28 March 2025

Via Electronic Mail

By email: cp24-24@fca.org.uk
Consumer Investments
Advice Policy
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

Re: The MiFID Organisational Regulation

Dear Sir/Madam:

MFA[1] appreciates the opportunity to represent the views of the global alternative investment industry in this written response to the Financial Conduct Authority's ("**FCA**") consultation on the MiFID Organisational Regulation (Consultation Paper CP24/24) (the "**Consultation Paper**").

MFA supports the FCA's broader objective of strengthening investor protection while maintaining proportionate and risk-based rules that reflect the sophistication of market participants. We appreciate the FCA's engagement with stakeholders and welcome its willingness to consider modernising aspects of the client categorisation regime to align with the UK's growth and competitiveness agenda. In this response, MFA addresses several specific areas where the existing framework may be in conflict with the Government's and the regulator's goals, especially where the rules are unnecessarily restrictive, operationally burdensome, or inconsistent with the operation of modern market practice.

MFA recommends right sizing the rules for client categorisation by:

- **Reforming the elective professional client opt-up regime**: MFA supports targeted changes to the quantitative test in COBS 3.5.3R, including replacing the trading frequency criterion within the quantitative test with a more flexible test based on aggregate notional value traded, and reducing or supplementing the portfolio size threshold. We also recommend broadening the experience criterion to include relevant experience outside traditional financial services roles.

- **Establishing a unified client categorisation framework**: MFA believes that the current bifurcation between MiFID and non-MiFID client categorisation frameworks is outdated and increasingly

[1] Managed Funds Association (MFA), based in Washington, D.C., New York City, Brussels, and London, represents the global alternative asset management industry. MFA's mission is to advance the ability of alternative asset managers to raise capital, invest it, and generate returns for their beneficiaries. MFA advocates on behalf of its membership and convenes stakeholders to address global regulatory, operational, and business issues. MFA has more than 180 fund manager members, including traditional hedge funds, private credit funds, and hybrid funds, that employ a diverse set of investment strategies. Member firms help pension plans, university endowments, charitable foundations, and other institutional investors diversify their investments, manage risk, and generate attractive returns throughout the economic cycle.

misaligned with the way investment services are structured and delivered. The dual regime generates unnecessary complexity for firms and confusion for clients. MFA urges the FCA to introduce a single, consolidated client categorisation framework that applies uniformly across all regulated activities, regardless of their MiFID status.

- **Aligning the financial promotions regime with MiFID client categorisation**: MFA wishes to highlight a regulatory imbalance that permits authorised firms to treat clients as professional for the purposes of the financial promotions regime, while unauthorised firms must rely on narrower and more burdensome exemptions. This distinction leads to inconsistent treatment of clients with identical characteristics and undermines the accessibility of investment opportunities. MFA encourages the FCA to harmonise the financial promotions regime by aligning the exemptions available to authorised and unauthorised firms.

- **Reclassifying UK local authorities as per se professional clients**: MFA considers that UK local authorities should no longer be presumed to be retail clients. Many local authorities, particularly local government pension schemes, allocate capital across a broad range of sophisticated investment strategies and are advised by professional consultants. The existing default classification does not reflect their investment experience, governance structures, or role in the capital markets. MFA recommends that the FCA amend COBS 3.5.2R to include UK local authorities as *per se* professional clients.

MFA supports the FCA's objectives of ensuring proportionality and improving regulatory clarity. We welcome further dialogue with the FCA on these recommendations and remain committed to contributing constructively to the development of a modernised and effective client categorisation regime. We have set out our responses to the relevant questions of the Consultation Paper in the Annex hereto.

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MFA appreciates your consideration of our recommendations. We look forward to working with the FCA to improve the effectiveness, clarity, and proportionality of the client categorisation regime. We would be pleased to discuss our recommendations in further detail. Please do not hesitate to reach out to me, via rhailey@mfaalts.org or 020 3585 2300.

Sincerely,

/s/ Rob Hailey

Managing Director
Head of EMEA Government Affairs

***Per se* professional clients**

Q25 Do firms that act on behalf of clients tend to request to opt down to professional status? Should such firms be removed from the list of entities that can be treated as *per se* ECP? Would this help clearer calibration of client protection rules?

MFA Response

MFA supports the removal of firms acting on behalf of underlying clients from the *per se* ECP category and their reclassification as *per se* professional clients. This change would better reflect established market practice and ensure that counterparties interacting with such firms apply the higher standard of protection afforded to professional clients by default.

In MFA's view, this change would improve the calibration of client protection rules by reserving ECP status for the most sophisticated market participants (e.g., those trading for their own account and requiring minimal regulatory protection). At the same time, professional client status would more appropriately capture firms that, while institutional in nature, act in an agency capacity for underlying investors.

Q26 Could the *per se* categories be simplified in other ways, eg, replacing different types of authorised firm listed separately with 'authorised person'? Or harmonising the differences in certain thresholds within the wholesale categories which differ for MiFID and non-MiFID business?

MFA Response

MFA supports simplifying the *per se* client categories by replacing the various types of authorised firms listed in COBS 3.5.2R and COBS 3.6.2R with a single "authorised person" category. In practice, any firm authorised and regulated by the FCA, the Prudential Regulation Authority ("**PRA**"), or an equivalent overseas regulator is likely to meet the intended criteria for *per se* professional client or ECP status under these rules. Adopting a single designation, with appropriate guidance to cover equivalent overseas firms, would streamline the regime without materially altering its scope. It would also facilitate the removal of obsolete classifications in the FCA Handbook, such as the "local" firm category, which has become redundant following the introduction of the UK Investment Firms Prudential Regime.

Separately, MFA supports harmonising the thresholds that determine whether a large undertaking qualifies as a *per se* professional client. At present, the criteria differ depending on whether the business is MiFID or non-MiFID in nature.

For MiFID business, COBS 3.5.2R(2) provides that a large undertaking qualifies as a *per se* professional client if it meets at least two of the following three criteria:

- a balance sheet total of EUR 20 million;
- net turnover of EUR 40 million; and/or
- own funds of EUR 2 million.

For non-MiFID business, COBS 3.5.2R(3) provides that a large undertaking qualifies as a *per se* professional client if it meets any one of several conditions, including:

- called-up share capital or net assets of at least £5 million (or its equivalent in any another currency at the relevant time); or
- any two of the following:
    - a balance sheet total of EUR 12.5 million;
    - net turnover of EUR 25 million; or
    - an average of 250 employees during the year.

MFA also notes that the basis of assessment differs between MiFID and non-MiFID business. For MiFID business, the thresholds must be assessed solely on the financials of the individual undertaking. For non-MiFID business, assessments may be conducted on a group basis. For example, a company may qualify as a *per se* professional client (for non-MiFID purposes) if it, or any of its holding companies or subsidiaries, has called-up share capital or net assets of at least £5 million (or its equivalent in any another currency at the relevant time).

MFA believes these inconsistencies create unnecessary complexity for firms operating across different business lines. MFA therefore supports a review of the current thresholds and urges the FCA to adopt a single, harmonised set of criteria applicable across both business types. In principle, the same size and level of assessment should apply regardless of whether a firm is conducting MiFID or non-MiFID business.

Elective professional clients

Q27 How important is it to your clients to have the ability to opt up to professional client status? What are the benefits to clients of opting up eg is there a cost saving from lower fees and /or better pricing?

MFA Response

Based on input from its members, MFA understands that the ability to opt up to professional client status can be highly valuable to investors, offering significant benefits in terms of investment access, cost savings, and pricing advantages.

From an investment perspective, professional client status allows individual investors and entities to access a broader range of products and strategies that may not be available to retail clients. This includes alternative investments, such as hedge and private equity funds, and other asset classes or instruments that are not mass-marketed. Many clients who seek to opt up do so to achieve greater diversification or pursue higher risk-adjusted returns than those typically available through retail-focused products.

Beyond access to investments, MFA understands that professional client status may lead to material cost savings and better pricing. Professional clients often invest in institutional share classes or bespoke arrangements that offer lower fees compared to retail investments. In retail funds, fees may be higher to account for distribution costs and regulatory obligations. By contrast, professional clients can negotiate lower management and performance fees, particularly when committing significant capital.

In addition, many investors who seek to opt up are employees or officers of investment management firms. In such cases, enabling their participation in fund products aligns their interests with those of other investors and strengthens internal governance and accountability. Importantly, many firms permit or require employees from various functions, including technology and operations, to invest in firm-managed funds. While these individuals may not have direct investment responsibilities, they typically have access to portfolio information, an understanding of the firm's risk framework, and familiarity with the underlying strategy. Taken together, these factors enable them to evaluate fund exposures independently and make informed investment decisions.

Q28 Do you think we should change our rules in relation to opting clients up to professional status? If yes, would you support any of the approaches suggested above, or a combination of these? Are there any alternative approaches you would suggest?

<u>**MFA Response**</u>

MFA supports targeted reforms to the professional client opt-up process under COBS 3.5.3R, with a view to modernising the framework so it better reflects the characteristics of today's markets. In MFA's view, elements of the current quantitative test are overly rigid and no longer serve as reliable indicators of investor sophistication. A revised approach should maintain strong investor protections while enabling firms to categorise clients appropriately where they can demonstrate a clear understanding of investment risk.

<u>A. Trading Frequency Test</u>

The existing requirement that a client must have executed an average of 10 transactions per quarter over the past year is, in MFA's view, ill-suited to many sophisticated investors. MFA notes that a growing number of investors adopt long-term strategies and increasingly allocate capital to illiquid asset classes, such as private credit. The current formulation of the quantitative test appears to have been designed with active equity traders in mind; it presumes that high trading frequency is a reliable proxy for investment knowledge and experience. In practice, however, many sophisticated investors engage in fewer but larger transactions, often in OTC derivatives, real estate funds, or private placements, and therefore fail to meet the test, notwithstanding substantial market exposure and expertise. Therefore, MFA recommends that, in addition to or instead of a trading frequency-based test, firms should be permitted to consider the aggregate notional or principal value traded by the prospective client across all asset classes over the preceding 12 months. This would better recognise investors who demonstrate sophistication through the scale of their investments rather than merely the frequency of those investments.

In short, MFA considers that this aspect of the quantitative test does not adequately account for differences across asset classes or the trading patterns of sophisticated investors. It places undue emphasis on trading frequency and disadvantages those investing in illiquid or long-duration assets where transactions are necessarily less frequent.

<u>B. Portfolio Size Test:</u>

MFA believes that the current requirement for a client's portfolio to exceed €500,000 may unduly exclude many highly sophisticated individuals who do not hold sufficient financial instruments in their portfolio. For instance, junior investment professionals may have deep technical knowledge and market expertise but may not yet have accumulated sizeable personal portfolios of financial instruments. Similarly, corporate executives, entrepreneurs, or industry experts may have substantial wealth and insight, but with capital concentrated in private business interests rather than in listed or transferable financial instruments.

Accordingly, MFA encourages the FCA to consider (i) reducing the portfolio size requirement to £250,000, as the European Commission recommends in its proposed Retail Investment Strategy Directive (EU RISD)[2], or (ii) adding additional criteria, such as professional credentials or demonstrable investment expertise to qualify as a professional client.

C. Experience Test

The current requirement that a client must have worked in the financial services sector for at least one year is an overly narrow measure of expertise. It excludes many individuals, including entrepreneurs and industry specialists, with substantial investment experience that may have not worked within financial services firms.

MFA believes that the test should focus on an investor's ability to understand and assess investment risk, rather than on employment history within the financial services industry.

As regards the FCA's suggested changes to the client opt up process:

- MFA supports revising the quantitative thresholds in COBS 3.5.3R(2) and introducing additional indicators of investor sophistication. The current quantitative criteria, as explained above, are inflexible and may exclude experienced investors from participating in the capital markets.

- MFA does not support making a fixed monetary portfolio threshold an absolute prerequisite for opting up retail clients, for the reasons noted above. MFA believes that wealth should be one factor among several in assessing client sophistication.

- While MFA understands the rationale for a cooling-off period, any such requirement should be short and proportionate. A 24–48 hour pause after a client requests professional status would allow time for reflection but avoid unnecessary delays in time-sensitive investment decisions. A longer cooling-off period (e.g., several weeks) could disrupt access to private investments with fixed subscription windows. If a cooling-off period is introduced, MFA believes clients should have the option to waive it by confirming they have considered the decision carefully.

Interaction of client categorisation with the financial promotion rules

Q30 In what circumstances do clients opt up to be treated as elective professionals for the purpose of exemption from certain financial promotion rules only?

[2] See Proposal for a Directive of the European Parliament and of the Council amending, among other directives, Directive 2014/65/EU as regards the European Union retail investor protection rules, available at: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52023PC0279

MFA Response

Based on feedback from its members, MFA understands that it is uncommon for clients to opt up solely to be exempted from the financial promotion rules. In practice, opt-up requests typically arise where a client has a genuine interest in a specific investment opportunity that cannot be marketed to, or made available for investment by, retail clients, whether due to applicable regulatory restrictions or the nature of the product itself.

Common scenarios include the following:

- **Investment in alternative funds by individuals or AIFM employees**:

  A frequent example involves an individual investor, or an employee of an alternative investment fund manager ("**AIFM**") wishing to invest in a hedge fund. Under Regulation 46 of the UK Alternative Investment Fund Managers Regulations 2013 ("**UK AIFMR**"), an AIFM (or an investment firm acting on its behalf) may market an alternative investment fund ("**AIF**") to, or accept subscription from, a UK retail investor where it complies with the financial promotion regime or is able to rely on an exemption from such. Where the AIFM, or the investment firm marketing the AIF on its behalf, is an authorised person for the purposes of the UK Financial Services and Markets Act 2000 ("**FSMA**"), the applicable restrictions on financial promotions are as outlined in section 238 FSMA (i.e., the restriction on the promotion of units in an unregulated collective investment scheme) and COBS 4.12B.6R. A communication to professional clients in relation to an AIF is exempt from the restrictions set out in section 238 FSMA and COBS 4.12B.6R. A person may qualify as a professional client for the purposes of section 238 FSMA based solely on the qualitative test set out in COBS 3.5.3R(1) (i.e., without needing to meet the quantitative test), as per Note 4 of the table in COBS 4.12B.7R.

- **Participation in private placements or bespoke investment opportunities**:

  Another circumstance is when an investor is invited to participate in a particular deal (e.g., a private placement of securities) and the arranger of the deal informs them that they can only be included if they are not a retail investor. If the investor has the capacity and is willing, they might opt up for that purpose. For example, a family office (which may otherwise be classified as a retail client if it does not meet the criteria of a large undertaking or regulated firm) could elect to be categorised as a professional client to take part in a private debt issuance or a pre-IPO share placement that a bank is arranging.

- **Limitations of client categorisation under COBS 3 for unregulated persons**

  MFA also wishes to highlight a structural limitation in the current client categorisation framework under COBS 3. At present, COBS 3 applies only to a "firm", which is generally defined in the FCA Handbook as a person authorised under FSMA to carry on one or more regulated activities in the UK. As such, the client categorisation provisions in COBS 3 do not apply to persons who are not authorised under FSMA.

This has important implications for the opt-up process. The procedural requirements set out in COBS 3.5.3R, including the qualitative assessment of a client's expertise and experience, and the provision and acknowledgment of the prescribed written warning, may only be undertaken by an authorised firm. Where an unauthorised person wishes to opt up a retail client to professional status, it may have to engage an authorised firm to carry out the necessary categorisation steps on its behalf.

MFA considers that this constraint introduces unnecessary friction into the client onboarding process and may unduly restrict investor access. MFA therefore encourages the FCA to consider revising the client opt-up framework to permit unauthorised persons to categorise retail clients as professional clients directly, subject to appropriate safeguards.

If the FCA is considering changes in this area, MFA would encourage guidance rather than prohibition. Any move to restrict or disallow the use of the opt-up process for the purposes outlined above could have unintended consequences. In particular, it could exclude sophisticated investors who are both willing and capable of assessing investment risk or inadvertently drive greater reliance on the comparatively less supervised self-certification exemptions.

Q34 Are there any areas where you think sector specific changes are needed? If yes, please explain your answer.

Address asymmetries in the operation of the financial promotions regime

MFA wishes to highlight an important and persistent asymmetry in the operation of the financial promotions regime under FSMA, which warrants careful review and reform.

Currently, an authorised person may categorise a client as a professional client for the purposes of the financial promotion regime based solely on the qualitative test in COBS 3.5.3R(1). This is expressly recognised in COBS 4.12B.6R and 4.12B.7R, Note 4, in relation to financial promotions related to non-mass market investments (e.g., unregulated collective investment schemes). However, unauthorised persons cannot rely on COBS 4.12B.6R or any part of COBS 4, since COBS applies only to authorised firms.

This creates a regulatory imbalance. A client with identical characteristics may be treated as a professional client by an authorised firm (and therefore more easily able to receive a financial promotion) but treated as a retail client in respect of the same promotion when approached by an unauthorised person, who must instead rely on more restrictive, if at all applicable, exemptions under the Financial Services and Markets 2000 (Financial Promotion) Order 2005 ("**FPO**").

This asymmetry has significant practical consequences. For example, many AIFMs, particularly those marketing AIFs under the UK national private placement regime, are not authorised persons under FSMA. These firms cannot opt up clients under COBS 4, even where the clients meet the same qualitative criteria. Instead, they must rely on the FPO's limited exemptions, such as the self-certified "sophisticated investor", or "certified high net worth individual" exemptions, which are generally narrower in scope; impose more cumbersome certification requirements; and are unavailable for some product types (e.g., promotions concerning listed securities).

MFA considers this outcome to be anomalous and inconsistent with the FCA's broader aims of proportionality, competition, and access to investment. We therefore encourage the FCA and HM Treasury to explore mechanisms to align the financial promotions exemptions available to authorised and unauthorised persons.

MFA would also encourage the FCA to adopt a more fundamental review and alignment of the MiFID client categorisation framework and the financial promotions regime. Specifically, where a client has been validly categorised as a professional client under MiFID that classification should be determinative for the purposes of the financial promotions regime. In other words, once a client is a MiFID professional client, there should be no further requirement for a firm to assess or rely on a separate exemption (e.g., under COBS 4 or the FPO) in order to communicate a financial promotion to that client.

This approach would remove unnecessary duplication in compliance processes, reduce legal uncertainty, and ensure consistent treatment of sophisticated clients across regulatory regimes.

Establish a more unified and coherent client opt-up process

MFA believes that the current distinction between MiFID and non-MiFID client categorisation frameworks is outdated, unnecessarily complex, and increasingly out of step with the way investment services are delivered in practice.

The current bifurcated structure has its roots in the Financial Services Authority's ("**FSA**") implementation of MiFID in 2007. At the time, the FSA expressly acknowledged the merits of a consistent client categorisation framework, noting that a consistent approach to categorisation may be preferable to avoid confusion and unnecessary complexity.[3] However, legal constraints under EU law led to the preservation of distinct MiFID and non-MiFID categories within the FCA Handbook. This structure persists today, despite being increasingly misaligned with market practice and client expectations.

Nowhere is this complexity more apparent than in COBS 3, which governs client categorisation. For example, COBS 3.1.5G(1) attempts to explain how the regime applies to mixed business, as follows:

> "*The requirement concerning mixed business will apply if a MiFID investment firm or third country investment firm advises a client on whether to invest in a scheme or a life policy. This is because the former is within the scope of MiFID and the latter is not. In such a case, the MiFID client categorisation requirements prevail*. "

The same provision goes on to state that where the MiFID and non-MiFID activities are "provided separately", the MiFID categorisation rules do not apply. In such cases, firms must explain to clients the basis on which the different activities are provided, including any differences in the client categorisation that applies.

This formulation is unnecessarily complex. In practice, firms must identify the regulatory perimeter for each activity, tailor their documentation accordingly, and explain to clients why they are treated differently for services that are, in substance, very similar. This drives up compliance costs and results in an inconsistent and confusing client experience.

[3] FSA, Implementing MiFID's Client Categorisation requirements, Augst 2006, p. 14.

This challenge is not isolated to COBS 3. Similar inconsistencies elsewhere in the FCA Handbook illustrate the same underlying problem. For example, COBS 4.12B.7R, Note 4 (which, as noted above, enables authorised firms to communicate financial promotions to non-retail clients) provides:

> "*In deciding whether a promotion is permitted under the rules of this section or under section 238 of [FSMA][an authorised firm] may use the client categorisation regime that applies to [non-MiFID business]. (This is the case even if the firm will be carrying on a MiFID activity at the same time as or following the promotion*."

This example highlights the artificial and impractical distinctions that arise from maintaining parallel MiFID and non-MiFID categorisation frameworks. A firm must apply non-MiFID criteria when considering whether a financial promotion exemption applies, even if the transaction itself will be subject to MiFID rules. For clients, this is unintelligible. For firms, it is administratively burdensome. There is no policy reason for this divergence to continue.

In short, MFA encourages the FCA to reform the client opt-up framework by introducing a single, harmonised regime for all client categorisation, irrespective of whether the activity is MiFID or non-MiFID business.

Reclassify UK local authorities as per se professional clients

The default presumption of retail status for local authorities is no longer justified and imposes unnecessary administrative burdens on both firms and local authorities. We urge the FCA to reconsider this treatment and to update the client categorisation regime to reflect the sophistication and market role of these entities.

Many local authorities are advised by professional investment consultants and allocate capital across a wide range of financial instruments and strategies, including alternative assets. This is particularly true of local government pension schemes LGPS. The notion that such entities lack the capacity to understand investment risks or require retail-level protections is inconsistent with practical reality.

We also note that the original rationale for treating local authorities as retail clients was based on legacy EU policy considerations during the development of MiFID II. These concerns were particularly influenced by high-profile local authority losses on structured derivative transactions during the global financial crisis.

In a post-Brexit context, there is no legal requirement for the UK to continue importing EU-derived presumptions that are not supported by empirical evidence or proportionality. The FCA has a clear opportunity to revisit this policy and tailor its rules to the structure of the UK public finance and investment sector. Reclassifying local authorities as *per se* professional clients would reduce the administrative burden on firms, increase efficiency in the provision of financial services, and more accurately reflect the capacity and role of these entities in UK capital markets.

Accordingly, MFA recommends that (i) the FCA amend COBS 3.5.2R to include UK local authorities as a category of *per se* professional client; or (ii) at a minimum, provide clear guidance that local authorities may be treated as *per se* professional clients where they meet objective criteria such as portfolio size, governance structure, or treasury function sophistication.