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24 March 2023

Dear Simon

Re: BVCA response to Part 3 of the National Security Bill 2022

We are writing on behalf of the British Private Equity and Venture Capital Association, 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, we represent the vast majority of all UK-based private equity and venture capital firms, as well as their professional advisers and investors. Between 2017 and 2021, BVCA members invested over £57bn into around 3,900 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital ("PE/VC") currently employ two million people in the UK, and 90% of the businesses our members invest in are small and medium-sized businesses.

The BVCA welcomes recent Government amendments to the National Security Bill. However, in addition to several other matters requiring further clarification, it remains imperative that the Bill be amended in line with comparable United States and Australian laws to explicitly exempt registration requirements for foreign powers engaged in bona fide commercial activities.

Background: Private equity approach to transparency

As you will be aware, private equity/venture capital firms are long-term investors, typically investing in unquoted companies for around three to seven years. This is a commitment to building lasting and sustainable value in business. As such, stakeholder engagement and transparency are fundamental to our industry – this is evidenced both through our engagement in the recent UK corporate governance reform (including the development of the Wates principles) and our work on Sir David Walker's guidelines for disclosure and transparency in private equity (the "Walker Guidelines"). Since 2008, the Walker Guidelines have provided a framework for the private equity industry to enhance stakeholders' understanding of our activities and address any concerns about a lack of transparency in the industry. These stakeholders include government, regulators, media, employees, customers, and the public more widely.

Against that backdrop, we understand and support measures to tackle clandestine political influencing activity via increased transparency. However, we feel strongly that such measures need to be carefully designed, proportionate, justifiable by reference to the perceived risks, and balanced with the need to ensure that the UK remains an attractive destination for the vast majority of global investors that are pursuing or are looking to pursue legitimate corporate objectives and business. This is brought into sharper focus in light of Brexit and in the face of strong competition from abroad.

In our industry in particular, there is often a decision to be made by investors as to the jurisdiction of incorporation of the various corporate entities through which they make their investments. Clearly a number of factors inform this assessment, but the speed and ease of investment, and the cost, reasonableness, clarity, and predictability of ongoing regulatory obligations and filing requirements are all important.

Concerns and comments about the proposed Foreign Influence Registration Scheme

In this context, we have concerns about the proposed Foreign Activities and Foreign Influence Registration Scheme, which was included within the National Security Bill (the "**Bill**") by way of an amendment after the Bill had already been introduced into Parliament (the "**Scheme**").

We welcome the Government's responsiveness and recent package of amendments, announced on 23 February 2023 ahead of the House of Lords' report stage, which have gone a significant distance towards alleviating many of our concerns to date. Unfortunately, even taking into account the amendments as they stand after the Lords' Third Reading on 13 March 2023 (the "**Latest Amendments**"), significant concerns remain.

In practice, the proposed Scheme will introduce burdens significantly beyond those required in 'competing' jurisdictions and, in its current form, is also liable to produce considerable uncertainty and over-compliance, unlike and in excess of that of equivalent schemes in alternative jurisdictions. As such, we believe that there is a risk that if certain aspects of the proposed Scheme are implemented in their current form, global investors may favour other jurisdictions when other factors are finely balanced.

Our two overarching concerns are that: (i) the proposed Scheme (and particularly its wide-ranging 'enhanced tier') may not focus sufficiently on activities having characteristics or a nexus that increases the risk or harm it is hoping to target; and (ii) there has there been insufficient substantive consultation with, or debate informed by, industry experts on those aspects which will cause the proposed Scheme's impact on PE/VC firms to be more onerous than equivalent schemes in other jurisdictions, including the notoriously onerous schemes of the US or Australia. In effect, the proposed Scheme could criminalise a wide range of industry activities that pose no threat to national security. Not only will this be burdensome for our members, but it will result in a deluge of registration activity and tie up limited government resources without advancing the aim of tackling malign foreign influence.

We note that The Lord Sharpe of Epsom OBE (Parliamentary Under-Secretary of State for the Home Office) explained to the Lords during the report stage on 7 March 2023 that the Government has committed to holding further consultation on the guidance and establishing expert panels to produce sector-specific guidance on compliance with the Scheme (although he was unable to explain or confirm who the Government would consult with).[1] While that is encouraging as far as guidance is concerned, it is no substitute for expert and industry consultation on the primary legislation and architecture of the Scheme itself. For all the reasons set out in this letter, we strongly urge the Home Office to consult and engage with industry and sector-specific experts before the Bill progresses to finalisation.

Our concerns are most dramatically illustrated by the disproportionate impact the proposed Scheme will have on PE/VC activities involving sovereign investors ("**SIs**"), whose investment

[1] HL Deb 7th March 2023, 828, col. 699.

funds (typically, sovereign wealth funds ("**SWFs**")) and vehicles are owned and controlled by foreign powers. The UK, as a global hub for inward investment, has long benefitted from the considerable amounts of capital SIs have available for deployment, and recent years have seen SIs increasing and diversifying that investment in the UK. The relevance and importance of SIs can hardly be overstated, given that their total assets under management (AUM) has increased more that tenfold in the last decade (to an estimated AUM over $15 trillion in 2020[2]) and SIs represent an extremely diverse group of investors in terms of their sector focus, risk appetite, legal structures, investment horizons, and income sources. UK limited partnerships (both English and Scottish) are one of the most common fund structures used in (and one of the reasons why the UK is the second largest global hub for) PE/VC investment. To the extent that SIs and SWFs are engaged in purely commercial investment activities in the United Kingdom, there is no sound policy basis to impose an additional regulatory burden under the Scheme.

To the extent PE/VC firms are required to register under the Scheme, we are also troubled by the lack of clarity and certainty concerning the nature and handling of the information in relation to their activities in the course of providing information for the purposes of registration or in response to any information notices. We believe that the current approach implicates significant commercial intelligence and data privacy concerns, which do not appear to have been appropriately considered or addressed through the Latest Amendments. This is particularly exigent insofar as the implications for the UK's capital markets are concerned, for example, since it seems to us to invite or at least increase the risk of (amongst other misconduct) market manipulation, unlawful disclosure of inside information, insider dealing, and similar financial crimes, as described further below.

This letter is not an exhaustive nor a detailed analysis of the proposed Scheme's anticipated impact on the PE/VC industry. Instead we have outlined below several of the key areas or issues where we consider that further detailed consideration and consultation is warranted, by highlighting the manner in which certain aspects of proposed Scheme will cause significant (and arguably unintended) burdens for most PE/VC firms and risk alienating our global investor base, to the detriment of the industry and the UK's competitiveness, and without a commensurate or efficacious benefit to the Government in achieving its stated purpose of tackling clandestine or covert political influence by foreign powers or entities and safeguarding UK democratic institutions. Our comments focus on the particular provisions that we believe will have the most obvious and direct impact on, and relevance to, our member firms.

Key comments/observations

The proposed Scheme will introduce a two-tiered registration scheme:

a) the 'primary tier' requiring registration of "foreign influence arrangements":[3] which focuses on arrangements to carry out 'political influence activities' within the UK at the direction of a "foreign power" (or to arrange for such activities to be carried out in the UK); and

[2] PwC, "Sovereign investors 2020: A growing force", 2020 (as cited in the Government's consultation "Sovereign immunity from direct taxation: Consultation on policy design", 2022).

[3] Pursuant to clauses 66 to 70 of the Bill.

b) the 'enhanced tier' requiring registration of "foreign activity arrangements": which applies to any arrangements to carry out any activity within the UK, or to arrange for future activities to be carried out in the UK, at the direction of a specified person (i.e. a foreign power or an entity that is controlled by a foreign power).[4]

We welcome the significant and helpful changes made to the primary tier in the Latest Amendments, which have effectively narrowed its application to entities directed by a "foreign power" (rather than a the previously broad "foreign principal") to carry out political influence activities.[5] While the change is helpful insofar as it relates to private non-government investors, there is a material risk that registration will still be required for SWFs and SIs. As noted above, it is hard to overstate the economic relevance and importance of SIs using such entities and/or the potential chilling effect that the Scheme's obligations may have.

How key aspects of the proposed Scheme will impact PE/VC firms

The Scheme goes significantly beyond the similar legislation in the United States (the Foreign Agents Registration Act "**FARA**") and Australia (the Foreign Influence Transparency Scheme Act 2018 "**FITSA**") in several respects, including as outlined below.

1. Broad definition of "foreign activity arrangements" without any focus on or limits linked to high risk activities or activities with characteristics related to national security:
   The Home Office has not explained why neither the primary nor the enhanced tier is focused on or limited by reference to activities, sectors, or products or services that have characteristics related to national security or a higher risk of clandestine or malign influence over public opinion or political activity. Initially, the enhanced tier caught literally any and all services and activities whatsoever, and did so deliberately. The Latest Amendments sought to introduce a modicum of proportion by allowing the Home Secretary to make regulations specifying which activities are subject to the provisions about foreign activity arrangements, either in relation to all specified persons, or to only the particular specified persons as may be identified in the regulations. The default position, however, will be that "all activities" remain caught. This leaves a great deal of uncertainty and significant discretion to secondary legislation. This aspect of the proposed Scheme remains markedly different to, and broader than, either the FITSA regime (which is kept to a more reasonable scope by limiting registration obligations to "registrable activities" with a clear with political or democratic nexus) or the FARA regime (which similarly limits its application according to the nature of the activities concerned).

   What is more, the Bill does not provide any *de minimis* threshold for the undefined "activities" being carried out in the UK, which means that registration will be triggered by a PE/VC firm undertaking even the slightest activity at the request of, or as part of fund management arrangements involving, a specified person, such as a SWF/SI, or a subsidiary

[4] Pursuant to clauses 62 to 65 of the Bill.

[5] We note that as currently drafted, the definition of "foreign power" in clause 32 applies only to Part 1 of the Bill (*Espionage, Sabotage and Persons Acting for Foreign Powers*), and not to Part 3 (*Foreign Activities and Foreign Influence Registration Scheme*): presumably this is an oversight, in which case it should be corrected, but if that is not the case, it is imperative to define clearly which persons, bodies and entities qualify as "foreign powers" for the purposes of the Scheme (and how) .

or investment vehicle owned or controlled a specified foreign power, as noted in example A in the Appendix.

2. No exemption for commercial activities:
   While the Bill includes a limited number of exemptions for: (i) legal activities; (ii) recognised news publishers' activities; (iii) arrangements concerning diplomatic missions and consular posts, or (iv) arrangements to which the UK Government is a party, an exemption for *bona fide* commercial activities is especially conspicuous by its absence.

   The exemption for commercial activities is a critical feature of both FARA[6] and FITSA[7] and significantly reduces the scope of those regimes. The absence of a similar exemption in the Scheme's enhanced tier means that a considerable amount of commercial activity beyond that which the Government intends to target may technically require registration. This will make compliance particularly onerous for UK PE/VC firms who work with investments by or on behalf of foreign government-affiliated commercial enterprises, including SWFs, for example.

3. Information and confidentiality concerns:
   Finally, we have concerns about the obligation on PE/VC firms to provide information (of a type to be determined in regulations not yet issued) about their foreign activity arrangements, whether for the purpose of registering such arrangements, or responding to any information notices. The scope of the Home Secretary's powers to issue information notices to firms that have registered (or which the Home Secretary considers ought to have registered) is an additional point of concern, given that there are no exemptions other than for legally privileged or "confidential journalistic material." We note with concern that the Latest Amendments have expanded the scope of the Home Secretary's power yet further, such that information notices can now also be given to anyone the Home Secretary reasonably believes to be carrying out (or arranging to carry out) relevant activities pursuant to a foreign activity arrangement even where they are not a party to the arrangement.

   Furthermore, the Bill gives the Home Secretary powers to make regulations of any sort about (i) the nature of the information that can be required for registration or pursuant to an information notice, and (ii) the publication of registered information or any information disclosed in response to an information notice. In the private equity context, this would likely entail the provision by PE/VC firms – and scope for potential (advertent or accidental) disclosure by the Home Office of – commercially sensitive, and potentially material, non-public or protected information. Quite apart from increasing the risk of misconduct related to market manipulation, unlawful disclosure of inside information, insider dealing, and similar financial crimes, the prospect (or risk) of compelled disclosure of such information on its own may have considerable deterrent effect on global investment in the UK or involving UK-based PE/VC firms.

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[6] FARA exempts persons "engaging or agreeing to engage only (1) in private and nonpolitical activities in furtherance of the bona fide trade or commerce of such foreign principal; or (2) in other activities not serving predominantly a foreign interest" of a foreign principal. (§613(d), FARA).

[7] FITSA exempts activity undertaken by foreign government employees undertaking activities which are commercial or business pursuits. (§29, FITSA)

We note that The Lord Sharpe of Epsom OBE explained to the Lords on 7 March 2023 that he had provided the Lords with indicative draft regulations (including an example registration form) setting out the information that will be (i) required from registrants and (ii) published, and that he expressly confirmed to the Lords that the Government will not publish information where there is a risk that doing so would prejudice national security, put an individual's safety at risk or involve the disclosure of commercially sensitive information.[8] Given that those indicative regulations are not public, it is difficult to derive reassurance on such a critical aspect of the proposed Scheme, which will fundamentally remain subject to Ministerial discretion and thus inherently uncertain and changeable.

Additionally, while we note that the Latest Amendments may have clarified (based on the amendment proposed by The Lord Anderson of Ipswich)[9] that the Home Secretary "may only specify information which the Secretary of State considers may be relevant to an arrangement or activity within" the scope of that section, this again leaves too much by way of certainty and discretion to the secondary legislation to provide reassurance as to our concerns.

4. Risk of contagion and over-compliance:
   The nature and severity of the reputational and criminal consequences provided for under the Bill, when combined with (i) the risk of related offences multiplying beyond the Scheme (e.g. aiding and abetting, conspiracy, etc.) and (ii) the potential breadth of the scheme's application and (iii) the lack of clarity or certainty as to how critical elements and powers will be interpreted and operated by the Home Secretary are liable to equate to considerable over-compliance by *bona fide* PE/VC firms. Such over-compliance (and associated costs) will also unnecessarily burden government resources. It also risks diminishing the usefulness of the disclosure register by inundating it with information of no public interest or intelligence value in a manner that buries information of actual public or intelligence concern.

Conclusion

The bureaucracy, administrative cost, delay and forced disclosure inherent in compliance with such a broad-ranging Scheme are undeniably going to deter investment and engagement with global investors, and particularly SIs and SWFs. It is also not clear from the Government's impact assessment (which focuses predominantly on the primary tier) that there is clarity on the practical implications of and the volume of legitimate data that will arise by the operation of the Scheme's enhanced tier. The administrative and operational resource that will be involved in and registration of such information will be disproportionately burdensome to PE/VC firms and risk materially affecting the UK's commercial and other interests in global engagement. By contrast, the Scheme does little to address or mitigate the significant risk of avoidance and non-compliance by or on behalf of malign or covert states and actors.

Any framework of this nature is necessarily complicated, wide-ranging, and of great importance, not least because its effectiveness will impact the UK's international activities, trade relationships, and cultural interactions at a global level. We believe strongly that in addition to points of technical detail, some fundamental policy and scoping issues remain unresolved. We therefore urge the Home Office to take the time required to make the proposed Scheme as

[8] HL Deb 7th March 2023, 828, col. 703.
[9] Amendment 154A, agreed. HL Deb 7th March 2023, 828, col. 716.

effective as possible at the point of introduction. In particular, and notwithstanding the Government's commitment to consultation on the guidance, we think it would be extremely valuable for industry to have the opportunity to provide detailed feedback on a further iteration of the proposed Scheme *before* it progresses or is finalised in Parliament.

Finally, we note that The Lord Sharpe of Epsom OBE explained to the Lords on 7 March 2023 that the Government has committed to producing a revised impact assessment before Royal Assent and issuing guidance on how the Scheme will operate during the implementation period, before the Scheme comes into force.[10] In light of the breadth of the Scheme, the nature of the obligations and potential penalties involved, and the inevitable complexity of the analyses that will be required of PE/VC firms in determining whether and how the Scheme will apply and impact their business, we would also urge the Home Office to ensure that there will be meaningful and reasonable period of time between the guidance being released and the Scheme becoming operational.

We trust that the above information is useful. The BVCA would of course be willing to discuss this submission with you further - please contact Ciaran Harris (charris@bvca.co.uk) at the BVCA.

Yours faithfully,

Tom Taylor

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[10] HL Deb 7th March 2023, 828, col. 699.

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