemptions from selling restrictions for specific groups of investors the Commission has recently launched a questionnaire to national regulators.

While these limitations might be acceptable at domestic level, they may unduly hamper cross-border placements: lack of a European market may result in (unnecessarily) high costs when it comes to placements across borders.

Chart: Private placement



To what extent does this market fragmentation actually hamper private placement across EU borders? In other words, what is the potential size of an integrated market compared to the current situation? Are the differences between national regimes so important that they impede the exploitation of certain legitimate business opportunities? At which stages of the value and "production" chain could cost savings be achieved through a European private placement regime? Can these savings be quantified, either in percentage terms or in absolute values?

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?

III. OBJECTIVES: DESIGNING A 'SHOWCASE'

Preliminary review work suggests that there is a lack of common understanding across Member States and stakeholders regarding the concept of private placement. In order to on the one hand validate this presumption and on the other hand gather information that could help to develop a common, or at least more homogeneous, understanding of private placement, this section seeks views regarding the constitutional elements of such a regime:

- *How to make the distinction between private placement and public offering?*
- *What would be traded in such a regime?*
- *Who would be eligible as investor?*
- *Who would be eligible as issuer/placement agent?*
- *Would investor protection be an issue?*
- *What requirements or restrictions would have to be imposed upon participants?*

If an evidence-based case for a private placement regime is made, answers to these questions will also help to determine whether a private placement regime at EU level could be envisaged that would create sufficient net benefits without having significant negative impacts on any stakeholders. – In the logic of an impact assessment this would be part of the definition of objectives: What would a first best solution look like?

a) The borderline between private placement and public offering

In order to be considered as operating within the private placement space, the provider would have to organize a placement in such a way as to stop short of public offer/marketing to the public. This would mean, for example, organising solicitation of investments, marketing and promotion in accordance with certain strict requirements.

As an example in the EU context, the Prospectus Directive 2003/71/EC (Art. 3) exempts closed-ended funds from the obligation to publish a prospectus if

- the offer is directed solely at qualified investors; and/or
- addressed to less than 100 natural or legal persons per Member State other than qualified investors; and/or
- the offer requires minimum consideration for purchase of EUR 50,000 per investor; and/or
- the offer consists of a minimum unit denomination of at least EUR 50,000; and/or
- the total consideration of the offer is less than EUR 100,000 over a period of 12 months

A selection of these criteria – individually or cumulatively –could be used to distinguish private placement from public offering. Are these criteria appropriate or should other/additional criteria be used?

> *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)?

b) Investment products to be sold in the framework of private placement

The taxonomy of the types of investment products that could be subject to private placement is obviously a central element of such a regime. The more products that are included, the more complex the regime might become and, at the same time, the more important it would be as a channel for facilitating trading in investment products. A regime limited to, say, closed ended investment funds or non-harmonised open ended funds would perhaps allow some "quick wins": agreement on such a regime could more easily be achieved than on a regime that covers other types of funds or even other securities. However, would such a restricted regime deliver sufficient benefits to make it worthwhile implementing? Would such a quick win be a satisfactory justification for differentiating between investment products? The answer to these questions would to some extent depend on the market demand and potential for private placement of the different investment products.

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.

c) Eligible investors in private placement

A second major determinant of a private placement regime is the definition of eligible investors. As important investor protection measures that apply in the event of public offers are suspended in private placements, the buy-side is usually restricted to investors with sufficient knowledge and market standing to be able to defend their interests on their own.

The definition of who qualifies as participant in a private placement and of the restrictions regarding activities in a private placement can take various forms. Different approaches and concepts are used to classify investors. Investor classifications broadly used are: institutional, retail, mass affluent, high net wealth, and qualified. Yet, there are no commonly agreed definitions of these classifications.

National private placement rules differ widely in this respect. While in some jurisdictions only institutional investors are eligible to participate in private placements. Others are more "liberal" in allowing other "qualified investors, possessing sufficient professional capacity and/or a minimum net wealth, access to private placement. In some cases, investors are allowed to self-certify themselves as eligible.

At EU level, various definitions exist: "eligible counterparty" in Article 24(2) MIFID[1], "professional client" in MIFID, Annex II, and "qualified investor" in Article 2 (1) Prospectus Directive.[2] The concept of professional client under MiFID is similar to, but not the same as, the concept of ‘qualified investor’ under MiFID. For details, see Annex I. The test in MiFID is both more and less liberal than the test in the Prospectus Directive. While the category of large undertaking for MiFID purposes is slightly broader than that applying under the Prospectus Directive, the concept of qualified investor includes expert investors, who may be treated as professional clients for MiFID purposes, but only on request. Further details may be seen in Annex II.

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

[1] Markets in financial instruments Directive 2004/39/EC
[2] For these definitions see Annex 1.

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?

d) Eligible providers in private placement

The sell-side may have to comply with certain qualification requirements regarding expertise, resources etc. already prior to issuing or placing the respective financial instrument. It might therefore be considered sufficient if the issuer, manager or the management company is domiciled, and authorized in one of the EU Member States.

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?

e) Investor protection

Even in a framework where only experienced, qualified investors are eligible, there will frequently be a strong informational bias towards the issuer. It could therefore be argued that investors would have to be provided with a (restricted) set of information and that regulators have to be kept informed in order to be able to ensure investor protection.

Alternatively it could be argued that institutions should require already in their own statutes that financial managers possess the necessary experience and qualification. Furthermore, private placement would only be an additional option for doing business. Market participants would always have the possibility to trade in the public space/public offering in order to benefit from a higher level of investor protection. To limit the potential for misunderstandings, providers could be required to inform their counterparties about the fact that certain requirements that apply in the case of public offerings were not applicable in the proposed private placement. On this basis, no specific elements of investor protection would be required for such a regime.

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)?

f) Restrictions and requirements

It is sometimes argued that the parties involved in private placement are experienced, fully qualified traders. Therefore, no specific rules are needed in addition to private contract law. A private placement regime would only need to ensure that deals stay within the predefined limits of the regime. As long as participants respect these, the details of the deals should be left to their discretion.

In contrast to such an all-comprising approach a minimalist solution would focus on the essential difference between public offering and private placement only: the requirement to publish information material, and to comply with marketing rules. All other requirements applicable to the offer of investment products should remain in place. Even some minimum information requirements should remain valid.

Would deactivation of mandatory disclosure rules on its own deliver significant benefits? Or would private placement only deliver meaningful benefits if local rules on disclosure, promotion, distribution, marketing or conduct of business were switched off?

In the context of a private placement regime, will it be necessary to remove national requirements or procedures for product approval in order to render cross-border private placement effective? If product-by-product registration is replaced, would it be useful (for purposes of building supervisory confidence, transparency) to foresee a (initial/regular) notification procedure to be required of entities placing instrument on a private basis in other Member States?

Filing of regular reports with each host authority about which instrument are being privately placed and identification of principal counterparties may ensure that host authorities have sufficient information to police perimeters of the private placement regime.

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?

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?

g) Other issues

The above should have covered the most relevant issues to be addressed to determine the case for a European private placement regime. However, if you consider that there are other relevant matters to be considered please feel free to add the respective information or comments.

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

IV. ASSESSING THE CURRENT EU FRAMEWORK

After analysing the situation at national level and discussing the 'ideal' regime, this section examines which features of a private placement are already provided by existing EU law. The objective is to see whether existing EU law could help overcoming the (potential) problems identified at national level.

In a next step, this review could contribute to the establishment of a common understanding/interpretation as for the national regimes. It could also help to gauge the extent to which the existing framework would need to be adjusted in order to implement an appropriate framework for private placement at EU level. – In IA terminology, this could be interpreted as the final element in the problem analysis, namely whether there is regulatory or market failure. Based on this, it could provide a basis for the development of potential options, should a need for action be substantiated.

Besides the various private placement regimes that exist at national level, some elements of such a regime are already provided by existing EU law. The prospectus directive and MiFID are arguably the most relevant ones. Their likely 'contribution' to an EU private placement regime are presented is some detail below.

a) Prospectus Directive 2003/71/EC

Objectives of the Directive

The Prospectus Directive harmonises the provisions regarding the production of a prospectus for public offerings. It requires the publication of a prospectus – drawn up in accordance with the Directive and its implementing Regulation and approved by the competent authority of the home Member State – when securities are offered to the public or admitted to trading on a regulated market in a Member State. The Prospectus contains detailed information about both the issuer and the product. It must also contain information about any guarantor, underwriters and intermediaries that are co-ordinating an offer. The concept of an offer of securities to the public is defined very broadly in the Prospectus Directive. Basically it covers any communication to 'persons'.

The Directive contains a comprehensive set of notification requirements for issuers that are exercising the passport under the Directive. This involves notification by the issuer's home competent authority to the host competent authority that a prospectus is to be 'passported' into that host State. This harmonisation might, however, be constrained by supplementary notification requirements imposed on the issuer or offeror in the host MS.

Elements relevant for an EU private placement regime

The Prospectus Directive provides exemptions from the requirement to publish a prospectus under certain conditions. These could be understood as elements of a European private placement regime.

Broadly speaking, two cases can be distinguished:

- ☐ **No prospectus**

Firstly, issuers/managers are exempt from the obligation to produce a prospectus in any of the following circumstances:

- an offer that is addressed solely to qualified investors.

- an offer that is addressed to fewer than 100 persons (other than qualified investors) per Member State;
- an offer subject to a minimum consideration of €50,000 per investor;
- an offer of securities with a minimum denomination per unit of €50,000;
- an offer of securities with a total consideration of less than €100,000, calculated over a 12 month period.

The term ‘qualified investor’ is defined in Art. 2(1)(e), see Annex I. Under this definition, even an individual may be a qualified investor if s/he satisfies the criteria designed to demonstrate financial sophistication set out in Art. 2(2), if the MS where that investor is resident has to authorise individuals who request it and meet the criteria.

It is important to note that these conditions have to be complied with up to the final placement. Any leakage to the public or other violation of the above rules might impact on the parties involved in the original placement as well.

- ☐ **‘Prospectus light’**

Secondly, the issuer/manager might be allowed to produce a ‘lighter’ version of the prospectus instead of a full prospectus in some specific cases of offers (merger or takeover: offers where there is no increase of capital; offers free of charge to existing shareholders; offers to employees etc). This much "lighter" document has to set out the nature of the securities and the reasons for the offer have to be provided.

Furthermore, the implementing Regulation contains different (lighter) disclosure rules for some types of securities (equity; debt and derivative securities with a unit denomination of less than €50,000; debt and derivative securities with a unit denomination of at least €50,000; asset-backed securities; depository receipts; and units in closed-end investment undertakings).

Private placement elements

In conclusion, the Prospectus Directive provides a framework with regard to who could participate in a private placement regime and (partly) how to deal with leakage. But it only provides a lighter regime with respect to disclosure. It does not touch upon other relevant aspects like conduct of business rules.

b) Markets in Financial Instruments Directive 2004/39/EC (MiFID)

Similar to the Prospectus Directive, MiFID sets out a general set of rules for investment services and their providers and lists certain circumstances under which these rules could be relaxed for certain types of investor. It is the latter that might constitute elements of a private placement regime.

Objectives of the Directive

MiFID provides a European passport for investment firms, allowing them to provide services across borders on the basis of their home country authorisation. At the same time it ensures a high level of protection for investors when employing investment firms, wherever they are located in the EU.

Rules applying to all types of investor

- To benefit from the EU passport, all entities that wish to provide investment services on a professional basis, including firms which are providing individual portfolio management, must be authorised accordingly.[3]
- MiFID contains rules on the internal organisation of investment firms and their management and disclosure of conflicts of interest.
- In addition, MiFID contains certain other obligations on firms including those relating to transaction reporting and market transparency.
- The application of these categories of rules does not depend on the client categorisation.

Conduct of business and allied rules applying only to retail or professional clients

As mentioned above, MiFID distinguishes three types of client: eligible counterparties, professional and retail clients (for definitions see Annex I). In general terms, the conduct of business set out in MiFID apply when the firm is dealing with professional and retail clients but not with eligible counterparties. The same holds for specific rules relating to best execution and order handling. Furthermore, where they do apply, as a general rule these requirements have to be applied taking into account the client's classification.

<u>Information provision:</u> Firstly all information, including marketing communications, addressed to (potential) clients must be fair, clear and not misleading and marketing communications must be clearly identifiable as such.

Secondly, there is a general obligation to provide (potential) clients with appropriate information in a comprehensible form relating *inter alia* to financial instruments and proposed investment strategies. Investment firms must provide (potential) clients with a general description of the nature and risks of financial instruments, taking into account, in particular, the client's categorisation as either a retail client or a professional client.

Finally, there are some requirements investment firms have only to comply with when dealing with retail clients. This includes the provision of appropriate information as to safeguarding of client financial instruments or client funds. Furthermore, (potential) retail clients must be informed about where a prospectus or simplified prospectus (in both cases, if any) is made available to the public. Art. 27 of the Level 2 Directive[4] lists further conditions with which all information addressed to (potential) retail clients must comply. Art. 31(5) of that Directive provides that certain information about third party guarantees must be provided to retail clients.

<u>Appropriateness and suitability:</u> Requirements relating to the suitability of investment advice and of recommendations made in the course of individual portfolio management, and the appropriateness of investment services and products in other circumstances are important to ensure that investors are provided with appropriate information and service quality. Professional clients are deemed to understand the risks arising from instruments in relation to which they are classified as professional clients for the purposes of the appropriateness and suitability tests. In practice, this has a similar result as exempting professional clients from the application of the appropriateness test.

---

[3] In addition, certain MiFID rules apply to UCITS Managers: see Article 5(4) of Directive 1985/611/EEC.

[4] Directive 2006/73/EC

Private placement elements

Relevant elements of a private placement regime can be seen in the definition of investor classes (eligible counterparties, professional and retail investors) and the implementation of tests to determine the relevant investor class. Furthermore, MiFID determines some investor protection requirements that are switched off for eligible counterparties and, partly, professional investors:

- conduct of business rules including information requirements and the suitability and appropriateness test;
- best execution rules;
- order handling rules.

It should be noted that MiFID requires home authorisation of investment firms and does also contain principles-based rules regarding information and advice.

c) Transparency Directive 2004/109/EC

In addition, there is a provision in the transparency directive 2004/109/EC which exempts issuers "*exclusively of debt securities admitted to trading on a regulated market, the denomination per unit of which is at least EUR 50 000 or, in the case of debt securities denominated in a currency other than Euro, the value of such denomination per unit is, at the date of the issue, equivalent to at least EUR 50 000*" (Art.8(1b)) from the obligation to publish annual and half-yearly financial reports as well as interim management statements. Furthermore, Article 20(6) provides issuers with the option to disclose regulated information to the public only in a language customary in the sphere of international finance provided that the securities whose denomination per unit amounts to at least EUR 50 000 are admitted to trading on a regulated market in one or more Member States.

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?

Should the review lead to the conclusion that there is a single market failure with respect to private placements across borders in the EU and that the existing 'building blocks' in their current form do not provide an effective framework further action might have to be considered. Such action could take many different forms. In principle, the full range of policy instruments would be available:

- adoption of new legislation in form of a directive or even regulation on private placement;
- amending existing European legislation (MiFID, Prospectus Directive, etc.) in order to create a private placement regime;
- mutual recognition of national private placement regimes

These and any other (e.g. soft law) measures would face the usual trade-off between greater harmonisation and legal certainty on the one hand and speediness of implementation and flexibility in application on the other hand.

The core question is how much legal certainty is needed to support the system and how comprehensive the regime should be: do we aim for a comprehensive and fully articulated EU private placement regime? Or will an incremental, piecemeal approach which tackles particular obstacles to cross-border solicitation be more effective?

Another issue is whether existing EU law like MiFID or the Prospectus Directive will have to be amended even if a new law is being adopted or the "national route" is taken.

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?

\- - - - - - - - -

ANNEX I: DEFINITIONS OF SOPHISTICATED INVESTORS IN MIFID AND PROSPECTUS DIRECTIVE

MIFID, ARTICLE 24(2): *"ELIGIBLE COUNTERPARTS"*

- investment firms, credit institutions, insurance companies, UCITS and their management companies, pension funds and their management companies,
- other financial institutions authorised or regulated under Community legislation or the national law of a Member State,
- persons and undertakings exempted from the application of this Directive under Article 2(1)(k) and (l) (persons whose main business consists of dealing on own account in commodities and/or commodity derivatives, not being part of a group the main business of which is the provision of other investment services; firms which provide investment services and/or perform investment activities consisting exclusively in dealing on own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets or which deal for the accounts of other members of those markets or make prices for them and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such firms is assumed by clearing members of the same markets),
- national governments and their corresponding offices including public bodies that deal with public debt, central banks and supranational organisations.

MIFID, ANNEX II: *"PROFESSIONAL INVESTOR"*

A professional client is a client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs. In order to be considered a professional client, the client must comply with the following criteria:

I. Categories of client who are considered to be professionals

The following should all be regarded as professionals in all investment services and activities and financial instruments for the purposes of the Directive.

(1) Entities which are required to be authorised or regulated to operate in the financial markets. The list below should be understood as including all authorised entities carrying out the characteristic activities of the entities mentioned: entities authorised by a Member State under a Directive, entities authorised or regulated by a Member State without reference to a Directive, and entities authorised or regulated by a non-Member State:

(a) Credit institutions
(b) Investment firms
(c) Other authorised or regulated financial institutions
(d) Insurance companies
(e) Collective investment schemes and management companies of such schemes
(f) Pension funds and management companies of such funds
(g) Commodity and commodity derivatives dealers
(h) Locals
(i) Other institutional investors

(2) Large undertakings meeting two of the following size requirements on a company basis:

- balance sheet total: EUR 20 000 000,

- net turnover: EUR 40 000 000,
- own funds: EUR 2 000 000.

(3) National and regional governments, public bodies that manage public debt, Central Banks, international and supranational institutions such as the World Bank, the IMF, the ECB, the EIB and other similar international organisations.

(4) Other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

The entities mentioned above are considered to be professionals. They must however be allowed to request non-professional treatment and investment firms may agree to provide a higher level of protection. Where the client of an investment firm is an undertaking referred to above, the investment firm must inform it prior to any provision of services that, on the basis of the information available to the firm, the client is deemed to be a professional client, and will be treated as such unless the firm and the client agree otherwise. The firm must also inform the customer that he can request a variation of the terms of the agreement in order to secure a higher degree of protection.

It is the responsibility of the client, considered to be a professional client, to ask for a higher level of protection when it deems it is unable to properly assess or manage the risks involved.

This higher level of protection will be provided when a client who is considered to be a professional enters into a written agreement with the investment firm to the effect that it shall not be treated as a professional for the purposes of the applicable conduct of business regime. Such agreement should specify whether this applies to one or more particular services or transactions, or to one or more types of product or transaction.

II. Clients who may be treated as professionals on request

II.1. Identification criteria

Clients other than those mentioned in section I, including public sector bodies and private individual investors, may also be allowed to waive some of the protections afforded by the conduct of business rules. Investment firms should therefore be allowed to treat any of the above clients as professionals provided the relevant criteria and procedure mentioned below are fulfilled. These clients should not, however, be presumed to possess market knowledge and experience comparable to that of the categories listed in section I.

Any such waiver of the protection afforded by the standard conduct of business regime shall be considered valid only if an adequate assessment of the expertise, experience and knowledge of the client, undertaken by the investment firm, gives reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved. The fitness test applied to managers and directors of entities licensed under Directives in the financial field could be regarded as an example of the assessment of expertise and knowledge. In the case of small entities, the person subject to the above assessment should be the person authorised to carry out transactions on behalf of the entity.

In the course of the above assessment, as a minimum, two of the following criteria should be satisfied:

- the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters,

- the size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds EUR 500 000,

- the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

II.2. Procedure [continues]"

PROSPECTUS DIRECTIVE ARTICLE 2 (1): ***"QUALIFIED INVESTOR"***

- legal entities which are authorised or regulated to operate in the financial markets, entities not so authorised or regulated whose corporate purpose is solely to invest in securities;
- national and regional governments, central banks, international and supranational institutions, other similar international organisations;
- other legal entities which do not meet two of the three criteria: ‘small and medium-sized enterprises’ means companies, which, according to their last annual or consolidated accounts, meet at least two of the following three criteria: an average number of employees during the financial year of less than 250, a total balance sheet not exceeding EUR 43 000 000 and an annual net turnover not exceeding EUR 50 000 000;
- certain natural persons: subject to mutual recognition who expressly ask to be considered as qualified investors and meet at least two of the criteria: (a) carried out transactions of a significant size on securities markets at an average frequency of, at least, 10 per quarter over the previous four quarters; (b) the size of the investor's securities portfolio exceeds EUR 0,5 million; (c) the investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment;
- certain small and medium-sized enterprises: subject to mutual recognition, who expressly ask to be considered as qualified investors.

ANNEX II: COMPARISON BETWEEN MIFID AND PROSPECTUS DIRECTIVE – LARGE UNDERTAKING CATEGORY AND EXPERT INVESTOR CATEGORY

"Large undertaking" category

To qualify, 2 out of the 3 tests prescribed by each Directive must be met.

	MiFID[5]	**Prospectus Directive**[6]
Balance Sheet total	> €20 million	> €43 million
Annual net turnover	> €40 million	> €50 million
Employees	--	> 250
Own funds	> €2 million	---

"Expert investor" category

To qualify, 2 out of the 3 tests prescribed by each Directive must be met.

	MiFID wording[7]	**Prospectus Directive wording**[8]
Previous transactions at least 10 per quarter over previous four quarters	The client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters.	The investor has carried out transactions of a significant size on securities markets at an average frequency of, at least, 10 per quarter over the previous four quarters.
Size of portfolio exceeds €500.000	The size of the client's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds €500.000.	The size of the investor's securities portfolio exceeds €0.5million.
Previous experience at least one year in a professional position in the financial sector	The client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.	The investor works or has worked for at least one year in the financial sector in a professional position which requires knowledge of securities investment.

[5] Annex II, Section I.2
[6] Article 2(1)(e)(iii)
[7] Annex II, Section II
[8] Article 2(2)