HM Treasury

By email: FRF.Review@hmtreasury.gov.uk

19 February 2021

Dear Sir/Madam,

BVCA response to HM Treasury consultation on the Financial Services Future Regulatory Framework Review Phase II

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), the industry body and public policy advocate for the private equity and venture capital ("PE/VC") industry in the UK.[1] Our response to this consultation follows feedback we have provided to the Government in other representations.

Our industry's central message is that the UK is home to a world leading PE/VC fund management industry, in part due to the world-class legal and regulatory standards that global institutional investors demand, and that these robust standards must be maintained as the cornerstone for the future of financial services in this country. At the same time, the UK cannot afford for its regulatory framework to become ossified, given the fierce competition between jurisdictions to attract PE/VC fund management activity and the host of political, environmental and societal challenges to which regulation must continually adapt in order to remain effective. Competition and change mean that the future of UK financial services regulation must be dynamic.

PE/VC fund managers require access to investors, transactions and talent. The UK regulatory regime must also facilitate this, whilst providing appropriate protections to investors.

With this in mind, we would like to make the following points, from the perspective of the PE/VC fund industry, on some of the broad themes raised by the consultation.

1. **Non-legislative improvements**

   Much can be done to improve the effectiveness of existing and future UK regulation for PE/VC fund management firms, whilst maintaining robust standards, by making changes to the way firms are supervised by Government and the regulator. From a PE/VC perspective, these include:

   - **"Alternative Assets Competitiveness Unit"**: We urge the Government to establish a cross-departmental centre of excellence with a detailed understanding of the alternative assets sector. Its mandate would be to ensure the UK retains its position as a competitive jurisdiction for our industry and can support firms to succeed on the global stage. This unit would review ongoing changes to UK and international legislation relevant for PE/VC funds (and other 'alternative assets'). It could support

[1] With a membership of over 700 firms, we represent the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers and investors. Between 2015 and 2019, BVCA members invested over £43bn into nearly 3,230 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 972,000 people in the UK and the majority of the businesses our members invest in are small and medium-sized businesses.

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firms' international activity by driving the operational effectiveness work (highlighted immediately above); 'joining the dots' between regulatory, legal and tax policies and legislation to ensure they are fit for purpose for 'alternative assets' (rather than undermining competitiveness due to a 'one size fits all' approach to financial services); ensuring appropriate positioning of the UK's 'alternative assets' ecosystem overseas, to support the UK as an investment destination; reviewing proposals for changes in other areas which may adversely impact the overall package of law and regulation applying to PE/VC firms in the UK; strengthening existing, and creating new, bilateral arrangements with countries (alongside comprehensive trade agreements), and directing firms towards these opportunities. This work would assist firms with activities like international fund marketing (to professional and sophisticated investors) and the unit could support firms in other ways, such as implementing processes that facilitate greater supervisory co-operation (e.g. organising confirmation letters of a firm's regulatory status). This unit should also ensure that changes proposed in the UK in one area do not negate those proposed in another (as we have seen in respect of limited partnership law, where HMT provided clarity via the new Private Funds Limited Partnership regime in 2017, whilst BEIS simultaneously initiated a review (that is still ongoing) on limited partnerships).

- **Supervisory efficiency and speed to market:** Without changing any regulatory rules, the UK can quickly boost the competitiveness of the UK business environment for PE/VC firms by improving operational processes and procedures at the FCA. Simply reducing turn-around times for notifications would increase the attractiveness of the UK and reinforce the message to global investors, in a highly visible way, that the UK provides a friendly environment in which the global PE/VC investment community can run their businesses efficiently. Improved technology and systems could play a part in these developments. Targeted improvements should include reducing processing times for:

  - Approving individuals as senior managers or approved persons
  - AIFMD 'new fund under management' applications
  - AIFMD 'material change' notices
  - 'Change in control' applications

2. Potential changes to existing financial services regulation affecting PE/VC firms

Much financial services regulation rightly concerns trading in listed securities. The core activity of PE/VC firms covers buying, building and selling private companies. Regulation developed for the traditional asset management sector will not always be appropriate for alternative asset managers (and vice versa). The two sectors have much in common but also many differences. Future regulatory requirements should be tailored accordingly.

There are a number of areas where improvements could be made to current and in-train UK rules and legislation. We refer to the proposed Investment Firms Prudential Regime ("IFPR") and sustainability regulation below and there are other pieces of existing regulation that should be better calibrated for the UK context (as has been suggested in the review of Solvency II and concerns raised regarding PRIIPs). Any future UK review of onshored EU legislation should identify where there is scope to modify the UK's detailed interpretation of EU rules to suit the UK market better, while maintaining compliance where possible. Certain EU rules as implemented in the UK may require and be capable of modification without risking prejudice to EU equivalence assessments e.g. certain notification requirements in AIFMD during the fund marketing process.

The UK should also re-assess areas where it has gone further than EU legislation required ('gold plating'), or taken an implementation approach which makes compliance with the law as stated difficult. For instance, we have previously raised concerns about the UK's implementation of the fourth Money Laundering Directive insofar as it relates to trusts; a common law concept rarely used in most of the EU.

Previous approaches to implementing EU law which assisted the UK in the context of supporting single market access into other EU member states may now need to be revisited now this access is no longer available. There is a real possibility that the UK will apply much tougher regulation to "adviser/arranger" firms than EU jurisdictions, through the UK's implementation of "on-shored" and forthcoming EU law.

The UK is a leader in developing regulatory standards. Future regulatory requirements should be proportionate and clear, but any changes to the UK's regulatory framework should only be made with great care. International investors trust effective and robust regulation, and the UK should not position itself as a "lightly regulated" jurisdiction.

3. Maintaining international norms

Regulatory trends, in areas such as prudential and sustainability regulation, are very often global. The UK should continue to make a leading contribution to and remain within international norms, whilst implementing rules in ways that recognise specific characteristics of the UK market and support the continued success of firms that choose to base themselves here. We have highlighted the following specific areas relevant to PE/VC firms:

- **Prudential rules for investment firms:** We welcomed the Financial Services Bill, as it seeks to implement the IFPR in a way tailored to the specificities of the UK market, whilst maintaining world-class prudential standards. With respect to implementation, we also welcome the FCA's proposals for a transitional period for MiFID adviser/arrangers (omitted in the EU text), and the longer implementation timeframe. Nevertheless, we urge the FCA and the Government to revisit the regulatory classification and treatment of UK PE/VC MiFID adviser arrangers, because EU Member States' approaches to similar firms put the UK at a competitive disadvantage (i.e. where similar activities are not licensed).

- **Effective sustainability regulation:** PE/VC firms are well-placed and incentivised to integrate climate and broader sustainability considerations into their operations. The Government and the FCA must support and encourage the transition to a carbon-free economy by ensuring UK sustainability regulation for private markets investment is both proportionate and focusses on materiality, whilst remaining compatible with international frameworks including the evolving EU disclosure regime. We have raised concerns about the EU's Sustainable Finance Disclosure Regulation with HMT and need clarity on the UK's approach to regulation covering sustainability-related financial disclosure (beyond the TCFD Roadmap).

- **Avoiding conflicting rules:** One of the challenges of formulating regulatory policy is the risk of creating rules in one jurisdiction which conflict with legitimate rules in another. This creates challenges and costs for international fund managers and their investors. These challenges can often be addressed through pragmatic approaches to implementation and dialogue between international regulators.

4. The right frameworks for fund vehicles and investors

The comments above relate primarily to the UK regulatory and supervisory environment for fund management and advisory firms. The UK should also take steps to make it more attractive for PE/VC firms to use UK-domiciled fund vehicles, and to attract investors to invest in those vehicles and locate in the UK:

- **Optimising UK fund vehicles:** We welcome and are engaging with HMT's review of the UK funds regime, which has the potential to improve to the UK's funds toolbox, and will in particular explore the potential of Long Term Asset Funds. However, the key vehicle for UK PE/VC funds is the UK limited partnership, and we need an expeditious conclusion to BEIS' proposed reforms to UK limited partnership legislation that, amongst other things, avoids jeopardising the limited liability status of investors. The ongoing uncertainty associated with the proposals (first put forward over three years ago) is having a significant impact on the UK's attractiveness as a domicile for PE/VC funds.

- **Attracting investors to the UK:** The Government should also consider new incentives which promote a commercially-attractive and predictable tax, legal and regulatory environment that will encourage PE/VC investment in, and through, the UK. This agenda should include measures designed to attract both EU and other global investors to establish a presence in the UK, taking advantage of the UK's position as an international hub for capital flows and its open approach to investment.

- **Defined contribution pension and semi-professional investment in illiquid assets:** The BVCA is very supportive of the steps being taken to address the barriers preventing DC pension savers and sophisticated individual investors from investing in long-term, illiquid assets. We are participating in the HMT, BoE and FCA working group to facilitate investment in productive finance, to which we bring the PE/VC industry's expertise in investing in long-term illiquid assets. In parallel, another significant barrier to DC investment into PE/VC funds must be addressed; the calculation method for the 0.75% charge cap applied to the default arrangements of DC pension schemes must be changed to accommodate the long-term nature of incentive models like carried interest, which align both with both investors' returns and investee companies' growth.

We would be happy to discuss the contents of this letter with you; please contact Tom Taylor (ttaylor@bvca.co.uk).

Yours faithfully,

Tim Lewis
Chair, BVCA Regulatory Committee