Consultation on Transposition of 4MLD
Sanctions and Illicit Finance Team
1 Blue, HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

By email: aml@hmtreasury.gsi.gov.uk

11 April 2017

Dear Sir or Madam

Re Response to HM Treasury's consultation on the transposition of the Fourth Money Laundering Directive (4MLD) and the draft Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 (the Regulations)

The British Private Equity and Venture Capital Association ("**BVCA**") is the industry body and public policy advocate for the private equity and venture capital industry in the UK.

With a membership of over 600 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 and counter-terrorist finance ("**AML/CFT**") regime is relevant to the private equity industry in a number of ways. Private equity fund managers are FCA regulated and will be caught by the Regulations as a 'financial institution'. In addition, companies in which private equity invests are part of the real economy and are directly impacted by the measures put in place by credit institutions to comply with the AML regime, including the requirements relating to correspondent banking.

BVCA welcomes the opportunity to respond to the Treasury's consultation on the draft Regulations and is highly supportive of the Government's intention to transpose 4MLD in an effective and proportionate way, which is tailored to the different sectors of the FS industry.

BVCA's view is that flexibility must be expressly drafted into the Regulations to enable firms to take an appropriate risk based approach to AML and avoid a rigid "tick box" methodology to Customer Due Diligence ("**CDD**").

We set out some general remarks on the Regulations in sections 1 – [5] below. Appendix 1 contains BVCA's responses to HM Treasury's further questions.

1. Customer due diligence

BVCA is generally supportive of the risk based approach to CDD in the Regulations.

However, Regulation 28 introduces onerous obligations in relation to corporate customers. It is unclear how the risk based approach in Regulation 28(12) is to be applied in practice, given the duty to exhaust "all possible means" in Regulation 28(7) and the phrasing of the obligation to "obtain and verify" in Regulation 28(3).] In our view the Directive is clear that the risk based approach is capable of overriding the other parts of Regulation 28. We also note that the definition of "senior management" in Regulation 19(7) does not fit with its use in Regulation 28(3). Further clarification in relation to these provisions would be welcomed by BVCA's members.

BVCA notes that Regulation 28(4) also contains a drafting inconsistency in that it contemplates that persons other than natural persons might be beneficial owners. This provision could be clarified to read "If the beneficial owner holds his interest in a customer indirectly through a legal person, trust, company, foundation or similar legal arrangement the relevant person shall take reasonable measures to understand the ownership and control structure through which the beneficial owner holds his interest in that customer".

2. Trusts: beneficial owners

BVCA recognises that the Government must implement the provisions of 4MLD in accordance with its terms. However, one consequence of the expanded definition of beneficial owner in the context of a trust may give rise to potentially unintended and highly onerous consequences which we do not believe have been anticipated during the consultation phase so far.

As drafted, any beneficiary of a trust will be a beneficial owner, as will the settlor, the trustee(s) and any individual who has control over the trust. The inclusion of the category of beneficiary is new and is not in itself defined. However, it is clearly a separate category from (and therefore distinguishable from) an "individual who has control over the trust".

This is to be contrasted with the current position under the MLRs 2007 where the definition of beneficial owner in the case of a trust means (a) any individual who is entitled to a specified interest (i.e. a vested interest in possession or remainder/defeasible or indefeasible) in at least 25% of the capital of the trust property or, (b) as respect any trust other than one which is set up or operates entirely for the benefit of individuals falling under (a), the class of persons in whose main interest the trust is set up or operates, or (c) any individual who has control over the trust.

The trustee of a relevant trust will be required to keep accurate and up-to-date records of all beneficial owners, including all beneficiaries and, if the trust is a taxable relevant trust will also have to provide information to the Commissioners of HMRC, including information on the beneficial owners, for the purposes of the central register.

BVCA welcomes the overall moves to improve the transparency of trusts and trust-like legal arrangements. However, we believe that from a Customer Due Diligence perspective some proportionality is required. Expanding the beneficial owner identification obligations beyond 25% to all beneficial owners, with no *de minimis*, is likely to create significant problems in the UK. The UK uses the trust concept far more than other European Union member States.

This new expanded definition makes little or no sense in the context of significant trusts with a very large number of natural persons who may be described as "beneficiaries" but who have no vested interest in the trust property and do not have any meaningful control over the trust. It

would be helpful, for instance, to make clear that beneficiaries of occupational pension schemes are not caught by this requirement.

BVCA believes that a clarification to the definition of "beneficial owner" in Regulation 6 would help. For instance, this could be by way of an amendment to the definition which makes an express reference to occupational pension schemes [and other trusts with a large number of beneficiaries] enabling the relevant firm, in carrying out its CDD measures in relation to such trusts, to treat the beneficiaries as a class and to take appropriate steps to identify that class:

"the beneficiaries, or where the individuals benefitting from the trust (i) have not been determined or (ii) are the pensioners in a pension scheme arrangement, the class of persons in whose main interest the trust is set up, or operates"

The term "pension scheme arrangement" could be separately defined by reference to the IORP Directive (Directive 2003/41/EC) and to other authorised and supervised entities, or arrangements, operating on a national basis, which are not IORPs but which are recognised under national law having as their primary purpose the provision of retirement benefits.

3. Correspondent banking

BVCA remains concerned that the provisions on correspondent banking in the Regulations allow for insufficient risk differentiation and may unduly and unnecessarily restrict the PE industry.

The definition of “correspondent relationship” in regulation 34(6) is now extremely broad and in BVCA’s opinion risks delaying legitimate PE transactions which in reality are very low risk. A proportionate and flexible application by banks will be essential.

However, it remains somewhat unclear how the new Regulations meet HM Treasury’s stated intention to incorporate a measure of flexibility to avoid unnecessary drag on the real economy. HM Treasury has indicated in its consultation response that it has provided for flexibility by taking account of sector assistance in the new regulations and that it will work with sectoral guidance drafters to ensure such issues are taken into account. Nevertheless, the construct of Chapter 2 overall is prescriptive and in BVCA’s opinion, allows little room for manoeuvre for a cautious and prudent bank.

4. Reliance on third parties

In its consultation response, the Government expresses the wish to tackle the barriers to firms using reliance. In the PE industry where transactions can be complex and involve multiple stakeholders there may be some reliance by PE fund managers upon banks and other firms conducting CDD on wider business relationships (outside the immediate regulatory relationship between the PE manager and its client). The BVCA previously indicated that it supported the UK implementing the provisions in 4MLD on reliance as they were drafted, avoiding unnecessary and costly gold-plating.

In BVCA’s view the current drafting in Regulation 38 only goes part way to achieving this and leads to a somewhat unsatisfactory and illogical regulatory outcome.

Regulation 38 is structured to allow reliance in two different ways. Regulation 38(1) allows a firm to rely upon the CDD of another party and Regulation 38(7) allows a firm to outsource CDD to another party. The requirements associated with each are different, but the liability of the firm remains exactly the same. Under Regulation 38(1), the firm "remains liable for any failure" to apply CDD measures but various obligations must still be met. By comparison, under Regulation 38(7) no requirements apply, even if the outsourced service provider is a completely unregulated third party but again the outsourcing must provide for the firm to "remain liable for any failures".

BVCA's view is that this drafting is unsatisfactory. That no requirements should apply when outsourcing to a completely unregulated firm which is not subject to the Regulations, while more onerous obligations arise when delegating CDD duties to a firm which is already regulated for AML purposes and may be undertaking CDD in any event, could appear illogical, unless the liability of the firm is not the same in each case. In BVCA's view the more stringent requirements in Regulation 38(2)-(6) should compensate for a corresponding reduction in liability for the relying firm. This approach would also be consistent with 4MLD which indicates that a firm may rely provided that "ultimate" responsibility rests with it. This connotes, in the first instance, a shared duty which is not mirrored in the Regulations. Regulation 38(1) simply states that the relevant person remains liable for "*any*" failure.

The drafting in this provision also gives rise to uncertainty. If a third party meets the requirements in Regulation 38(3), can it still be an outsourced service provider within Regulation 38(8), avoiding the requirements of Regulation 38(2)? Similarly, could a firm within Regulation 38(4) from a high risk third country still be appointed as an outsourced service provider within Regulation 38(8)? It appears the answer to both these questions is yes but again, the policy rationale for this is unclear. Nor is it clear how a firm should demonstrate that Regulation 38(7) is being applied (and hence that there is no breach of the other provisions in this Regulation).

5. Record keeping

Regulation 39 sets out different periods of record retention depending on whether a firm collects CDD to meet its own CDD duties (Regulation 39(3)) or is being relied on by another firm to keep records (Regulation 39(5)), with a shorter period of retention potentially arising in the latter case.

This is also somewhat unsatisfactory in view of the liability structure in Regulation 38, as discussed above. It appears the Regulations incorporate a lighter record keeping duty for the third party whilst maintaining full liability for the longer retention period for the firm which appoints it. The drafting is also unsatisfactory for the third party, as the effect of Regulation 39(6) is that a firm which is subject to the shorter record retention period in Regulation 39(5) may nevertheless be required to provide CDD information to another firm based upon the longer period in Regulation 39(3) even though it may not know when that period will expire, because this will depend on the date of termination of another firm's business relationship.

6. PEPS

BVCA welcomes Regulations 47(1) and 47(2)(e) which provide for a less rigid approach to PEPs in appropriate circumstances. BVCA would welcome further clarity as to how these provisions interplay with Regulation 33(7) which requires financial institutions to take due account of any guidelines issued by the European Supervisory Authorities.

We would be very keen to discuss the contents of this letter further with you and please contact Gurpreet Manku (gmanku@bvca.co.uk) at the BVCA to arrange a meeting.

Yours faithfully,

Tim Lewis
Chair, BVCA Regulatory Committee

Appendix 1

Company formation

The government is interested in views on its approach to one-off company formation, including under which circumstances it might be appropriate, as part of the risk-based approach, for a trust or company service provider to apply simplified due diligence where it concerns the formation of a single company.

The BVCA supports the application of simplified due diligence where a trust or company service provider is conducting one-off company formation.

Pooled accounts

The government welcomes views on its approach to allow SDD only when firms providing pooled client accounts are low risk.

The BVCA has no comments on this proposal.

Reliance

The government would welcome views on whether the reference to "at the latest within two working days" should be included and if not, how long third parties should be given to provide this information.

BVCA does not consider that the inclusion of this provision will materially reduce the barriers to firms' use of reliance. Our wider comments on Regulation 38(1) and how this provision interacts with a firm's use of an outsourced service provider in Regulation 38(7) are set out overleaf.

Policies, controls and procedures

The government would welcome views from the sector on the requirement for the policies, controls and procedures to be documented.

BVCA agrees that such systems and controls should be documented in writing whether in electronic or hard copy form. In BVCA's view, this is consistent with current FCA Handbook requirements.