

## **European Securities Markets Expert Group**

### **Differences between the Definitions of “Qualified investor” in the Prospectus Directive and “Professional Client” and “Eligible Counterparty” in MiFID - Is Alignment Needed?**

#### **I. Introduction and summary**

The exemption contained in the Prospectus Directive for offers to "qualified investors"<sup>1</sup> and the provisions of the Markets in Financial Instruments Directive (MiFID) addressing the treatment of "professional clients" and "eligible counterparties"<sup>2</sup> both contemplate that the full range of protections granted under those directives should not apply to transactions with defined classes of investors who should be able to make their own investment decisions. However, the scope of the definition of "qualified investor" in the Prospectus Directive and the definitions of "professional clients/eligible counterparties" in MiFID do not coincide: there is some overlap but they each cover different groups of investors. In particular, the Prospectus Directive and MiFID adopt different approaches to the treatment of sophisticated individuals: the Prospectus Directive allows investors to self-certify as qualified investors if they are willing to place their name on a register available to all issuers, whereas MiFID creates a regime in which investment firms establish whether an individual investor has the necessary financial and other qualifications and the experience and expertise to be treated as professional client. As described in par. II.2 not all countries have completed the implementation of the register defined by the Prospectus Directive and its effectiveness is difficult to evaluate at present. Differences are also to be noted in the approach followed by each of the Directives to define which undertakings require a reinforced protection.

In any case these differences in definition create or may create complexity and costs for investment firms. Investment firms have to put in place and maintain systems to obtain relevant data from investors, keep records and apply the corresponding MiFID categorisations. However, they cannot necessarily rely on that categorisation when acting for an issuer in making a private placement of securities - they may have to classify again their

---

<sup>1</sup> Article 3(1)(a) and (b) Directive 2003/71/EC. See article 2(1)(e) and (f), (2) and (3) for the definition of a qualified investor.

<sup>2</sup> See in particular articles 19(10)(c), 21(6)(a) and 24 MiFID and the implementing directive 2006/73/EC. See Annex II and article 24 MiFID for the definition of a professional client and eligible counterparty.

clients to determine whether they are qualified investors (or rely on other exemptions under the Prospectus Directive, such as the exemption for offers of securities which have a denomination of or require a minimum investment of €50,000 or more and the exemption for offers to fewer than 100 investors per Member State<sup>34</sup>).

The complexity of the rules also has an impact on issuers that wish to privately place their securities (i.e. without registering a prospectus), whether they are using investment firms as intermediaries or placing them directly. The fact that investment firms cannot rely on their categorisation of an individual as a professional investor to treat that investor as a qualified investor for the purposes of the Prospectus Directive, may restrict issuers' ability to conduct private placements with some classes of experienced individual investors. If intermediaries were able to rely on their MiFID categorisation, that might facilitate the distribution of some products by private placement although where the firm provides a MiFID service such as advice or receipt and transmission of orders to the investor the firm would still have to comply with the MiFID requirements to provide appropriate information to investors.

Finally, the use in EU directives of two different concepts, neither of which is aligned with the corresponding concepts used in the US, creates some additional complexity for firms seeking to conduct cross-border offerings in both the EU and the US. The use of differing definitions for very similar purposes could also add further complexity to the process of achieving mutual recognition of rules between the EU and the US<sup>5</sup>.

The purpose of this paper is to analyse to what extent it would be feasible or desirable to align the definition of "qualified investor" in the Prospectus Directive with the definition of "professional client" and "eligible counterparty" in MiFID, taking into account the objectives of the Prospectus Directive and MiFID.

In summary, we recommend;

- Ensuring that the definition of "per se" qualified investors in the Prospectus Directive incorporates the generally somewhat broader category of "per se" professional client

---

<sup>3</sup> Article 3(1)(b), (c) and (d) Prospectus Directive.

<sup>4</sup> Article 3(1)(c) and (d) Prospectus Directive.

<sup>5</sup> For example, see the reasons put forward by the SEC to use the term "qualified investor" as defined in the Exchange Act Section 3(A) (54), in the recent Proposed Rule Release n° 34-58047, proposing amendments to improve regulation of foreign broker-dealer activities in US. Both the rationale and the tests for defining such persons are closely aligned in concept with those used in the Prospectus Directive.

in MiFID, while maintaining the elements of the definition of undertakings as qualified investors that bring additional flexibility to that of undertakings as professional investors;

- Allowing an intermediary that is an investment firm or credit institution subject to MiFID to treat its professional clients and eligible counterparties as qualified investors for the purposes of the Prospectus Directive, whenever placing securities or advising an issuer in its fundraising activities;
- Reviewing carefully the usefulness of the registers of investors contemplated by the Prospectus Directive and possible alternative methods to allow issuers directly to offer their securities to sophisticated individual and other investors. Although the preliminary indications are that there is not much use made of these registers in the Member States that have so far implemented them, we do not have sufficient information at this point in time to determine whether the registers are indeed performing the functions they were set up to perform, and further fact-finding might be necessary to conclude whether there is an actual need of the market for these registers. We contemplate that the fact-finding exercise would determine (i) whether there are particular issues in some Member States that would justify the retention of the regime under which investors can register as qualified investors on the basis of self-certification and (ii) whether the functions that the registers were set to perform can be satisfactorily replaced by any form of information offered by investment firms, either by providing certifications to issuers as to the status of individual investors or more generally. This fact-finding exercise could be carried by CESR submitting questions to its Members as to the respective national registers, and the possible existence of particular issues in some Member States if registers were to be eliminated, and by seeking information from small and large issuers through relevant European and national associations and also by seeking information from the business angel networks and similar bodies who represent individual investors

Alignment of the definitions in the manner set out above should increase the efficiency of the placement process making use of the information collected by intermediaries and should be of benefit to sophisticated investors as it should enhance investor choice. The study outlined

above should indicate the demand for alternative ways in which issuers can access sophisticated investors, whether the registers (or other routes) might be the way forward and whether these registers ought to be centralized by Member States or set up and maintained by investment firms as a natural prolongation of their categorization of clients.

## **II. Investor protection under the Prospectus Directive and MiFID**

One of the main objectives of the *Prospectus Directive* is to protect investors by requiring issuers that make a public offer of their transferable securities<sup>6</sup> to provide complete information to investors by publishing a prospectus containing full information about the issuer and the securities which has been approved by the relevant competent authority.

The Prospectus Directive established for the first time a harmonised EU definition of what constitutes an "offer to the public". This constituted a major innovation. When the predecessor directive (Directive 89/298/EEC) was adopted, it proved to be impossible to reach an agreement on a common definition.<sup>7</sup> However, the Prospectus Directive recognised that it was important to ensure a common approach in order to avoid disparities in investor protection, in particular since electronic communication networks made it possible to reach investors throughout Europe (and elsewhere). Different interpretations of what constitutes an "offer to the public" across the Member States could have had the effect that in certain cases securities could be sold in some Member States only with the publication of a prospectus, while in other Member States the same offer could take place on a private placement basis without complying with prospectus publication rules.

The harmonisation of the definition of "offer to the public" in the Prospectus Directive also required that there should be a harmonised set of exemptions from the prospectus requirements in the directive. A harmonised definition of what constitutes an "offer to the public" would have achieved little if Member States were still free to pick and choose which exemptions they would apply. Therefore, the Prospectus Directive also introduced for the first time a fully harmonised definition of when an offer of securities would be regarded as a private placement and thus exempt from the prospectus publication requirements in the

---

<sup>6</sup> There are differences between the definition of transferable securities as used in the Prospectus Directive and the definition in MiFID, which are the subject of a separate ESME group paper.

<sup>7</sup> See recital 7 Directive 89/298/EEC.

directive. A key element of the private placement exemptions is the exemption for offers that are made solely to qualified investors.<sup>8</sup>

The Prospectus Directive is basically product driven and the exemption for offers to qualified investors is based on the concept that certain categories of investors need less protection than others when making their investment decisions. The exemption for offers to qualified investors applies to a defined category of investors, without taking into account the individual characteristics of the individual investors included in that category and subscribing to an offer.

**MiFID** aims to ensure a high level of client protection through calibrated conduct of business rules which investment firms have to observe when providing investment services (including underwriting and placement of securities) and ancillary services across the EU in relation to a broad class of financial instruments which includes (but is not limited to) transferable securities.

MiFID is in essence services driven and calibrates the operation of its conduct of business rules by applying differing levels of protection depending on whether the investment firm is providing services to or dealing with a retail client, a professional client or an eligible counterparty. Under MiFID, regulated investment firms need not provide eligible counterparties with certain protections (such as best execution) and firms can deal with professional clients with considerably fewer formalities than those that apply in relation to dealing with retail clients.

MiFID's three-tier client categorisation system (*retail client/professional client/eligible counterparty*) has some similarities with the categorisation system in the Prospectus Directive, in that it establishes classes of investors that are presumed to require fewer protections. However, it is a more dynamic system than that in the Prospectus Directive as it allows clients and the investment firm to agree on the level of protection that the client will receive by permitting the firm to "opt up" or "opt down" clients from one category to another.

---

<sup>8</sup> There are also other exemptions from the obligation to publish a prospectus when making an offer to the public, including the exemption for restricted offers (such as the exemption for offers addressed to fewer than 100 persons in a Member State) and exemptions that apply in specific situations where there are alternative protections or where there is less of a need for investor protection (such as the exemptions that apply in mergers or to bonus issues of securities). See article 3 and 4 (1) Prospectus Directive.

### III. Differences between the definitions

#### 1. *Qualified investors versus professional clients*

The major differences between the definition of qualified investor in the Prospectus Directive and the definition of professional client in MiFID are as follows:

- **Large undertakings** are "per se" qualified investors under the Prospectus Directive and are also "per se" professional clients under Section 2 of Annex 2 of MiFID, **but** the quantitative criteria that define a "large undertaking" differ between the two directives.

**Table: Comparison of the definitions of "large undertakings"**

	<b>Qualified investor</b>	<b>Professional client</b>
<b>Sources</b>	<b>Prospectus Directive – Art. 2(1)(e)(iii) and (f)</b>	<b>MiFID – Annex II, Section 1(2)</b>
<b>Criteria</b>	<p>Legal entities fulfilling two of the three following criteria:</p> <ul style="list-style-type: none"> <li>- <b>250 or more employees</b> on average during the financial year;</li> <li>- <b>balance sheet total of €43m or more;</b></li> <li>- <b>net turnover of €50m or more.</b></li> </ul> <p>(by reference to their last annual or <b>consolidated</b> accounts)</p>	<p>Undertakings fulfilling two of the following criteria:</p> <ul style="list-style-type: none"> <li>- <b>balance sheet total of €20m or more;</b></li> <li>- <b>net turnover of €40m or more;</b></li> <li>- <b>own funds of €2m or more.</b></li> </ul>

- **Small and medium sized enterprises** (i.e. entities that are not large undertakings) can opt to be treated as qualified investors under Article 2.1(e) of the Prospectus Directive by registering on a register established in their Member State (Member States can choose not to apply this regime). Under MiFID, small and medium sized enterprises

can be treated as professional clients under the same conditions as natural persons (see below).

- **Natural persons** can opt to be treated as qualified investors under Article 2.1(e) of the Prospectus Directive by registering on a register established in their Member State, provided they "self certify" that they meet two out of three quantitative criteria concerning their investment portfolio and investment experience (although Member States can choose not to apply this regime). Section II.1 of Annex II MiFID also allows investment firms to treat natural persons as "elective" professional clients, provided that they meet two out of three quantitative criteria similar to those in the Prospectus Directive.<sup>9</sup> However, in addition, the investment firm can only categorise the natural person as a professional client if it has undertaken an adequate qualitative assessment of the expertise, experience and knowledge of the client, that 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.
- **Public bodies that manage public debt** are recognised as "per se" professional clients under Section I(3) of Annex II MiFID, whereas they would not be qualified investors under the Prospectus Directive.
- **Other institutional investors** are recognised as qualified investors under article 2.1(i) of the Prospectus Directive if their sole corporate purpose is to invest in securities. Section I(4) of Annex II MiFID applies a broader definition by treating other institutional investors as "per se" professional clients if their "main activity" (not sole purpose) is to invest in financial instruments (not just securities).
- **"Entities dedicated to the securitisation of assets or other financing transactions"** are recognised as "per se" professional clients under Section I (4) of Annex II MiFID.

---

<sup>9</sup> The criteria set out in MiFID are as follows:

- 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 €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.

However, these are not automatically treated as qualified investors under the Prospectus Directive unless they qualify under another category.

Both directives recognise entities which are authorised or regulated to act in the financial markets and national and regional governments, central banks and international and supranational organisations as, respectively, "per se" qualified investors (under the Prospectus Directive) and "per se" professional clients (under MiFID). See article 2(1)(i) and (ii) Prospectus Directive and Section I(1) and (3) of Annex II MiFID.

## 2. *The registration of qualified investors*

As already noted, the Prospectus Directive allows (but does not require) Member States to treat certain small and medium sized enterprises and natural persons as qualified investors if they register on a register established by the Member State in which they have their registered office or residence. Some countries, such as **Sweden**, chose not to make use of this option. However, it seems that these registers are not widely used even in those countries that chose to make use of this option in the Prospectus Directive.

In **Austria**, no investor has yet registered on the register established with the Financial Market Authority for natural persons and small and medium sized enterprises.

In **Belgium**, only 19 investors have registered on the register (which is only open to companies and not natural persons) and the CBFA received around a dozen requests to access the register from issuers in the last 12 months.

In **France**, 196 investors (32 legal entities and 164 natural persons) had registered on the register established by the AMF by 31 December 2007.

In **Germany** only 4 investors had registered on the register established by the BaFin by 31 December 2007. In 2005 one investor and in 2006 eight investors had made an application which is valid for one year only. Until end of 2007, no issuer or offeror has ever asked for inspection since the implementation of the register in July 2005. BaFin has been entitled to implement an official regulation governing the register by the German Ministry of Finance in April 2008, but such a regulation has not been considered necessary until now.

In *Italy*, in December 2007 Consob published for consultation a draft regulation on the second stage of the implementation of the Prospectus Directive in Italy. Under the draft regulation, Consob would, upon request, record the names of small and medium sized enterprises and of natural persons who satisfy the conditions set out in the regulation. Issuers and offerors would be able to consult the register by application to Consob. In its comments on the draft regulation, Consob indicated that it was considering the possibility of outsourcing the keeping of the register. The final regulation has not yet been published.

*Spain* opted to implement the register by delegating its creation and maintenance to investment firms. Investment firms must create and maintain a register of small and medium sized enterprises and natural persons that have requested, in writing, to be treated as qualified investors, but are not required to carry out any activity directed at verifying that these clients meet the qualified investor requirements. The register must be available to CNMV at all times, and to all issuers, within three days of their requesting it. We are not aware of any Spanish firm having established such a register, and informal contacts have suggested that this lacuna is related to the absence of any real interest in the part of customers to see such a register established.

There were about 320 investors registered on the *UK* register (in March 2008) and the FSA receives no more than four requests to access the register a month.

### 3. *Qualified investors versus eligible counterparties*

Article 24(2) of MiFID defines the category of "per se" eligible counterparties. For the most part, the category of "per se" eligible counterparties is identical to the category of "per se" professional clients, although it also includes undertakings that are exempt from the application of MiFID under article 2(1)(i) and (k) that are not required to be authorised to operate on financial markets.

Correspondingly, almost all "per se" eligible counterparties would also be "per se" qualified investors under the Prospectus Directive, except for those undertakings exempted under article 2(1)(i) and (k) MiFID and public bodies which deal with public debt.

By virtue of the directive implementing MiFID,<sup>10</sup> the category of persons that can be treated as eligible counterparties on their request is broadly similar to the category of professional clients already discussed above.

#### **IV. Underlying conceptual differences**

As discussed above, the Prospectus Directive is essentially product driven and focused on product information whereas the MiFID is service and therefore client driven. These conceptual differences explain to a large extent the differences in the dynamics of the exemption for qualified investors under the Prospectus Directive and the regime for professional clients and eligible counterparties under MiFID.

The opting up mechanics under the qualified investor exemption are principally based on objective criteria and are triggered upon the investor's initiative only, but the mechanics are established in terms of "all or nothing". Once an investor opts up, and requests inclusion on its national register, it opts up for all future issues regardless the nature of the product offered or the type of issuer making the offering. The investor can opt out of qualified investor treatment (by removing his name from the register) but the opting out cannot be tailored according to the type of product or issuer. "Per se" qualified investors cannot opt not to be treated as qualified investors for certain types of products (although they of course retain the option of not investing in any securities offered to them).

The MiFID client categorisation system and related calibrated client protection regime is dynamic in application reflecting a multiplicity of relationships (some of them entailing fiduciary duties) and financial services. An investment firm can treat clients (natural persons or legal entities) that are not "per se" professional clients as professional clients upon their request, if they meet the qualitative and quantitative criteria discussed above in relation to natural persons. Conversely, an investment firm can agree to treat "per se" professional clients and eligible counterparties as retail clients, on its own initiative or at their request (but the investment firm can refuse such a request). A person may be categorised as a professional client (or eligible counterparty) generally or in relation to particular products or services.

---

<sup>10</sup> See article 50 Directive 2006/73/EC.

## **V. Rationale for the qualified investor exemption – professional client / eligible counterparty treatment**

### *1. Qualified investor*

Since investor protection is regarded as one of the principal objectives of the Prospectus Directive, it is appropriate to take account of the different requirements for protection of the various categories of investors and their level of expertise. The Prospectus Directive provides an exhaustive list of objective investor categories, which on their face are considered to be capable of judging the merits of an offer without the need for comprehensible and easily analysable information through the provision of a prospectus. This approach presumes that certain predetermined factors such as asset size or institutional type are sufficiently determinative of sophistication to justify a waiver from the prospectus requirement. The approach is understandable given the nature of a securities offer, where it would be unusual for the issuer to have a sufficient relationship with the final investor to be able to make an actual assessment of the investor's expertise or understanding.

### *2. Professional client / eligible counterparty*

As described above, MiFID introduces a three-tier client categorisation system for the purposes of the application of conduct of business rules (including information requirements and suitability and appropriateness obligations). This results largely from the work undertaken by CESR (then FESCO) as early as 2000, and the existing regime bears the traces of that origin<sup>11</sup>. Under this system, retail clients benefit from the full range of protections. For professional clients, certain protection requirements are (partly) "switched off" and the "know your customer" and suitability requirements are less severe. None of the main protective rules apply to dealings with eligible counterparties.<sup>12</sup> As discussed above, the arrangements are dynamic, allowing for a firm to recategorise clients to confer more (or less) protection, either generally or in relation to particular products or services. These dynamics reflect the close relationship between the firm and the client, which enable the firm to make an informed assessment about the appropriate degree of protection that is to be given to the investor (and allows the investor to choose more or less protection, subject to appropriate safeguards).

---

<sup>11</sup> A European Regime of Investor Protection – The Professional and Counterparty Regimes, 8 July 2002.

<sup>12</sup> This client category only relates to the provision of the services of order execution, dealing on own account and reception and transmission of orders with certain pre-determined categories of active market participants.

## **VI. Justification for the lack of alignment and potential drawbacks**

The Prospectus Directive and the MiFID aim to create a harmonised regime of investor protection across the EU.

The Prospectus Directive reflects the need for a level playing field within the EU and therefore identical criteria for defining private placements within the EU. However, the Directive departs from the aim of harmonisation by allowing Member States the option to individually enlarge the class of defined per se qualified investors to encompass self-certified and registered sophisticated natural persons and small and medium sized enterprises, which allows different Member States to follow different approaches in the treatment of private placements addressed to this class of investors.

Additionally, in the majority of cases offers/private placements of securities will be made through professional intermediaries that are authorised as investment firms. This is a source of friction since regulated firms will have categorised their clients for MiFID purposes, but may not be able to rely on this client categorisation in making placements with their own client base, although in many cases, they may be able to rely on other exemptions for their private placement, such as the exemption for offers to fewer than 100 investors in a Member State or of securities with a denomination of €50,000 or more.

Finally, the register-based “opt up” for certain qualified investors do not appear to be working effectively. In particular, we suspect that investors are deterred from registering because of concerns about privacy. There is likely to be an understandable reluctance on the part of sophisticated or wealthy individuals to parade themselves as such on a register which invites issuers of all kinds to approach them directly (and since it is unlikely to be possible in practice to prevent others accessing the list, anyone at all could seek to approach the investor based on his registration). Additionally, these sophisticated/wealthy individuals might be using the services of more than one investment firm at a time, and “opting up” would require them to notify all the firms of their intention. Another reason might be that investment firms are reluctant to encourage their clients to put their names on a register as it may encourage other investment firms to approach those clients and seek to win their business. However, a conclusive judgement is not yet possible since in some countries, the register system has not yet had time to be tested to determine whether it performs a useful function.

The level of prescription for purposes of application of a calibrated client protection regime in particular in relation to the “know your customer”, suitability and appropriateness rules under MiFID is not so evident but has been a deliberate choice to realize an EU harmonised conduct of business regime.

Because the regimes governing qualified investors under the Prospectus Directive and professional clients/eligible counterparties under MiFID are similar in terms of the categories of investors covered and their broad overall objectives, there is a natural inclination to consider fully aligning the two regimes.<sup>13</sup> In particular, professional clients are presumed to have the experience, knowledge and expertise to make their own investment decisions and to assess the risks that they incur and therefore it should be possible to treat them as qualified investors for the purposes of the Prospectus Directive. However, it is also important to keep in mind that the Prospectus Directive also covers offerings and placements not conducted through intermediaries and, therefore, needs to be adapted to the needs of issuers as well as those of investment firms.

An additional drawback of the existing divergence in the treatment of exemptions under the Prospectus Directive and MiFID is that it creates a supplementary layer of difficulty in establishing greater convergence with the US.

US rules include a variety of qualified investor which apply for different purposes under its legislation, including definitions of qualified institutional buyers, accredited investors, qualified investors, institutional customers, qualified eligible persons, eligible contract participants, US institutional investors, major institutional investors and qualified purchasers, each of which provides overlapping and differing tests.

---

<sup>13</sup> The linkage is also built in the Directive texts. As an example: art. 31 of the Directive 2006/73/EC (MiFID level 2) requires an investment firm when providing product information to a retail client that is subject of a public offer and a prospectus has been published, to inform the client where that prospectus is made available to the public.

While regulatory convergence between the US and the EU would facilitate mutual recognition, it would seem that internal EU convergence could be an important step towards that result<sup>14</sup>.

## **VII. Recommended approach**

We recommend that the definition of qualified investor includes professional clients.

While we acknowledge the difference in original purpose and investor protection scope of each of the Directives, we did not identify any prejudice to investor protection in aligning the definition of "per se" qualified investor in the Prospectus Directive with the definition of "per se" professional client in MiFID. In principle, we prefer alignment on the basis of the definitions in MiFID (rather than alignment on the basis of the definitions in the Prospectus Directive) on the pragmatic basis that investment firms will have categorised their clients in accordance with the definitions in MiFID (which are mainly somewhat broader) and changing those definitions would impose significant costs on firms (and result in some clients no longer qualifying as professional investors). In contrast, it seems unlikely that issuers or intermediaries would have to make corresponding changes as a result of amendments to the definition of qualifying investors in the Prospectus Directive. However there are some differences between the PD and MiFID in relation to the position of large undertakings and there may be some flexibility in the PD not present in MiFID. We recommend that views be sought as to whether complete alignment in this case would be desirable or whether some elements of the PD approach should be retained, for example by keeping the current PD definition of large undertaking as well as the MiFID definition

In addition, it is necessary to adopt wording which takes account of the possibility that some intermediaries may be relying on the transitional provisions adopted pursuant to article 71(6) MiFID to classify investors as professional clients in reliance on corresponding concepts under predecessor regimes. Also, MiFID allows an investment firm to continue to rely on the information provided by the client until the firm becomes aware that the client no longer

---

<sup>14</sup> The EU-US Coalition on Financial Regulation March 2008 Report on "Mutual Recognition, Exemptive Relief and "Targeted" Rules' Standardisation: The Basis for Regulatory Modernisation" contains much valuable information and discussion.

meets the criteria for categorisation as a professional client.<sup>15</sup> Therefore, there may be cases where a firm is treating a client as a professional client even where it does not meet the criteria set out in Annex II MiFID.

Alignment of the definitions would:

- (1) reinforce the role as “gatekeepers” assigned by MiFID to financial intermediaries, who would need to make an informed judgment on their customers’ capacity to subscribe certain securities without having had access to a standardised-form prospectus,
- (2) clarify the regime for private placements, extending the exemption to the obligation to register a prospectus whenever a firm or an issuer is offering securities exclusively to "professional clients" or "eligible counterparties",
- (3) enable investment firms to rely on a unique categorisation of clients for all their services, including the order reception/placement of securities in relation to primary market placements of securities.

This alignment could be achieved by:

- (1) conforming the list of “per se” qualified investors under the Prospectus Directive with the list of “per se” professional clients under MiFID, by replacing paragraphs (i), (ii) and (iii) of article 2.1(e) of the Prospectus Directive with the following:

"(i) persons that meet the criteria set out in paragraphs (1) to (4) of Section I Annex II of Directive 2004/39/EC; or

(ii) legal entities other than those persons which, according to their last annual or consolidated accounts, do not meet two of the three following criteria: an average number of employees during the financial year of less than 250, a total balance sheet not exceeding EUR 43000000 and an annual net turnover not exceeding EUR 50000000.

---

<sup>15</sup> See last paragraph, Annex II MiFID.

(2) adding a new paragraph (ii) to article 2(1)(e) of the Prospectus Directive:

"(ii) in relation to a placement of securities by an intermediary that is an investment firm or credit institution subject to Directive 2004/39/EC, other persons that the intermediary categorises as professional clients or eligible counterparties in accordance with that Directive in relation to the services it provides to those persons with respect to that placement;"

and making any needed adjustments throughout the text.<sup>16</sup> There may need to be transitional arrangements with respect to any offers in progress at the time of implementation.

In addition, we recommend that it should be made clear (both in the Prospectus Directive and MiFID) that it is possible to rely on the last annual or consolidated accounts in assessing whether an undertaking is a large undertaking under paragraph (2) Section I Annex II MiFID (compare article 2(1)(f) Prospectus Directive - although it would be desirable to make clear that it is possible to rely on the consolidated financial figures in the consolidated accounts). However, it should be possible to use other means to assess this (this is particularly important in relation to MiFID where firms may be dealing with a broad range of EU and non-EU entities not all of which will have annual accounts).<sup>17</sup>

Nevertheless, we recommend that the consultation process in connection with the proposals to amend the Directive should seek to identify whether any practical problems might arise for any class of investors as a result of aligning the definition of "per se" qualified investors in the Prospectus Directive with the definition of "per se" professional clients in MiFID. There might be entities that are "per se" qualified investors under the Prospectus Directive but that would not be "per se" professional clients under MiFID. However, this only will affect entities with more than 250 employees but which do not meet two out of the three financial tests in MiFID (which are in any event set at slightly lower levels than in the Prospectus Directive). We consider that it is unlikely that this represents a significant group of potential

---

<sup>16</sup> For example, a consequential change (if the register regime is retained) would be the need to replace the references to small and medium sized enterprises in article 2(1)(c)(v), (3) and (4), which may require transitional provisions for existing registered entities.

<sup>17</sup> This paper does not consider whether there are other changes that could be made to the definition of professional client in MiFID. For example, it is recognised that there are issues because the existing tests do not recognise that small undertakings in a larger group of companies and subsidiaries of listed companies should be recognised as professional clients.

investors but it is important to seek to identify whether this could cause practical problems. If it could, then we would suggest adding the 250 employees test to paragraph (2) Section I Annex II MiFID (so that an investor would have to meet two out of four size requirements for both the purposes of both MiFID and the Prospectus Directive).

At this stage, we do not propose the removal of the Member State option in article 2(3) of the Prospectus Directive to allow the creation of registers, even though the evidence so far suggests that there is limited use of these registers (where they exist at all). However, as there are some Member States which are only just implementing a system of registers, it is difficult to reach firm conclusions at this stage.

Nevertheless, a member of the Group has expressed on record its opinion that Members States should not be given the option to create these registers, for the following reasons: firstly, the registration procedure is not operational , given the small number of Member States which have adopted it and the very limited interest it has met for the reasons stated in this report.

Secondly, the registers are set up at national levels and constitute factors of distortion in the application of European rules among Member States.

Thirdly, this procedure appears detrimental to clarity of the European legislation in the context of a dialogue with the US.

Fourthly, the auto-certification feature by investors appears not to be in line with the client categorisation procedure which is an assessment made by intermediaries introduced by MIFID. The coexistence of the two procedures might lead to conflicting or uncomfortable situations.

Therefore, thought should be given by the Commission on whether there are particular issues in some Member States that would justify the retention of the register regime under which investors can register as qualified investors on the basis of self-certification (e.g. because "business angels" or other informal capital providers rely on it to obtain direct access to issuers). We understand that these issues, if any, would have to be identified in an exercise of fact-finding. This exercise could also help determine the best form these registers are to take to be of assistance to issuers while protecting any concerns investors might have over the undue dissemination of information regarding their wealth/experience.

In part, the need for the registers should be further diminished if the proposals set out above are implemented. However, if there is a genuine demand for this kind of direct access to investors that are willing to self-certify as qualified investors, it may be that there are other ways of achieving this objective in a more effective way. For example, we consider that it is likely to be helpful if issuers were allowed directly to offer securities to investors where an investment firm has confirmed that it is satisfied that those investors would qualify as professional clients or eligible counterparties in relation to an offer of that kind. We note that in some cases an issuer will not want to incur the cost of a placement fee and will engage an investment firm to provide it with general advisory but not placement services and in such a situation this would seem to be a sensible outcome for both the issuer and the investors. The fact-finding exercise should seek to identify whether these sorts of arrangements would provide a satisfactory alternative to the current system of national registers.

The fact-finding exercise could be carried by CESR submitting questions to its Members as to the respective national registers and by seeking information from small and large issuers through relevant European and national associations. It is likely to be necessary to seek the views of those representing smaller issuers as it is likely that these issuers have a greater interest in alternative ways of accessing providers of capital, rather than simply relying on intermediaries. It may also be possible for competent authorities to ascertain the views of investors that have registered to ascertain whether it has been useful for them.