Prudential Banking Team
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

By email: PrudentialConsultation@hmtreasury.gov.uk

1 April 2021

Dear Sir, Madam

Re: HMT Consultation on Implementation of Investment Firms Prudential Regime and Basel 3 Standards (the "Consultation Paper")

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), 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 2015 and 2019, BVCA members invested over £43bn into nearly 3,230 UK businesses, in sectors across the UK economy ranging from heavy infrastructure to emerging technology. Companies backed by private equity and venture capital currently employ 972,000 people in the UK and the majority of the businesses our members invest in are small and medium-sized businesses.

Exercise of powers 143B(2) FSMA: Definitions in Part 9C

The Consultation Paper outlines HM Treasury's intention to use its delegated powers in section 143B(2) to extend the definition of 'group' in s.421 FSMA for the purposes of the application of rules 'on a consolidated basis'. The intention, as outlined in the Consultation Paper, is to align the definition of 'group' with that contained in Article 18 CRR. This provision applies consolidation to the circumstances in which an institution exercises a significant influence over another institution or financial institution without holding a participation and when two or more institutions or financial institutions are placed under a single management. We are concerned that the potentially very broad scope of the concepts of significant influence and single management could create material uncertainty regarding the scope of consolidated supervision to private equity and venture capital structures.

Whilst Article 18 of CRR is an existing provision in financial services legislation, it was designed to apply to banks. It also applies to firms regulated under CRR today. It does not currently apply to private equity and venture capital firms. So post-Brexit, applying this rule to such firms will represent an extension of the pre-Brexit regime.

Many private equity and venture capital firm groups have an investment firm which acts as an adviser arranger to the fund management company and the underlying funds. The adviser arranger will assist the fund management company and funds in relation to the initial acquisition of portfolio companies, and it will also have a role in the ongoing oversight of the performance and operation of the portfolio companies. The adviser arranger may, in some circumstances, have the ability to exercise rights in relation to portfolio companies or may provide managerial support to the portfolio company (including, for example, employees of the adviser arranger that will serve as directors of the portfolio company).

Such portfolio companies are not typically included as part of the private equity or venture capital firms' group accounts. These are investments of the funds, rather than being part of the private equity and venture capital firm group for accounting purposes. Private equity funds are invested in by third party institutional investors (e.g. pension schemes, insurance companies) seeking a return on their investment, as an alternative to investment in listed equities and bonds. The funds are owned by these third party passive investors, not by the private equity advisor arrangers or their manager affiliates. We believe it is important to ensure this distinction between portfolio companies which are investments of the funds, and the private equity and venture capital firm groups which manage the investments on a fiduciary basis is recognised in the approach to consolidated supervision in order to avoid the inappropriate consolidation of certain portfolio companies with private equity and venture capital firm groups.

If portfolio companies that are investment firms, financial institutions, ancillary services providers or tied agents are made subject to consolidated supervision with the investment firm adviser arranger of the private equity or venture capital funds which own the portfolio companies, this will place a very significant regulatory burden on the adviser arranger (and any UK investment firm holding company of the adviser arranger). Such consolidated supervision would be inappropriate and would fail to recognise the distinction between the private equity and venture capital firm group and the portfolio company investments of the funds (a distinction which is recognised for accounting purposes).

The effect of such a provision would also be to act as an incentive to move private equity structures outside of the UK in order to avoid the risk of triggering this provision.

We would therefore ask that if HM Treasury uses its powers in section 143B(2) to expand the definition of 'group' to include the relationships referred to in Article 18 CRR that it, or the FCA, also seeks to clarify the scope of these relationships in such a way that portfolio companies are not inadvertently brought within the scope of consolidated supervision.

We would welcome the opportunity to discuss this concern further with HM Treasury and the FCA in order to ensure that the scope of consolidated supervision under the UK investment firm regime is appropriate for the private equity and venture capital industry in the UK.

We would be very keen to discuss the contents of this letter with you and look forward to hearing from you in order to establish whether a meeting of this sort is possible.

Yours faithfully,

Tim Lewis
Chair, BVCA Regulatory Committee