Written evidence submitted by the British Private Equity and Venture Capital Association (BVCA) (ECCTB03)

Briefing on Part 2 of the Economic Crime and Corporate Transparency Bill (Limited Partnership Reform)

The Economic Crime and Corporate Transparency (ECCT) Bill proposes significant changes to UK limited partnership law. While the British Private Equity and Venture Capital Association (BVCA) fully supports the Government's commitment to fight economic crime and end abuse of the financial system, which harms all reputable investors and businesses, we have serious concerns about some specific measures in the ECCT Bill. We think some technical aspects of the proposals could have unintended consequences that harm legitimate users of limited partnerships and damage the competitiveness of the UK as a destination for private equity and venture capital, thereby damaging business investment across the UK.

We fully support the policy aim of fighting economic crime, and agree that this means increasing the powers of Companies House and making some amendments to the UK Limited Partnerships Act. The Bill contains several strong proposals that taken together we feel will make it extremely difficult for criminals to use UK limited partnerships. These include the requirement for an authorised corporate service provider to register new limited partnerships and make ongoing filings (a robust gatekeeper that criminals will struggle to circumvent), the requirement for annual confirmation statements (an alarm bell that will be activated by absent or suspicious filings) and, if it is appropriately calibrated, the power for HMRC to obtain accounts (an investigation and enforcement tool for ad hoc concerns raised by the authorities).

However, other aspects of the Bill would make UK limited partnerships significantly less attractive to institutional investors (including pension funds and insurance companies) investing in the UK via UK-managed private capital funds. These funds play a vital role in driving innovation, back two million jobs across the UK (with 66% of investments outside London) and invest 90% of their investors' capital into SMEs. The Government's commitment to this policy objective was confirmed by amendments introduced in 2017 (see section 4 below) to enhance the competitiveness of the limited partnership as a fund vehicle[1]. The current proposals could undermine those welcome reforms.

We believe that with suitable technical amendments, the Bill could both protect legitimate users of this valuable investment structure, while ending abuse. Our recommendations will protect legitimate business investment, allowing the UK's private fund structure to remain globally competitive and one of the most attractive in the world, whilst at the same time ensuring that the Government's objectives of tackling economic crime and corporate transparency are achieved.

Key concerns

The UK limited partnership is the primary UK fund structure used by private capital investors to invest in funds that finance the growth of UK businesses. It is the legal bedrock of the UK's world-leading private capital industry (second only to the US), and has been replicated by various competitor jurisdictions, given its world-class effectiveness as a vehicle for investing in growing businesses. Its effectiveness must be maintained for the UK to remain a competitive jurisdiction for private capital firms to operate in, and importantly, to invest in and grow UK businesses.

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[1] The Legislative Reform (Private Fund Limited Partnerships) Order 2017 (https://www.legislation.gov.uk/ukdsi/2017/9780111153208)

The Bill can yet achieve this, whilst also ending the usefulness of limited partnerships to criminals as the Bill intends, if it is amended to reflect a number of key considerations. These include the following:

1. **Passive investors, as limited partners, should not be unduly burdened with administrative responsibilities, as this could significantly undermine the appeal of UK limited partnerships as investment vehicles** (clauses 119 (3), 124 (2) and 129 (1)).

   UK and international institutional investors, such as pension funds and insurance companies, invest their beneficiaries' capital into funds managed on a discretionary basis by third-party managers on the basis that the management and operation of those funds will be the responsibility of those expert fund managers. The Limited Partnerships Act embeds this passive investment relationship in law, designating the passive investors as "limited partners". In that respect, limited partners are similar to shareholders in investment trusts, or unitholders in unit trusts.

   Various aspects of the Bill's proposals would radically dilute this fundamental principle by imposing active obligations on passive investors, giving limited partners certain responsibilities that they would not have as shareholders in a company. Passive investors will simply not be willing to, or able to, adopt a more active role in overseeing a fund's affairs, by continually monitoring the fund manager's status as general partner to ensure, for example, that it does not resign or withdraw without their knowledge. We expect they would instead choose alternative structures where that is not expected of them. In this context, the imposition of criminal penalties on investors for administrative omissions related to the management of a fund would make the UK limited partnership less attractive as an investment vehicle, which could have a damaging impact on levels of business investment.

   The proposed new sections of the Limited Partnerships Act that are particularly concerning include (but are not limited to) 6ZA(2) (to be inserted by clause 119(3)) – Failure to notify registrar of dissolution and 28 (to be inserted by clause 129(1)) – False statements: basic offence.

   In most cases, the institutional investors who constitute the majority of "limited partners", as passive economic investors, would not expect to be exposed to potential criminal liability. Whilst new section 29 involves an element of dishonesty, the other new offences are either administrative offences or could be committed inadvertently by a limited partner (or general partner), and should not be subject to criminal penalties.

   Equally, we do not think these particular proposed changes support the Bill's central aim of reducing the use of limited partnerships for money-laundering, for example because criminal users of limited partnerships will simply ignore these particular notification requirements. We therefore recommend that these sections be deleted from the Bill.

2. **Investment fund vehicles must ensure limited liability for investors** (clause 125(2))

   Another fundamental principle at stake is that the flipside of passive investors not having responsibility for the operation of an investment fund is that their liability must be limited to the amount of capital they have contributed to it. As well as being a core principle of investment funds, this is critically important to institutional investors from a practical perspective, particularly pension funds that manage different strategies for different members. Investors must be certain that in all circumstances their investment in a limited partnership will not expose any other assets that they manage to potential liabilities connected to that fund investment (as long as they do not actively become involved in the management of the fund).

We welcome the Government's recognition, by including an "administrative revival" mechanism (clause 125 (2)), that the dissolution processes proposed by the Bill must protect this feature of limited partnerships.

However, the proposed mechanism will not fully protect investors' limited liability in the case of voluntary deregistration or if, as suggested during the Bill's Second Reading, the Government introduces further mandatory/involuntary deregistration provisions that will apply where limited partnerships are "no longer carrying on business, or if a court orders that it is in the public interest". In those circumstances, it will be important for the Bill to include wording to protect investors' limited liability by ensuring that any acts or omissions of a general partner following deregistration do not bind the partners in the fund, which may still continue in law as a general partnership, and to clarify that investors' liabilities arising prior to deregistration remain limited (even if they only manifest themselves after deregistration). We would be happy to provide further input on the language required, at the appropriate time.

It is also important, if the Bill imposes new obligations on limited partners, that investors' satisfaction of those obligations does not amount to them taking part in the management of the partnership's business (abstention from which is the basis of their limited liability). We therefore strongly recommend that if limited partners are required to make notifications under section 6(3B)(a) or elsewhere, that a new limb be included in new section 6A(A1) to clarify that making such notifications is not considered to be taking part in the management of the partnership's business, under section 6(1).

3. **There would be unintended consequences of requiring limited partnerships to have a "registered office" which would undermine the UK's reputation as a globally competitive destination for investment** (clauses 103 and 104, and variously throughout).

   We understand the Government's objective for UK limited partnerships to have a stronger connection to the UK, to aid law enforcement vis-à-vis any illicit use of limited partnerships for money laundering. However, achieving that connection by requiring them to have a "registered office" would have dramatic negative (and presumably unintended) consequences for existing investment fund structures and reduce the usefulness of UK limited partnerships as investment fund vehicles in future. We believe there is an alternative approach that delivers the same policy outcome without the downsides.

   The private capital fund management industry is highly regulated in the UK and internationally, and UK private capital fund structures are fine-tuned to comply fully with relatively complex and overlapping regulatory frameworks in different jurisdictions. In this context, the proposed requirement for a registered office, whilst it might seem a relatively simple change, would in practice invalidate many investment funds' regulatory structures at a stroke.

The reason for this arises from FCA rules reflecting the EU Alternative Investment Fund Managers Directive (AIFMD), which were retained following Brexit. Under these rules, UK limited partnerships that have their principal place of business in a jurisdiction outside the UK are currently treated as "non-UK alternative investment funds", with important regulatory consequences. If these partnerships were now required to have a UK "registered office", they would (unless the relevant FCA rules and AIFMD implementing provisions were also changed) be treated as UK alternative investment funds.

This would radically change the regulatory treatment of such funds where they have a UK based, FCA regulated adviser but non-UK based (typically EU) manager, which is a common structure in the industry. From a regulatory perspective, these structures would need to appoint a third-party depositary, with costs borne by investors. This change would cause a significant issue for firms considering whether to use a UK limited partnership in future. However, where private capital firms have already taken this approach, they would be forced to fundamentally reassess their existing international regulatory structures, at significant cost and disruption to the business and investors.

The UK's private capital fund management industry has been so successful in part because the UK's legal and regulatory frameworks are seen internationally as predictable, robust and sufficiently flexible to attract a variety of international institutional investors. This seemingly straightforward change (from a legal perspective) would jeopardise each of these elements of the UK's reputation from a regulatory perspective.

We think the Government's policy intent can be much more straightforwardly achieved by requiring limited partnerships to have an address for the service and inspection of documents (using a similar list of options to the "appropriate address" concept currently proposed in the Bill), as opposed to a "registered office". We strongly recommend that clauses 103, 104 and other relevant areas of the Bill be amended to that effect and would be happy to provide further input on this issue.

4. Legitimate investment fund vehicles should be excluded from the scope of these changes

We strongly recommend the inclusion of a relatively simple amendment that would go some way to protecting legitimate investment funds and reassuring global institutional investors by excluding demonstrably legitimate investment fund limited partnerships, which are clearly not the target of this legislation, from the scope of the proposed changes.

The Government updated UK limited partnership law in 2017 with a view to making UK limited partnerships more competitive as international investment fund vehicles. It did this by enabling qualifying limited partnerships to register as a new category of limited partnership called the

Private Fund Limited Partnership (PFLP), which was specifically designed for institutional investors.

The Bill should protect the use of UK limited partnerships as fund vehicles by inserting a new clause removing from the scope of the proposals limited partnerships that are registered as PFLPs (or meet the requirements to be) and have appointed a manager/operator that is appropriately authorised. Again, we would be happy to provide further detail on this point.

As indicated, we would be happy to provide further detailed briefings on the above, as well as other areas of the Bill's practical impact on the use of limited partnerships as legitimate investment fund vehicles. For further information, please contact Tom Taylor (ttaylor@bvca.co.uk) and Georgina Waite (gwaite@bvca.co.uk).

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