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By email: stewardshipcode@frc.org.uk

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Re: BVCA response to FRC Stewardship Code review

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 620 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.

With stewardship being inherently integral to the private capital space, we welcome the opportunity to respond to the proposed revision to the UK Stewardship Code ("the Code"). We would argue that stewardship within the private capital industry is more targeted and engaging than is necessarily the case for public companies. This is because of the ongoing active ownership model and the fact that stewardship is tailored to reflect the investment focus. Continued engagement with the investors in private capital and effective stewardship and corporate governance frameworks in the businesses in which our members invest is a vital aspect of the private capital investment model. This is supported by the BVCA's Creating Sustainable Growth Factsheet which shows high levels of governance adoption rates by small and medium-sized companies (between 70% and 90%, based on the governance topic). Across the private capital industry, a range of stewardship, reporting and responsible investment practices have developed to meet increasingly elevated standards and to align with investor expectations. These include mechanisms to help align interests by focusing on long-term sustainable value, ensuring compliance with reporting requirements set by fund governing documents and adhering to industry guidance and initiatives. Strong governance is also a core aspect of the private capital model when investing in portfolio companies and we have previously shared our experiences with the FRC through our involvement in the development of the Wates corporate governance principles for large private companies and the refresh of the Walker Guidelines in 2024.

Considering the stewardship practices inherent in the private capital ownership model, we maintain that the Code is less applicable to private capital firms as adopting it would result in duplicative reporting requirements, albeit in a different form, with limited benefit. Furthermore, across our membership a small number of firms (less than 5% of our members) use the code, some of whom are providing a range of services and may have multi-asset strategies, rather than focusing specifically on private capital fund investment. This is due to private capital managing and demonstrating specifically tailored methods of governance and stewardship, as mentioned.

We further welcome the steps that have been taken by the FRC to reform the Stewardship Code for private markets but still hold the opinion that the Code is not, overall, compatible with private capital. Specifically, the Principles on Engagement, Collaboration and Escalation together with expectations around reporting are not immediately compatible with the private capital investment model which is predicated on alignment of interest and positive engagement through direct investment. Although we do not feel the Code is as applicable overall for private capital, we would be happy to support with any specific guidance or "how to" prompts from a private capital perspective. Furthermore, given the importance of stewardship and the fact that a small number of firms within our membership are signatories to the Code, we have provided our views on the questions in the consultation.

Our response to the consultation has been structured as follows:

1. The private equity and venture capital model: This section sets out further background information about the private capital investment model.
2. Stewardship and governance in the industry and industry publications: This summarises the good stewardship and governance practices in place and publications developed by the industry on professional standards and responsible investment.
3. Response to questions in the consultation paper: Drawing on the background information provided in the preceding sections, in this section we provide our responses to the questions found in the consultation paper. We have only provided answers to questions which are of specific relevance to our members.

1. The private equity and venture capital (private capital) model

Private capital firms are long-term investors, typically investing in unquoted companies (often referred to as "portfolio companies") for around three to seven years. This is a commitment to building lasting and sustainable value in business.

1.1. How private capital firms structure their funds with investors

A private capital fund is typically structured as a limited partnership, created through detailed negotiation between investors (the "limited partners" or "LP") and the private capital manager (also known as the "general partner" or "GP") and their legal advisers. This results in a governing document (for example, the limited partnership agreement or "LPA") that sets out the key terms of the fund. In advance of making a legally binding investment, the governing documents are heavily negotiated between private capital firms and their investors and professional advisers.

The private capital firm owns the general partner (one of the partners in the fund) and the fund manager, which manages the fund. Private capital firms are regulated by the Financial Conduct Authority in the UK and subject to various reporting and disclosure requirements, including under the Alternative Investment Fund Managers Regulations.

Investors make commitments to invest in the fund, i.e. the amount they originally agree to subscribe to the fund. The amount committed is not paid immediately on a fund's closing but in tranches over the commitment period on an "as needed basis" (typically four to seven years).

Investors in private capital funds are typically institutional and sophisticated investors. This includes pension funds, university endowments, insurance companies, sovereign wealth funds, fund of funds, corporate investors and private individuals. Further detailed information on the investor base can be found in our annual survey.[1]

1.2. How private capital firms invest

The fund invests in a number of unlisted portfolio company operating groups, typically aiming for a measure of diversification by geography, sector, etc.

In many cases, the fund will take a controlling position in the equity of the holding company (but this varies between private equity and venture capital strategies). Members of the management team of the portfolio company itself will often also have a shareholding to incentivise them and align their interests to those of the fund to promote lasting and sustainable value.

Third party banks may lend to each portfolio company group. There is typically no cross-collateralisation or exposures between one portfolio company group and any of the others. Each investment is in its own silo, separated from the others.

[1] BVCA Report on Investment Activity 2023 – available here

1.3. How interests are aligned between private capital firms and their investors

Fund profitability
Profits are achieved by the fund only on the successful realisation of the fund's investments, which arise on the sale of the portfolio company or following proceeds received from dividends or as a result of its initial public offering on a listed market. Profits are only achieved when total distributions (investor returns) exceed total contributions (investor's drawn capital) i.e. investor cash out exceeds investor cash in. Fund profits for the purpose of paying out distributions are therefore realised and real (as opposed to being based on accounting valuations). Typically, proceeds received by a fund are distributed in a timely fashion to investors and are not held within the fund pending a fixed distribution date sometime in the future.

Carried interest
Carried interest is a fundamental element of economic incentivisation in private capital structures. The detailed terms of a particular fund's carried interest structure are agreed by the investors and fund managers and set out in the fund's governing document. To ensure alignment with their interests, investors expect key executives and key members of the investment team to be part of the carried interest-based arrangements.

Investors must receive back from the fund in cash an amount equal to their drawn down commitments (the amounts they pay in to the fund at the time the distribution is being made) plus a preferred return on this amount. Only then does the carried interest vehicle start to participate in a percentage of the profits. After this preferred return has been reached, profits are allocated in accordance with a pre-determined formula agreed with investors and set out in the fund governing documents. In other words, carried interest operates on a cash to cash (realised profits only) basis. It does not pay out based on accounting valuations.

Co-investment
Co-investment by private capital executives is often also required by investors and to promote alignment of investor interests and those of the team, by ensuring that the investment team has "skin-in-the-game" alongside investors. This means those team members put at risk the loss of their own money through their personal investment in the fund (typically held through a co-investment vehicle).

2. Stewardship in private capital and industry publications

Delivering sustainable value for beneficiaries is at the heart of private capital investment. Regular, high-quality engagement, and clear alignment between private capital firms and their investors is a key component of the investment model. Furthermore, a robust track record is key for private capital firms to successfully raise capital from investors for future funds. This is reflected in various aspects of the private capital model, as well as industry publications and it is for this reason that the Stewardship Code is not largely being followed.

2.1. Relationship between private capital firms and their investors

When seeking to raise a new fund, private capital firms will share with prospective investors an Information Memorandum, which sets out the key details of the fund, such as the investment policy of the fund. During this period, investors will undertake their detailed due diligence of the private capital firms. This covers many areas including:

- information on the PE/VC firm
- investment strategy and processes
- key members of the PE/VC firm and how interests are aligned
- fund terms
- governance/risk/compliance
- environmental, social matters
- track record
- accounting/valuation/reporting
- legal/administration
- diversity and inclusion

To aid investors with their due diligence, the Institutional Limited Partners Association ("ILPA") has a developed a model due diligence questionnaire to aid investors with their due diligence.[2] Separately the Principles for Responsible Investment ("PRI") has developed a due diligence questionnaire to establish dialogue between investors PE/VC firms specifically on ESG matters.[3] Even before investors have committed to a fund, engagement with PE/VC firms is personal and two-way.

For private equity funds formed as a limited partnership, the key legal document is the Limited Partnership Agreement (LPA), which sets out in detail the legally binding relations between the limited partners (the investors) and the general partner (the PE/VC manager). The partners are free to agree whatever commercial terms they choose to be in the LPA, save that a limited partner may not take part in the management of the limited partnership; if it does, it will lose its limited liability status.

The LPA sets out the rights and obligations of the partners and seeks to cover every aspect of the formation, operation and termination of the partnership, from the key commercial issues to the detailed constitutional and administrative issues. LPAs typically includes clauses on:

- Parties: Each person who is party to, and therefore bound by, the LPA is clearly identified. LPs admitted to the partnership after it is initially set up (and before it closes to new investors) are required to sign a separate deed agreeing to adhere to the terms of the LPA.
- Purpose of the Partnership: This clause binds the general partner to carry on the fund's investment activities as outlined in the LPA and may touch on investment constraints and limits within which the general partner should operate its investment policy.
- Duration of the Partnership: This is typically for ten years with a provision for extending the life of the Partnership, typically for up to two years.
- Accounts and reports: The GP will prepare accounts for the partnership as well as separate records for each limited partner to enable each to track capital contributions, capital called and returned, income received and capital profits.
- Meeting of investors: The GP will normally convene annual general meetings of the investors, enabling investors to ask about their investments and question the manager. GPs are also typically entitled to convene an extraordinary meeting at any time, along with certain LPs.
- Advisory Board: LPAs often provide for the constitution of an LP advisory board with the purpose of representing the interests of the limited partners, as well as advising on other matters such as potential conflicts of interest for the manager and its associated companies and valuations of portfolio investments. To protect the limited partners' limited liability, this board will be specified to be supervisory only. These boards are usually called Limited Partner Advisory Committees ("LPACs").

Alongside the LPAC, private capital firms may sign bespoke agreements with investors based on their individual needs. These bespoke agreements may include preferential economic terms, certain regulatory terms required by the investor, country-specific terms as well as numerous other terms and provisions that the investor desires, or requires, such as additional ESG related reporting, prior to making an investment in the fund. Many institutional investors will themselves be required to report to their beneficiaries and so may require certain bespoke reporting.

Over the years, investor reporting guidelines have been shared with the UK and European industry in Invest Europe's professional standards handbook[4] to aid private capital firms in their reporting. These guidelines are suggested to be used alongside legal and regulatory reporting requirements. The guidelines include detail on:

- Timing and structure of investor reporting
- Fund information, including an overview of the fund, GP fees, carried interest and fund operating expenses, and relation party transactions and conflicts of interest
- Information on the underlying investment portfolio

[2] ILPA Due Diligence Questionnaire – available here
[3] PRI limited partners' responsible investment due diligence questionnaire – available here
[4] Invest Europe Professional Standards Handbook – available here

- Investor information, including drawdown and distribution notices
- Performance measurement and reporting

Furthermore, private capital firms regulated under the Alternative Investment Fund Managers Directive are required to comply with transparency provisions in the Directive when control of a portfolio company is acquired. Private capital firms are required to disclose their intentions to the regulator, the company itself and its shareholders about the future of the business and repercussions on employment by the company and material change in the conditions of employment. Additionally, disclosure is required on the identity of the private capital firm with control, the policy for preventing and managing conflicts of interests and the policy for external and internal communication relating to the company, particularly regarding employees.

As explained in the previous section, carried interest and private capital manager co-investment, which are both agreed in the LPA, are key features of the private capital model that ensures alignment of interests between investors and the private capital manager. This encourages managers to build businesses that are sustainable and have long-term growth interests with returns for private capital managers only crystallising at the same time that returns are distributed to investors.

Private capital firms have embraced the responsible investment agenda and the focus by our industry on measuring, managing and mitigating ESG risks, including climate change, as well as seizing the opportunities that good responsible investment practice provides, continues to grow. The BVCA has published a number of guides, most recently a Responsible Investment Toolkit[5], which provides practical guidance for ESG consideration at the private capital firm level and at the various stages of an investment into a portfolio company, as well as case studies illustrating responsible investment in practice. The BVCA annually presents Excellence in ESG and Impact Awards to recognise outstanding ESG and Impact practices within the industry.[6]

A number of private capital firms are also signatories to the Principles of Responsible Investment.[7] Investors often require a manager to comply with/have reference to PRI even where the private capital firm itself is not a direct signatory. As previously noted, investors may perform specific due diligence on ESG matters when evaluating a prospective private capital firm. Furthermore, regular reporting on ESG matters is typically requested by investors and there are industry-led initiatives, such as the ILPA/PRI LP ESG Due Diligence Questionnaire and the ESG Data Convergence Initiative, which has been established to support with this.

The increased focus on responsible investment in part has been driven by investors and consideration of ESG factors is now expected by most investors. Institutional investors are typically invested into a number of different private capital funds alongside other investors and can observe best practice. Furthermore, institutional investors have engaged through platforms such as ILPA, PRI and IIGCC (and indeed the BVCA) to raise standards on responsible investment in private markets and expectations across the industry continue to rise. Private capital firms that do not keep up with investor expectations may find fundraising difficult.

2.2. Relationship between private capital firms and their portfolio companies

Private capital firms seek to introduce and strengthen existing corporate governance arrangements that are in place in the portfolio companies in which they invest. This allows them to effectively monitor and manage their investments from a strategic perspective, and to implement value-building initiatives.

Private capital firms also specify certain additional rights in the portfolio company's constitutional documents and agree contractual rights in the shareholders agreement it enters into with the management (who, as mentioned above are typically incentivised by equity ownership programmes) and other shareholders of the portfolio company, such as (i) requiring certain strategic and significant operational matters to be subject to prior investor/shareholder consent and (ii) the ability to make board appointments. The type of investor consents will vary depending on the size and nature of the investment and will also address potential conflicts

[5] BVCA Responsible Investment Toolkit – available here
[6] Past winners of the BVCA Responsible Investment awards can be found here
[7] Further details are on the UN PRI homepage – available here

of interest. This is a key difference to the rights of shareholders in listed companies as private capital investors are able to protect their interest.

Over the years, examples of good practice in corporate governance have been shared with the UK and European industry in Invest Europe's professional standards handbook.[8] Importantly this is not a prescriptive set of guidelines as the arrangements put in place will depend on a wide variety of factors specific to the company. The types of governance arrangements implemented include board composition; audit and risk committees; remuneration; policies and procedures; and regular and detailed management information.

2.3. Sir David Walker's Guidelines on disclosure and transparency in private equity

Private equity firms that invest in the largest portfolio companies in the UK are expected to comply with the Walker Guidelines on disclosure and transparency in private equity. In 2007, the BVCA commissioned Sir David Walker to establish guidelines that provide a framework for the private equity industry to enhance stakeholders' understanding of our activities and address concerns about a lack of transparency in the industry. Since 2007, the industry has embraced and adopted these voluntary Guidelines with 90 portfolio companies within scope currently, owned by more than 70 PE firms. Enhanced reporting by portfolio companies, and disclosures by private equity firms helps to demonstrate that they are responsible owners and builders of businesses.

The private equity firms, including some of the largest firms operating in the UK (both domestic and non-domestic) firms are also required to produce certain disclosures on their public website. Many of these disclosures are now normally found on websites of PE firm, even if they are not in scope of the Guidelines. Required disclosures include:

- A description of where the FCA-authorised entity fits in the PE firm's structure.
- An indication of the firm's investment history, approach and investment holding periods.
- A commitment to comply with the Walker Guidelines on a comply or explain basis.
- Identifying the senior leadership of the UK element of the firm.
- Confirmation that arrangements are in place to deal appropriately with conflicts of interest.
- A description of UK portfolio companies in the PE firm's portfolio.
- A categorisation of limited partners in the PE firm's funds, by geography and type of investor.

An independent body, the Private Equity Reporting Group ("PERG"), monitors conformity with the Guidelines and periodically makes to recommendations to the BVCA for changes to the Guidelines. The majority of PE firms and their portfolio companies are compliant with the Guidelines. Having an independent body that monitors compliance with the Guidelines ensures high expectations and standards.

The Guidelines were updated in 2024 to ensure that they remain fit for purpose. Disclosures, including on ESG topics, will be enhanced for the 2026 reporting period (2025 corporate reporting information). This directly aligns with the stewardship's drive for increased transparency and promotion of the development of good practice.

2.4. Sustainability Disclosure Reporting (SDR) and stewardship

Private equity firms are beginning to align with the labelling requirements set out in the SDR and will be subject to rigorous stewardship requirements. The requirements emphasise the critical role of investor stewardship in achieving a sustainability product's objectives. Asset managers must establish a clear stewardship strategy, detailing the necessary activities, expected outcomes and the resources allocated to support sustainability goals. This commitment must be transparently reflected across various disclosures. Consumer-facing disclosures must clearly communicate, in plain language, how stewardship supports the product's sustainability objectives. Pre-contractual disclosures should provide detailed insights into the stewardship strategy, including alignment with the UK Stewardship Code 2020 where relevant. Public product-level reporting must demonstrate how the strategy has been applied, outlining undertaken activities and achieved or anticipated outcomes. The FCA

[8] Invest Europe Professional Standards Handbook – available here

further underscores that stewardship is fundamental to all SDR-labelled products, requiring firms to disclose how their approach supports sustainability objectives and to implement an escalation plan for addressing assets that fail to show sufficient progress.

3. Response to questions in the consultation paper

Q1. Do you support the revised definition of stewardship?

There is a compelling case for the stewardship definition to emphasise long-term value creation and sustainability. The BVCA's assessment is that environmental and social considerations are integral to a steward's fiduciary duty and essential for embedding stewardship effectively. While we do not oppose the proposed new definition, we understand the caution that other industry bodies are expressing regarding the removal of environmental and societal considerations from the definition altogether. Given that stewardship is shaped by market standards, industry guidance and investor expectations, the practical impact of this change in definition may be limited. Nevertheless, we support clear guidance in the commentary accompanying the definition that would include environment and societal impacts in the factors that signatories should consider when they exercise their stewardship obligations. Regardless of how the FRC lands on the final wording of the definition, we emphasise the importance of prioritising a single materiality approach in stewardship activities and disclosures related to the environment and society. This is supported by our view that, whilst sustainability objectives are important, in the absence of a specific double materiality mandate, they should support a wider long-term value creation objective.

Q2. Do you support the proposed approach to have disclosures related to policies and contextual information reported less frequently than annually? If yes, do you support the approach set out above?

We agree with this proposal and the approach set out in the consultation.

Q3. Do you agree that the Code should offer 'how to report' prompts, supported by further guidance?

We agree that the Code should offer "how to report" prompts and guidance. We support the idea to have a 'living' document as guidance as the FRC can adapt it as issues arise in future. As there is no consultation on the guidance or prompts it will be important for the FRC to clarify how signatories can give feedback on the Code and guidance itself. Specifically, we recommend that "how to report" prompts offer specific guidance for different asset classes. Furthermore, detailed case studies and best practice reports should be provided to ensure relevance and specificity to the reporting organisation. The BVCA would be happy to support to the FRC in tailoring these materials for private markets.

Q4. Do you agree that the updated Code for Asset Owners and Asset Managers should have some Principles that are applied only by those who manage assets directly, and some that are only applied by those who invest through external managers?

Important context for this response is that, in private capital, the investors who own the funds are referred to as Limited Partners (LPs), and those responsible for managing the funds as General Partners (GPs). We agree that the updated code should differentiate between those who manage assets directly and those who invest through external managers. It is important to note that funds of funds and secondaries investors in private markets should be grouped with Asset Owners, as they invest indirectly in assets and through external managers. We recognise that there is a difference in exercising stewardship between these stakeholders.

Q5. Do the Principles of the updated Code better reflect the different ways that stewardship is exercised between those who invest directly, and those who invest through third parties?

We agree that the updated Code better reflects stewardship practices for direct and indirect investment. This reflects our response from question 4.

Q6. Do you agree that the updated Service Providers' Code should have some Principles that are applied only by proxy advisors, and some that are only applied by investment consultants?

N/A

Q7. Do the streamlined Principles capture relevant activities for effective stewardship for all signatories to the Code?

As discussed in our opening remarks, many of the principles are less applicable to private markets due to the inherently tailored nature of stewardship approaches in this space and the Code's limited compatibility with these practices. Therefore, for current private capital signatories, it would be helpful if the FRC were to create more asset-specific guidance. This would help those signatories better align their reporting with the Code. Again, the BVCA would be happy to support with any private capital focused elements.

Q8. Should signatories be able to reference publicly available external information as part of their Stewardship Code reporting, recognising this means Stewardship Code reports will no longer operate as a standalone source of information?

Yes, we think that signatories should be able to reference other publicly available information. The PERG is allowing this going forward with the Walker Guidelines and we strongly support that. The FRC will need to set clear instructions on how and when an organisation can reference to ensure that signatories correctly reference.

Q9. Do you agree with the proposed schedule for implementation of the updated Code?

Yes, we think that the proposed schedule is reasonable.

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We welcome further discussion with the FRC as they finalise their review and publish the new Stewardship Code. Please do not hesitate to get in touch (please contact Ciaran Harris at charris@bvca.co.uk) if you have any comments or questions.

Yours sincerely,

Jonathan Martin

Chair, BVCA Accounting, Reporting & Governance Committee