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By email: anti-money-laundering@lawcommission.gov.uk

5 October 2018

Dear Sirs

BVCA response to Law Commission Consultation Paper No 236 on Anti-Money Laundering: the SARS Regime

We are writing on behalf of the British Private Equity and Venture Capital Association ("**BVCA**"), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 700 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested over £27 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 385,000 people and 84% of UK investments in 2015 were directed at small and medium-sized businesses.

The UK anti-money laundering regime is relevant to the private equity and venture capital industry in a number of ways. Private equity and venture capital fund managers are FCA regulated and are required to carry out KYC checks on investors in their funds and on persons from whom they buy and to whom they sell companies. Those managers are subject to the Suspicious Activity Reports ("**SARS**") and consent regimes. Companies in which private equity and venture capital invest are a significant part of the UK economy and are directly impacted by the measures put in place by banks to comply with these regimes. An inefficient or unworkable SARS regime delays transactions and hinders the growth of both the private equity and venture capital industry and the companies in which they invest. A high administrative burden on the industry and their advisers under the SARS regime has incurred significant public and private time and money and deflected valuable resources away from investigation of serious crime.

The BVCA welcomes the opportunity to respond to the Law Commission's Consultation on the SARS regime. We are strongly supportive of an effective SARs regime in the UK as part of an effective regime to report on and deter money laundering.

The application of the ML Regulations and SARS regime in private equity and venture capital deals

Private equity and venture capital managers may be required to file SARs during the fundraising process or when buying or selling companies on behalf of the funds they manage.

Fundraising: Investors in private equity and venture capital funds are typically longer-term institutional investors who will need to fulfil strict eligibility criteria. During a fundraising, the

private equity or venture capital firm will undertake know your customer checks prior to permitting an investor to invest in a fund. The firm is obliged to consider whether any notifications may need to be made under the SARS regime as part of the fundraising process. It is not uncommon for long-term relationships to develop whereby investors will reinvest in subsequent funds, typically prompting firms to carry out further AML checks.

Transactions: Private equity and venture capital funds invest in predominantly private, unlisted companies (whether alone or as part of a corporate group) ("**portfolio companies**"). When deciding whether to invest funds into a potential portfolio company, the private equity or venture capital firm will need to undertake detailed due diligence on the company, its management, any outgoing shareholders and any co-investors, including AML checks, again with regard to the SARS regime. The level of due diligence will be tailored according to the portfolio company concerned, including the jurisdictions in which it operates and the products it offers. Where the due diligence process identifies potential proceeds of crime, this currently triggers a disclosure obligation.

When selling an investment, the private equity or venture capital firm will again apply further due diligence and ML Regulation checks on the purchaser(s).

Our responses to the Law Commission's questions

General response

We welcome all proposals from the Law Commission that assist in streamlining and de-duplicating the disclosures made under the SARS regime, and enhance its efficacy. In particular, the Law Commission's proposals are welcome in three key areas: (i) including the absence of a UK nexus as a reasonable excuse not to report; (ii) greater sharing of information between regulated entities; and (iii) reducing the disclosure burden where the relevant information is already in the public domain.

However, we are disappointed that the Law Commission's proposals have fallen short of the overhaul necessary to address the issues faced in the unwieldly SARS regime and provide a more workable and effective mechanism for the reporting of money-laundering activities. SARs are designed to allow law enforcement to operate effectively and efficiently in placing the impetus on firms to report suspicious transactions but the exact implementation had led to firms making excessive numbers of Defence Against Money Laundering ("**DAML**") SARS, which consume significant public and private time and resources.

Answers to specific questions

Without prejudice to the views expressed above, we also set out below our responses to certain questions raised in the Consultation Paper.

Q. 1. Do consultees agree that we should maintain the "all crimes" approach to money laundering by retaining the existing definition of "criminal conduct" in section 340 of the Proceeds of Crime Act 2002?

If not, do consultees believe that one of the following approaches would be preferable?

(1) A serious crimes approach, whether based on lists of offences or maximum penalty

(2) Retaining an all crimes approach for the money laundering offences but requiring SARS only in relation to "serious crimes" (to be defined by category and or sentence as discussed above). This could be achieved by extending the reasonable excuse defence to those who do not report, for example, suspected non-imprisonable crimes or those crimes listed on a schedule; or

(3) Providing the opportunity to the regulated sector to draw to the attention of the FIU any non-serious cases, whilst maintaining a required disclosure regime for offences on a schedule of serious offences listed in one of the ways identified above.

We do not agree that the "all crimes" approach should be maintained. The "all crimes" approach has led firms to submit an overwhelming number of DAML SARS to protect themselves in instances where the criminal activity is entirely unrelated to serious crime. It has also required firms to investigate and report on such unrelated matters. We are concerned that this leads to a significant waste of resources both for firms and for the law enforcement authorities, distracting law enforcement resource from those matters which do require due investigation to combat, amongst other things, money-laundering and terrorist financing. We also see a duplication of efforts in sharing information amongst both regulated entities and law enforcement agencies where multiple reports regarding the same matter have to be made and reviewed due to inefficient sharing of key information.

Of the proposals above, we believe that an approach using a defined list of serious crimes would provide the most effective mechanism for the operation of the SARS regime. (We believe that an approach categorising "serious crimes" by their maximum penalty would increase the burden on firms in requiring them to identify the penalty of each offence, leaving a degree of uncertainty, which may not reduce the number of information-poor DAML SARS.) We also agree with the Law Commission's concerns that a maximum penalty or non-imprisonable crime approach may diminish the importance of certain environmental or regulatory crimes.

Therefore, while we note the Law Commission's concerns expressed in the Consultation Paper as to the rigidity of such proposals, we are of the view that it is likely that any perceived disadvantages would be outweighed by the benefits of institutions only submitting SARS in instances of serious crime. Law enforcement could be confident that each SAR reviewed would be able to assist them in building up their picture of serious crime in the UK, rather than spending significant time reviewing DAMLs reporting minor "technical breaches" unrelated to serious crime.

If such lists were to be adopted, we would propose that Government should develop and provide drafts of such lists to industry to assess their viability prior to final publication.

Q. 2. We would value consultees' views on whether suspicion should be defined for the purposes of Part 7 of the Proceeds of Crime Act 2002? If so, how could it be defined?

We would welcome any assistance in interpreting the meaning of "suspicion", whether by way of definition or guidance. Such guidance would assist in designing policies and training for employees to ensure that appropriate activities are reported to the organisation's MLRO and in deciding when it would be necessary to submit a SAR.

Q. 3. We provisionally propose that POCA should contain a statutory requirement that Government produce guidance on the suspicion threshold. Do consultees agree?

We refer to our answer above and would welcome any additional guidance on the suspicion threshold. So as to ensure such guidance is relevant to all sectors, we would propose that any indicative lists were provided in consultation with industry prior to publication.

Q. 12. We provisionally propose that statutory guidance should be issued to provide examples of circumstances which may amount to a reasonable excuse not to make a required and/or an authorised disclosure under Part 7 of the Proceeds of Crime Act 2002. Do consultees agree?

We welcome any proposals for additional guidance as to what may amount to a reasonable excuse not to make a required and/or an authorised disclosure. Such guidance would assist in providing certainty and consequently, in setting out situations where law enforcement has found that DAMLs are not useful, it would mean that firms could take the decision not to submit DAMLs in such circumstances and remove the burden of review from law enforcement.

Q. 18. We provisionally propose that a short-form report should be prescribed, in accordance with section 339 of the Proceeds of Crime Act 2002, for disclosures where information is already in the public domain. Do consultees agree?

We welcome the Law Commission's proposals for a reduced disclosure regime in respect of information already in the public domain. We agree that often private institutions may hold additional information beyond that in the media. However, we note that such disclosures should not, in themselves, impose more onerous requirements on firms in identifying what may or may not be within the public domain.

We would be happy to provide comments on any draft template.

Q. 25. We provisionally propose that statutory guidance be issued indicating that where a transaction has no UK nexus, this may amount to a reasonable excuse not to make a required or authorised disclosure. Do consultees agree?

We support the Law Commission's proposal that there should be no obligation to report where there is no UK nexus. In such cases it is inappropriate to make such a disclosure to the NCA who will have no or limited remit to investigate such activity. Any such disclosure is therefore likely to result in duplicative disclosures to both foreign and UK law enforcement, wasting time and resources. We agree with the proposal that in the situation where a notification must be made to an overseas FIU, it should not be necessary to also submit a SAR in the UK and would welcome guidance to that effect.

We note, however, that were such guidance to be issued, it would be important to provide particular guidance on the precise scope of "no UK nexus".

Q. 29. Do consultees believe that sharing information by those in the regulated sector before a suspicion of money laundering has been formed is: (1) necessary; and/or (2) desirable; or (3) inappropriate?

We note the concerns expressed by the Law Commission in the Consultation Paper. However, we consider that the sharing of certain information by those in the regulated sector is consistent with the effective investigation of suspected money laundering and would reduce duplication in reporting. Under the current regime, a firm would typically submit a SAR without consulting any other parties. This leads to multiple disclosures from the parties to a transaction and means that each party will stall the transaction as they await consent for each of their particular, and likely identical, disclosures. In addition, the NCA will have to review and assess these multiple, near identical, disclosures.

Permitting those parties who are not the subject of the SAR to discuss limited, pertinent information, would prevent unsuspecting parties from continuing to deal with the suspicious party without the risk of committing an offence of "tipping off". Such communications would also allow the relevant parties to assess the relevance of their own information and compile a comprehensive report when providing a disclosure. The NCA would not have to wade through multiple reports about the same transaction to identify any relevant information and could be properly informed of all the circumstances of the transaction.

However, prior to any such disclosure, firms would require statutory relief from both (i) certain statutory and civil obligations to not disclose such information, such as those under the General Data Protection Regulation and Data Protection Act 2018 and contractual confidentiality provisions, and (ii) sanctions under the "tipping off" offences in the Proceeds of Crime Act 2002.

We note that firms may already share information under the framework provided by the Criminal Finances Act 2017 once a SAR has been filed. We would therefore invite the Law Commission to consider whether such disclosures could be made prior to the submission of a SAR and how this regime might be improved or encompassed in any review.

Q. 30. We invite consultees' views on whether pre-suspicion information sharing within the regulated sector, if necessary and/or desirable, could be articulated in a way which is compatible with the General Data Protection Regulation. We invite consultees' views on the following formulations: (1) allowing information to be shared for the purposes of determining whether there is a suspicion that a person is engaged in money laundering; (2) allowing information to be shared for the purpose of preventing and detecting economic crime; (3) allowing information to be shared in order to determine whether a disclosure under sections 330 or 331 of the Proceeds of Crime Act 2002 would be required; or (4) some other formulation which would be compatible with our obligations under the General Data Protection Regulation?

In some instances it is likely to be possible to share certain information without disclosing personal data. Where personal data may need to be disclosed, the wording of the exemption should be appropriately worded to provide relief from any sanctions under the GDPR and/or ensure that any disclosures would not prejudice a subsequent investigation.

Q. 34. Do consultees believe that the consent regime should be retained? If not, can consultees conceive of an alternative regime that would balance the interests of reporters, law enforcement agencies and those who are the subject of disclosures?

We are of the view that the current consent regime should be maintained. This regime provides an essential defence to permit legitimate business activity, particularly given the "all crimes"

approach, due to which private equity and venture capital deals will often carry a risk of a section 328 breach, as potential portfolio companies may hold the "proceeds of crime" flowing from non-serious offences. We do not consider any of the other approaches considered in the Consultation Paper to be appropriate for firms in balancing their risk of prosecution under s.328 Proceeds of Crime Act 2002. If the consent regime were to be removed, the only way to overcome such risk would be to repeal s.328.

37. Do consultees believe that consideration should be given to a new offence whereby a commercial organisation would be criminally liable for their employees or associates failure to report suspicions of money laundering or terrorist financing?

We understand that the Ministry of Justice is yet to complete their consultation on reform of the law on corporate liability, particularly whether the "failure to prevent" or "strict vicarious liability" models should be extended to apply to money laundering and would refer to the findings of such consultation once completed. However, the need for such offences should not be considered a general response to all economic crimes and it should be considered whether such an offence would address any perceived failings in the context of each particular regime. Such review should also balance any perceived benefits against a greater burden and risk on institutions and any effect that such offences might have on particular industries.

We would be concerned that any such corporate offence may risk blurring the responsibility of appropriate individuals within a commercial organisation to report such suspicions. In addition, responsible private equity and venture capital firms may be reluctant to invest in "difficult" firms or sectors where the risk is higher, particularly if investors become liable for actions prior to the change in ownership.

Therefore, while we understand the Law Commission's move to consider such an approach, it is not clear to us whether such a change would be helpful.

38. Do consultees believe that consideration should be given to introducing an offence for a commercial organisation to fail to take reasonable measures to ensure its associates reported suspicions of criminal property?

Without prejudice to our answer at 37 above, we would support the implementation of a consistent approach across the various "failure to prevent" offences, including the introduction of a corresponding defence similar to those for other such offences.

Additional Guidance

In any instance where proposed amendments to the current regime would be implemented, we would welcome further guidance as to the meaning and/or application of such changes.

We would be very keen to discuss the contents of this letter with you. Please do not hesitate to contact me at tim.lewis@traverssmith.com, if you have any questions.

Yours faithfully,

Tim Lewis

Chair, BVCA Regulatory Committee