January 2025
BVCA responses to consultation on SWF exemption

The BVCA is the industry body and public policy advocate for the private equity and venture capital (private capital) industry in the UK. With a membership of over 600 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and investors. In 2023, £20.1bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized businesses.

Thank you for your opportunity to engage on this topic. We have responded to the questions set out by the Home Office below and welcome further engagement.

1. **Are there any other characteristics (in addition to those listed within the conditions) which are possessed by sovereign wealth funds / public pension funds? We are particularly interested in any characteristics which are unique to sovereign wealth funds / public pension funds, as opposed to other investment entities.**
   - The five conditions are characteristics of SWFs, however, it may be worth revising these, as follows:
     - **Condition 4**: to ensure that the funding sources/types are not overly narrow:

       "*Condition 4: that the principal source of funds for the investment by the SOI is the foreign power* (including but not limited to the balance of payments surpluses, official foreign currency operations, the proceeds of privatisations, fiscal surpluses, and/or receipts resulting from commodity exports)"

     - **Condition 5**: to account for the fact that not every SWF has a single purpose – many SWFs combine two or more purposes/functions (e.g. stabilisation, savings, development), but are encompassed within overarching financial objectives – this may also serve to ensure that the word 'benefit' is not interpreted too broadly:

       "*Condition 5: that the sole purpose of the investments is to* achieve financial objectives for the *benefit the foreign power or its people (including through the payment of pensions to government employees)*"

     The amendments/refinements above are consistent with the IMF International Working Group on Sovereign Wealth Funds' definition/characteristics of SWFs in Appendix 1 to the 'Generally Accepted Principles and Practices for Sovereign Wealth Funds' (GAPP), also known as the 'Santiago Principles'.

   - As noted in response to question 3 below, in practice it will be challenging (and sensitive) for PE/VC firms to ascertain with certainty the extent to which a given SWF/PPF meets any of the five Conditions, and seeking detailed information as regards the decision-making/objectives of the SWF/PPF may (in itself) serve to deter legitimate investment activity by those SWF clients.

2. **Are you aware of any sovereign wealth funds / public pension funds which you believe are affected by FIRS and would not benefit from condition 4 as currently drafted, as they receive the majority of their funding from sources other than the foreign power? If so, please provide further details of the funding sources of the entity including, if possible, details of the proportions of funding which come from each source.**
   - No

3. **Do you have any other feedback on the scope of the proposed exemption?**
   - The draft exemption for state-owned sovereign wealth funds ("**SWFs**") and public pension funds ("**PPFs**")) proposes to exempt SWFs/PPFs from the Political Influence Tier insofar as their political influence activities are directly connected with their investments in the UK. This exemption is stated to have been designed to signal that the UK remains open to engagement with SWFs/PPFs and aims to ensure that these funds are not deterred from engaging with the UK Government on matters related to their investments.
   - Yet, the exemption for SWFs/PPFs expressly does <u>not</u> apply to the Enhanced Tier, which is the tier that:
     - is most problematic for the private equity/venture capital ("**PE/VC**") industry;
     - entails disproportionate burdens as regards legitimate foreign investment activity; and
     - is most likely to deter SWF/PPF investment in the UK.
   - In light of the above, we make the following observations:

     a) Utility of the exemption from the Political Influence Tier may be minimal in practice
     - Failing to extend the exemption to the Enhanced Tier is likely in practice also to reduce the utility (and/or use) of the exemption for the Political Influence Tier, since SWFs/PPFs are likely to be deterred by the burdens and additional publicity/lack of confidentiality associated with the Enhanced Tier from making investments in the first place. There will be little need for such sovereign/pension investors to engage with the UK Government about their investments if there are no investments or commercial activities about which to engage.
     - It is also arguable that the exemption for the Political Influence Tier will be of fairly modest utility in any event, because the SWFs/PPFs that are inclined to engage in political influence activities *<u>directly related to their investments</u>* are very likely also to engage in political influence activities *<u>generally</u>* (e.g. regarding UK foreign policy), and would therefore be required to register with the FIRS under the Political Influence Tier in any event.

     b) Rationale re linkage transparency applies equally to both tiers, but the exemption does not
     - The Word document regarding the proposed exemption states that the reason for exempting SWFs/PPFs from the Political Influence Tier is that "*the link between* [SWFs/PPFs] *is generally already transparent, meaning that there is minimal benefit in requiring them to register with FIRS.*" This rationale is echoed in the PowerPoint deck.

- Yet, it is not clear why this same linkage transparency and reasoning does not also apply to substantiate an equivalent exemption in respect of the Enhanced Tier to exempt the commercial/investment activities carried out in the UK at their direction (e.g. investment activity), in respect of which the burden and deterrent effect will be disproportionate and bring little to no benefit to, or intelligence value for, the UK government, without advancing the aim of tackling covert and/or malign foreign influence.

c) Lack of clarity around whether SWF/PPF engagements fall within definitions in the Enhanced Tier Guidance

- As noted in our response to the draft Enhanced Tier Guidance previously, it would be useful to clarify (by way of guidance or case studies) whether a foreign state's investment in PE/VC fund structures, which typically occurs by way of limited partnership (i.e. where the foreign state's investment entity/SWF becomes a limited partner in the PE/VC fund partnership vehicle alongside other limited partners/investors):
  - falls within the meaning of "partnership" in the following statement: "*Commercial activities carried out in partnership with private companies do not require registration*." (p.10, draft Enhanced Tier Guidance); or
  - would constitute "carrying out activities which are solely commercial in nature" in the following statement: "[...] *In the majority of cases, those carrying out activities which are solely commercial in nature would have no reason to know that they were acting pursuant to a registerable arrangement. Where that is the case, the person may continue with their activities without taking any action to comply with FIRS*." (para. 64, draft Enhanced Tier Guidance)

d) Ongoing uncertainty in relation to SWF/PPF investment activity

- In the absence of any form of Enhanced Tier exemption for SWFs/PPFs, and notwithstanding the draft sector and general Guidance provided to date, there remains considerable uncertainty as regards the FIRS obligations associated with SWF/PPF investment activities (for PE/VC firms and for the sovereign/pension investors themselves). Quite apart from the unattractive publicity and administrative burdens associated with FIRS registration, the very existence of such legal uncertainty is liable to lead SWF/PPF investors to favour other jurisdictions when all other factors are equal or finely balanced.
- By way of example, particular uncertainty remains as to:

  (i) <u>Anticipated scope of specifications</u>, and particularly:
  - the sorts of circumstances that may lead the Secretary of State may specify a foreign power or foreign power-controlled entity (FPCE) "*reasonably necessary [...] to protect the safety or interests of the United Kingdom*" for the purposes of either tier; and/or
  - (for the purposes of the Enhanced Tier) whether the Secretary of State will take a targeted approach to specifying the "relevant activities" in scope, or whether the default or common approach will be that "all relevant activities" are specified.

(ii) *How much notice and/or transition time* will be provided for compliance by PE/VC firms and/or SWFs/PPFs once the Secretary of State issues regulations specifying any foreign power or FPCE. If the existing ten (10) calendar day period (per s.65(4) of the Act) applies from the date of specification, this would be unreasonably short and very challenging for PE/VC firms, who would need to conduct assessments of a significant volume of pre-existing investment commitments and arrangements.

e) (Enhanced Tier) Risk of over-compliance due to inability to determine whether registration is required

- While Chapter 10 of the draft Enhanced Tier Guidance is useful, in the PE/VC context and in practice/reality, it will often be difficult (and sensitive) for PE/VC firms to request (or receive responses providing) information from the state-owned or state-controlled entity (e.g. a SWF or PPF) with the level of detail referred to in the scenarios for determining whether the registration obligation is triggered (i.e. whether Condition 2 in the Political Influence Guidance or the SOI Conditions outlined in the SWF exemption materials are met), such as:
    - which appointees on the board (or relevant delegated/investment committee) of a SWF/PPF are acting at the direction of the government/foreign power;
    - the identities of the members of the board (or relevant delegated/investment committee) who voted in favour of making the investment in the PE/VC firm's investment fund/program; and/or
    - whether the investment serves the foreign government's interests beyond its commercial interests.

- To the extent that such detailed and sensitive information about the inner workings of the SWFs/PPFs' decision-making is either not available or not forthcoming from relevant SWF/PPF clients, PE/VC firms are likely to over-comply and register unnecessarily with the FIRS, which will not only be burdensome for our PE/VC members, but also result in a significant volume of registration activity and tie up limited government resources without advancing the aim of tackling malign foreign influence.

f) Sector or industry-focused specification approach:

- In light of points (d) and (e) above, and given that the Secretary of State's specification of foreign powers/FPCEs and 'relevant activities' will effectively act as the primary limitation on the application of both tiers, it is submitted that a considerable degree of uncertainty and over-compliance could be mitigated by ensuring that such specification – particularly as regards 'relevant activities' – is confined to industries/sectors/products that have a clear national security significance or nexus (e.g. sensitive technologies, nuclear or defence sectors, etc.) or which are a source of particular national security or strategic concern pertaining to the particular foreign power/FPCE in question.