Transparency and Trust Team
Department for Business, Innovation and Skills
1 Victoria Street
London
SW1H 0ET

By email: transparencyandtrust@bis.gsi.gov.uk

9 January 2015

Dear Sirs,

Re: BVCA response to the discussion paper on corporate directors

1. 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 500 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers.

2. Our members have invested £30 billion in over 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 790,000 people and almost 90% of UK investments in 2013 were directed at small and medium-sized businesses. As major investors in private companies, and some public companies, our members have an interest in reporting matters, the conduct and information presented by such companies, and the burdens placed on the management of such companies.

3. We have submitted a number of representations and held meetings with the Department of Business, Innovation and Skills over the last year to discuss the Small Business, Enterprise and Employment Bill (the "Bill") and are monitoring the passage of the Bill through Parliament.

4. We are supportive of the Government's intention to allow for limited exceptions to the provisions prohibiting corporate directors. There are many reasons for using corporate directors and so the limited exceptions to their general prohibition ought to cover these legitimate uses. Our response is focussed on the questions that are most pertinent to our industry.

Private companies

Q22: Should we use large private company status as a basis for an exception from the prohibition of corporate directors?

5. We do not agree entirely with this proposal as a basis on which to build an exception to the general prohibition of corporate directors. Whilst we agree there are substantial corporate governance, as well the cost, benefits from the use of corporate directors for larger private companies and their groups, this is not limited to those that have large private company status.

6. This is especially important in the context of the private equity and venture capital industry and the corporate governance arrangements relating to the businesses in which the industry invests. As shown from our data in paragraph 2, the majority of the companies in which the industry

invests are not large private companies. We expand on the safeguards that could be put in place, where the company does not have large private company status, in the responses to questions 23 and 24.

Q23: Should any exception extend to all large private companies, or only to large private companies in group structures?

7. There are often legitimate uses for corporate directors in group structures, which facilitates administration and governance without any significant risk of abuse. In many private equity structures, a series of private companies may be used as acquisition structures in order to facilitate the acquisition of a target company. These structures are necessary for a variety of reasons, including where bank debt is used to the finance the acquisition and holding companies in the group structure allow for structural subordination of this debt and other, lower ranking forms of financing.

8. We believe the exception should apply to all private companies in a group structure provided that the parent company, where it is not a large private company, is subject to the prohibition on corporate directors. This will ensure that the companies within the group can utilise the benefits of corporate directors regardless of their size.

Q24: How far should an exception extend in the group?
- Should it apply only to dormant companies?
- Should it apply to: wholly owned subsidiaries; or subsidiary bodies corporate controlled through voting rights or control of directors; or subsidiary undertakings subject to wider means of parental company influence?

9. As explained above, we believe it is appropriate to extend the exception to all private companies in a group excluding the parent company when it cannot use the large private company status exemption. Based on the examples provided in the discussion paper, this exception should therefore cover all **subsidiary undertakings subject to wider means of parental company influence**. This exception should not be limited to only dormant companies as many trading companies would benefit from a corporate governance perspective from having a corporate director.

10. In the situations given above, even where the group companies are not wholly owned subsidiaries, allowing the use of corporate directors, particularly where it is another related entity within the group structure, would not increase the opacity of the group company.

Q25: Should it apply only to companies appointing another company in the group or a parent company only? Should this be made explicit?

11. In a fund structure, determining which entities form part of a group can be a complex analysis. A private equity or venture capital firm might want to appoint a specialist corporate director to several of its investee/portfolio companies and that might not be in the same group, or even affiliated, with the company itself. Therefore we do not believe the appointment should be limited to another group company or the parent company.

12. To ensure the exceptions are not abused, the proposal in question Q26 to require the corporate director itself to appoint only directors that are natural persons, will be an appropriate safeguard.

Q26: Should it apply only to companies appointing a corporate director whose directors are all natural persons?

13. We agree with this approach.

Q27: Are there any other arrangements or relationships we should consider?

14. An exception should be developed for a regulated financial investor that has been given a contractual right to appoint a director to a portfolio company as a condition of its investment. The regulated financial investor may want to appoint an individual or company within its own group, or an external specialist corporate director, in order to safeguard its interests in a portfolio company. As the investor will be subject to its own regulatory scrutiny, this should be an effective safeguard and ensure this exception is not subject to misuse.

15. We would welcome the opportunity to discuss this proposal in more detail.

Limited Liability Partnerships (LLPs)

Q37: Do you agree with the approach that use of corporate members of LLPs should continue unchanged in the present reforms?

16. We share the Government's view that there is currently no compelling reason to prohibit corporate members of LLPs, since members of LLPs are not equivalent to directors and do not generally have the same functions or duties. Any changes would cause very significant disruption as corporate LLP members are widely used – and needed – for a variety of legitimate reasons.

17. We have made the following representations separately before, however we have replicated them here as we feel it is important to reemphasise why corporate members in LLPs are different to corporate directors and why they are valuable.

18. Members of LLPs are not equivalent to directors in a company as a matter of law as they do not owe the same statutory duties to the LLP as a director owes to a company. Members and directors are treated differently for good reasons. The obligations and rights of the members of LLPs principally arise under the LLP Act. However, certain parts of the Companies Act 2006 ("CA") and of the Insolvency Act 1986 have been applied to LLPs. The CA specifically does not apply directors' duties to members but has applied certain provisions which otherwise apply to shareholders. Therefore to ban corporate members in LLPs would not fit well with the existing legislative framework.

19. Whilst some LLP members may have a fiduciary relationship with the LLP, others may not, and this will be entirely dependent on how individual members' roles and responsibilities have been defined in the LLP's governing documents. Therefore, extending a general prohibition to corporate members in LLPs will be equivalent to preventing corporate ownership in a company as, in many cases, corporate members are simply equivalent to shareholders (as co-owners of the residual profits of the business, with certain shareholder-like rights). This would be clearly against the policy intention.

20. Designated members in an LLP do have certain additional statutory duties which are more akin to a company secretary-like role rather than that of a director. As there is no proposal to require

a company secretaries to be natural persons, then there is no benefit in requiring a designated member to be one either (if such a proposal were to be put forward).

21. LLP members may have director-like functions if the other members give them executive management or strategic responsibilities. Where this is the case, it is highly likely that a natural person(s) would have been allocated this role either at the level of the LLP or on the board of the corporate member. Equally, it is perfectly possible that no member of the LLP will have director-like responsibilities, but that these will have been given to non-members instead.

22. Furthermore, where there are individuals with significant control (as defined in the Bill), they will be disclosed on the PSC Register. This on its own would act as a suitable deterrent for abusive behaviour and illegal activities.

Q38: Can you provide any further information or evidence we should consider in relation to the abuses or value of corporate members of LLPs?

23. The LLP combines the internal flexibility and tax transparency of a partnership with the external disclosure and reporting regime of a company. Unlike partnerships, LLPs have the legal status of corporate bodies, and offer limited liability to members – crucially, even those who are actively involved in the management of the LLP's business. This last point underlines the popularity of LLPs in the private equity and venture capital industry (as well as the broader asset management industry). LLPs are frequently also used by the private equity industry (and others) as vehicles for consortium arrangements and joint ventures precisely because they permit members to act as "owners" and participate in profits. Excluding corporate LLP members will shut down this avenue for such structures generally, limiting the flexibility for which they were introduced.

24. Many fund managers previously structured as companies have transferred their businesses to LLP structures as they are able to operate with the added benefits of partnerships whilst retaining their limited liability status. A partnership structure allows for effective succession planning by creating incentives for key and valuable personnel (in terms of profit-sharing and partnership units' allocation) without the rigidity of a corporate share capital structure. This is desirable not only for the fund management business itself, but more importantly, investors in the funds managed. In our industry (and this would equally apply to other asset classes), retention of key personnel has become a primary investor concern with extensive time spent on due diligence of the capabilities of the management team.

25. When companies convert to LLPs, the company transfers its business and assets in exchange for an LLP interest as this ensures the transfer is not regarded as a taxable disposal. This makes perfect sense as no change in the business or its ownership has occurred and the LLP's governing agreement would reflect the economic rights previously in place. Tax would still be due in later years if the LLP were to dispose of all or part of the transferring company's previous business. This is one reason why many fund management LLPs have corporate members. Other reasons for corporate membership include the need for external seed capital or to finance expansion, and where management entities have spun out from larger corporates which retain an ownership interest (e.g. banks disposing of non-core business lines).

26. Given the prevalence of LLPs – not just in the private equity and venture capital industry but more generally – the introduction of a prohibition of corporate directors would cause widespread disruption and cost to a significant number of businesses. It would in many circumstances not be permitted or contemplated by the contractual arrangements applicable to

the LLPs thereby potentially triggering dispute. It would also have tax consequences. We consider that these effects are disproportionate relative to the impact such a change would have on achieving the policy objective.

Q39: Do you agree we should review the issues in relation to corporate members of LLPs in parallel with the review of the Small Business, Enterprise and Employment Bill provisions covering corporate directors of companies, or sooner if compelling evidence of abuse of the LLP structure were to emerge?

27. We agree with the proposal to review the position in accordance with the review of the Small Business, Enterprise and Employment Bill provisions covering corporate directors of companies (i.e. in five years after they have come into force).

Please feel free to contact Gurpreet Manku at the BVCA if you have any queries on this response.

Yours faithfully

Simon Witney
Chairman – BVCA Legal and Technical Committee