Amy Kaye
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

By email: cp22-19@fca.org.uk

2 December 2022

Dear Ms Kaye

Re: Creation of baseline financial resilience regulatory return

The BVCA is the industry body and public policy advocate for the private equity and venture capital (PE/VC) industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based PE/VC firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ over 2 million people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

We welcome the opportunity to feedback on the FCA's consultation proposals to create a baseline financial resilience regulatory return and have responded to consultation questions on which our members have specific views.

Q1: Do you agree with the scope of firms proposed to be in subject to FIN073? If not, please explain.

We welcome the FCA's recognition that the current approach of collecting financial resilience data through ad hoc surveys, which started in June 2020 with the COVID-19 Impact Survey, places significant administrative burden on firms. We support the FCA's stated intention to reduce both the administrative and financial burden caused.

Of the 23,000 solo-regulated firms that have been asked to complete the mandatory Financial Resilience Survey (FRS), which replaced the COVID-19 Impact Survey, we understand from the consultation paper that the data helped to identify some 100 firms (0.43%) where the FCA had material concerns about financial resilience. We also recognise that the FCA's access to up-to-date financial resilience firm data helped the FCA to intervene earlier than might otherwise have been possible and potentially prevented consumer harm.

However, we believe that the proposed scope for a new baseline financial resilience regulatory return (FIN073), to include all FCA regulated firms with few exceptions, is too wide. We recommend that the scope of firm coverage should follow a risk based approach and be focused on those firms or sectors where there is a genuine risk of poor financial resilience. Amongst those firms, the data should only be requested from those firms from whom the FCA does not already obtain substantially similar data.

Risk-based approach

The consultation paper outlines that access to up-to-date baseline financial resilience data is key to the FCA's data-led approach of assessing the financial resilience of firms, liquidity risk and data "which by its nature, can become out of date very quickly." The paper goes on to say that "liquidity risk can crystallise rapidly and is often a driver of failure for firms that are unable to service their liabilities." We suggest there is a clear opportunity for the FCA to focus its proposed collection of data through FIN073 to those firms undertaking regulated activities that, from analysis of the existing data and historic failure rates, present the greatest (or most material) risk of failure and related consumer harm. This will help to reduce significantly the estimated £15 million implementation costs and ongoing annual costs of £2.5million that is projected to be borne by UK regulated firms as a whole because of these proposals.

PE/VC firms are generally regulated as UK AIFMs or MiFID investment firms. They typically manage or advise on closed-ended professional investor funds that acquire, hold and then sell illiquid stakes in unlisted companies during a 10-15 year extendable lifespan and present very little risk of a liquidity crisis or of firm failure that would cause consumer harm – particularly when monitored on a quarterly basis.

If a PE/VC manager were to fail, it seems unlikely that this would come about due to a liquidity crisis given that PE/VC firms' liabilities are in most cases largely separate to those of the funds they manage (which themselves typically do not employ financial leverage nor grant redemption rights). Firms using this model have a very low exposure to a possible firm failure. As investors cannot redeem, the most likely scenario for a firm to decide ultimately to close its business is that it fails to raise new funds over a protracted period. This means the firm would gradually reduce its staffing to reduce operating costs for the existing closed ended funds, prior to commencing a wind down at the end of the life of those funds or transfer to a replacement manager. . As PE/VC funds are typically closed-ended vehicles with long-term horizons, the fund would be wound down in an orderly manner and over many years. Management fees would continue to be payable until the funds are wound up (in line with the terms of the contractual arrangement agreed with investors), albeit on a diminishing scale proportionate to the committed capital less returned capital, enabling the PE/VC manager to reduce the scale of its operations as its activity reduces.

Alternative scenarios involve the departure of key executives or major reputational damage making it desirable to identify a replacement manager. These types of event would require the firm to put the FCA on notice of the event and the firm's plans, at which point the FCA could ask firms to provide additional financial information. This is unlikely to pose any risk to the investors in the fund, as the winding up of the PE/VC firm has no impact on the value of the assets held by the fund.

On that basis, we suggest that introducing a quarterly return to confirm the liquidity position and financial resilience of PE/VC firms which have not reported a relevant material event to the FCA is unnecessary from a regulatory perspective, and disproportionately burdensome for these firms.

Duplication

While we welcome the proposed carve-out for investment firms subject to MiFIDPRU, we recommend that the exclusion to mitigate duplication is also extended to authorised UK AIFMs with MiFID top-up permissions, i.e. those with authorisation to provide certain additional investment services, as per Article 6(4) of the UK Alternative Investment Fund Manager Directive (AIFMD). This is because these firms are already required under the Investment Firms Prudential Regime to perform an Internal Capital and Risk Assessment (ICARA) that incorporates business model assessment, forecasting, stress testing, recovery planning and wind-down planning, as well as complying with the Overall Financial Adequacy Rule (OFAR), demonstrating to the FCA that the firm has adequate financial resources. This is in addition to submitting FSA029 with Balance Sheet information and FSA030 with a Profit & Loss Account to the FCA on a quarterly basis. We believe that the information and data that the FCA proposes to collect from these firms through FIN073 is therefore duplicative and unnecessarily burdensome.

Upcoming Financial Resilience Surveys

Given that the FCA has recognised that the collection of financial resilience data through the FRS is duplicative for MiFIDPRU investment firms, it seems logical for the FCA also to reduce the unnecessary burdens on these firms more quickly, in advance of the introduction of FIN073, by removing them from scope of future FRS questionnaires that fall due before the introduction of FIN073 (expected in H2 2023).

Q4: Do you agree with the proposed frequency of FIN073? If not, please explain.

As per our response to Q1, liquidity crises and financial resilience-related issues are not material concerns for authorised UK AIFMs dealing in investments. On that basis, we recommend that such firms be excluded from scope of FIN073.

However, if this is not possible, then we strongly recommend that the requirement for such firms to complete of FIN073 on a quarterly basis be reduced to annual reporting to reflect the materiality of such liquidity risks, firm failure and any related risk of consumer harm.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above in more detail (please contact Tom Taylor ttaylor@bvca.co.uk / Nick Chipperfield nchipperfield@bvca.co.uk).

Yours sincerely,

Tim Lewis, Chair, BVCA Regulatory Committee