By email: aml@hmtreasury.gsi.gov.uk

Review of AML/CFT Supervision
Sanctions and Illicit Finance Team
1st Floor Blue
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

2 June 2016

Dear Sirs

Re: Response to Action Plan for anti-money laundering and counter-terrorist finance

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 600 firms, the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members have invested more than £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 490,000 people and almost 90% of UK investments in 2014 were directed at small and medium-sized businesses.

The UK anti-money laundering and counter-terrorist finance ("**AML/CFT**") regime is relevant to the private equity industry in a number of ways. Private equity fund managers are FCA regulated and are required to carry out KYC checks on investors in their funds and on persons from whom they buy and to whom they sell companies. Those managers are subject to the Suspicious Activity Reports ("**SARs**") and consent regimes. Companies in which private equity invests are part of the real economy and are directly impacted by the measures put in place by banks to comply with the regime.

The BVCA's central recommendation: proportionality and risk based approach

The BVCA is supportive of HM Government's ambition to update the AML/CFT regime to focus on higher-risk areas. Paragraph 1.1 of the action plan identifies these as "serious and organised crime, grand corruption and terrorism" (i.e. "**Serious Crime**"). An essential part of this effort will be to remove the unnecessary administration which is currently required of the financial services sector in relation to non-core areas. This will require changes to the law and to the FCA's supervisory approach. This should enable the private and public sectors to better focus their efforts on Serious Crime.

Suggested changes

(a) Limit the SAR regime to apply only to Serious Crime which has not been publicly reported

This should significantly reduce the number of SARs, freeing up resource to focus on the higher risk SARs. Broadly, SARs are required in the UK where a person in the regulated sector has reasonable grounds to suspect money laundering, i.e. certain behaviours relating to "criminal conduct" as defined in the Proceeds of Crime Act 2002 ("**POCA**"). "Criminal conduct" is defined to cover any crime. This forces the regulated sector to investigate and report on matters which are not related to Serious Crime. Anecdotally we understand that none of these non-core matters are ever investigated. This is a significant waste of time and resource. The definition should be limited to cover Serious Crime, insofar as this is compatible with the UK's obligations under the EU Money Laundering Directives.

The position could be further improved by removing any obligation to report crimes whose details are already public. For instance, this would cover circumstances where KYC due diligence carried out through internet search engines reveals details of actual or alleged criminal activity reported in the media. As this information is already public, there is nothing to be gained by having the regulated sector report this to the authorities.

(b) Either (i) remove the consent regime and the risk of committing an offence without consent or (ii) maintain the consent regime and limit the circumstances in which consent is required

If the consent regime is to be removed, then section 328 of POCA (becoming concerned in an arrangement facilitating money laundering) must be removed as well. Otherwise the law will effectively prohibit large amounts of legitimate business activity. This is in part due to the breadth of the definition of "criminal property" and its use in section 328 of POCA. It is also due to the fact that money is fungible property and so there are a wide range of circumstances where suspicions may exist that criminal offences may have occurred which taint an otherwise legitimate transaction. We would be happy to meet with you to discuss practical examples if that would assist.

If section 328 and the consent regime are retained, the current reporting situation could be improved by limiting a section 328 offence (and so effectively limiting the consent regime) to transactions where a person suspects a Serious Crime which has not been prosecuted.

(c) Speed up the process for approving industry specific guidance from the Joint Money Laundering Steering Group ("JLMSG")

A further essential element of the current regime is the work of the various sectors of the financial services industry in being able to set tailored standards. The FS industry is not homogenous. The impact of the anti-money laundering regime on bank accounts is completely different to its impact on commercial M&A transactions and fund raising, which are the contexts in which private equity firms are mainly affected. It is vital that as law and business practices develop, the guidance applicable to the industry develops to reflect this. We note that the action plan contemplates streamlining a number of existing standards. It is important that industry tailored standards remain. It is also important that the authorities tasked with reviewing the industry-developed standards do so promptly. It is now over 18 months since the latest version of the JLMSG Guidance was submitted to

HM Treasury for review, but this has not yet been approved. This gives rise to unnecessary cost and uncertainty for firms.

Responses to questions in consultation document

In Appendices 1 and 2 to this letter the BVCA has responded to those questions posed in Annexes A and C of the consultation paper which we consider are of most relevance to our members.

If you have any queries on this letter please do not hesitate to contact me or Tim Lewis at Travers Smith (tim.lewis@traverssmith.com).

Yours faithfully,

Sheenagh Egan
Chair
BVCA Regulatory Committee

BVCA

Appendix 1

Response to questions posed in 'Annex A: Legislative proposals' of the consultation paper

Section 2(a): Public-private partnership

1. ***The Government is seeking views on the change in focus of the SARs regime from one on transactions to one on the entities responsible for money laundering and terrorist financing.***

   a. ***What benefits are there for the reporting sector in moving the focus of the SARs regime from transactions to entities for tackling money laundering and the financing of terrorism?***

   The BVCA supports efforts to simplify the SARs regime. As the consultation does not make clear how this will work in practice, it is not possible for us to comment substantively. It is not clear how moving to an entity reporting regime would allow the UK to satisfy the requirements of Articles 33, 34, 36 and 38 of the Fourth Money Laundering Directive ("**MLD 4**"). Recital 37 of MLD 4 provides that "[a]ll suspicious transactions, including attempted transactions, should be reported", which is reflected in Article 33 MLD 4, which provides that "[a]ll suspicious transactions, including attempted transactions, shall be reported". As noted above a more important change would be to limit SARs to Serious Crimes.

   b. ***What would be the effect on costs to business in making that shift?***

   Investments in the PE industry, both by investors in PE funds and by PE funds in portfolio companies, often involve the establishment of new legal entities. Therefore, there may be little difference in practice between the burden of reporting on transactions and reporting on entities. The BVCA is not opposed to entity reporting in principle but to provide PE firms with any relief, the new model must take into account the usual structure of a PE transaction.

2. ***To support that change, the Government is considering removing the current consent regime.***

   a. ***What are the risks in removing the consent regime, and how could these be overcome?***

   As noted above, due to section 328 of POCA, the current UK consent regime provides an essential defence to permit legitimate business activity. Due to the current wide definitions of criminal property, etc. in POCA, many transactions carry a risk of a section 328 breach. For instance, a purchaser might face this risk where a target company is discovered to have infringed a health and safety law in the ordinary course of its business; it makes a profit in the ordinary course of its business; the profit may be linked to the products sold in breach of the requirement and this profit may constitute criminal property. Acquiring the company could then lead to the seller (possibly unwittingly) retaining the proceeds of crime, so the purchaser risks breaching section 328. In the absence of a proportionate and risk sensitive legal framework, firms are caught between pleas from the authorities not to over report and the risks of a section 328 prosecution. If the consent regime is removed it appears the only way to overcome this risk would be to repeal section 328.

BICA

b. ***If the current SARs consent regime is replaced, removing the statutory defence for SARs reporters, what legal protections should be available for reporters who unwittingly come into the possession of criminal property?***

The issue is not simply unwittingly coming into possession of criminal property. The issue is also entering into transactions to purchase a company which has committed a non-serious criminal offence, the effect of which is to give rise to some form of criminal property in the hands of the company/its owners. Under the current law, it is an offence for a buyer of such a company to acquire it where the buyer knows of or suspects this non-serious criminal activity. A similar issue arises for criminal offences which have been fully investigated and criminal offences which both have no nexus to the UK and will never be investigated. This is illustrated in our introduction to this letter.

As noted above the only immediate solution we can see is to repeal section 328 of POCA. Otherwise the government would in effect be criminalising legitimate business activity and we do not believe this to be the policy intent.

c. ***What would be the costs to your business of this change?***

If there is no effective defence to section 328 the cost could be significant. Firms would be faced with risking breach of this section in the hope the authorities would take a pragmatic approach to prosecution.

3. ***Should a reformed SARs regime include powers for law enforcement agencies to direct reporters to take certain actions, including maintaining a customer relationship, and provide legal cover for the reporter to do so?***

If this power is to be included, firms must be given full legal protection. Firms should not be obliged to continue with relationships or take actions to the extent this would breach the laws of other jurisdictions.

4. ***The Government is proposing to provide legislative cover to support better data sharing within the private sector.***

a. ***What legislation and guidance needs to be in place to allow effective sharing of information between private sector firms in order to prevent and detect financial crime?***

Before firms could comfortably share information, they would likely require statutory relief from a number of potential civil obligations, such as contractual obligations as to confidentiality, as well as statutory obligations, such as the requirements of the Data Protection Act 1998. Firms sharing information with other firms who they do not suspect of involvement in money laundering offences or other criminal activity would require unambiguous relief from the tipping-off offence in the Proceeds of Crime Act 2002.

b. ***What benefits would you see from having the ability to develop SARs in partnership / report jointly with other private sector entities?***

There could be significant benefits.

Currently, once a firm has suspicions it will typically submit a SAR without consulting any other parties that might also be involved in the transaction. This is to avoid the risk of the reporting firm committing the tipping-off offence. For similar reasons, the reporting firm will not inform any other parties once the report has been submitted. This means that although the reporting firm cannot proceed with the transaction until or unless the UKFIU grants consent, the other parties to the transaction have no explanation as to why the transaction has stalled. Other parties to the transaction may continue to deal with the person about whom the report has been made, unaware of the reporting firm's suspicions. Alternatively, they may file their own parallel SARs with the NCA. Unless the Consent Team at the UKFIU consents to each reporter continuing with the transaction at the same time, whether the transaction may complete will be contingent on the administrative process of processing all the consent requests in good time. It would be preferable if once suspicions have formed, parties to the transaction (with the exception of the person who is the subject of suspicion and their advisers) are able to discuss their suspicions, build a clearer and more complete picture, and submit a joint report to the NCA. The UKFIU would benefit from a more complete report and is then able to decide whether it is able to consent to the transaction proceeding fully appraised of all available facts. The other parties to the transaction would benefit from being required to obtain only once consent from the UKFIU Consent Team.

Section 2(b): Enhanced law enforcement response

10. ***The Government is considering the introduction of a power to enable the Government to designate entities of primary money laundering concern.***

    a. ***What benefit would such a power provide?***

    This could make performing KYC checks more straightforward on designated entities. The consultation does not make clear what if any effect the new power would have on KYC checks on other entities.

    b. ***What would be the impact of such a power on firms in the regulated sector?***

    It would be important that firms could cheaply and easily confirm whether those persons with whom they deal are designated persons. The BVCA would be concerned if its members were subject to additional filing and reporting requirements or were required to implement systems and controls substantially beyond those that they already maintain for AML/CFT purposes.

    e. ***What would be the costs to your business?***

    We do not have sufficient information about the proposal to answer this question.

BVCA

Appendix 2

Response to questions posed in 'Annex C: AML Supervisory Regime' of the consultation paper

1. ***Should the government address the issue of non-comparable risk assessment methodologies and if so, how? Should it work with supervisors to develop a single methodology, with appropriate sector-specific modifications?***

   BVCA members are mostly subject to the sole supervision of the FCA which has a consistent approach to risk assessments. The BVCA values the specific risk assessments methodology set out in the JMLSG Guidance for Private Equity firms. We consider that this is the appropriate location for any risk assessment guidance. This guidance has been tailored for the scenarios most frequently encountered by the PE/VC industry. This guidance relies upon approval by HM Treasury. To the extent that the authorities wish to influence sector specific guidance we recommend that they do so through the JMLSG.

   Regulatory transparency and consistency of approach is essential. Firms should not be punished for taking reasoned approaches where they genuinely seek to comply with the law even if in hindsight things could have been done differently.

2. ***How should the government best support supervisors – and supervisors support each other – to link their risk-assessments to monitoring activities and to properly articulate how they do so?***

3. ***Should the government monitor the identification and assessment of risks by the supervisors on an ongoing basis? Should the supervisors monitor each other's identification and assessment of risks? How might this work?***

4. ***Should smaller supervisors be encouraged to pool AML/CFT resources into a joint risk function and would this lead to efficiencies? If so, how should they be encouraged?***

   BVCA members are largely subject to the sole supervision of the FCA and the BVCA favours responsibility for AML/CFT supervision remaining with the FCA.

10. ***Should the government seek to harmonise approaches to penalties and powers? For example, should supervisors have access to a certain minimum range of penalties and powers and what should these be? Should there be a common approach for deciding on penalties and calculating fines based on variables such as turnover that are scalable to the size of the business?***

    The FCA has imposed substantial fines on a number of firms since the financial crisis. Its penalties regime is set out in the Decision Procedure and Penalties Manual (DEPP) of the FCA Handbook. There are a number of elements that the FCA uses to determine the appropriate level of financial penalty, including disgorgement, to prevent firms or individuals form benefiting from breaches of the FCA's rules, discipline, to penalise wrongdoing, and deterrence, to prevent the firm or individual and others from committing similar breaches. The FCA regime is very tough and the BVCA does not see the need for, or support, a penalties regime based on turnover.

11. ***Should the government seek to establish a single standard for supervisors disciplinary and appeals functions?***

    The BVCA considers that a common standard is important and that appeals should be allowed to an independent tribunal, such as the Upper Tier Tribunal.

13. ***Should all supervisors have powers to compel supervised businesses to submit comprehensive and up-to-date information to aid risk assessment?***

    The BVCA's members are largely authorised by the FCA and, as such, are already subject to extensive reporting requirements. The BVCA does not support the imposition of further onerous reporting obligations on its members.

14. ***Is there a need for supervisors themselves to undergo training and/or continuous professional development? If so, what form might this take and should it be government-recognised?***

    The BVCA does not consider that better training for supervisors on the UK AML/CFT regime would lessen the compliance burden on firms because the burdens stem from the UK's AML/CFT legislation, rather than from supervisors placing burdens on firms that go beyond the legislation.

15. ***Is there a need for relevant persons in the supervised populations across all sectors to undergo training and/or continuous professional development to aid their understanding of AML/CFT issues?***

    The BVCA does not consider that there is a lack of understanding of AML/CFT issues among its members given the clear guidance for Private Equity firms in the JMLSG Guidance. Rather, the challenge faced by the PE/VC industry is that UK AML/CFT legislation is drafted so broadly that it leads to over-reporting.

19. ***How could inconsistencies between the JMLSG guidance and the FCA's Financial Crime Guide best be resolved? Should the two be merged? Or should one be discontinued and if so, which one and why?***

    The BVCA's primary concern is that the PE industry has specific guidance available to it which has been authored by persons with experience of the industry and who are familiar with the types of scenarios in which firms are likely to need to apply KYC and AML/CFT controls. The JMLSG Guidance is essential for this and must be preserved. To the extent that the authorities wish to influence sector specific guidance we recommend that they do so through the JMLSG. If either is to be discontinued it should be the FCA financial crime guide.

20. ***What alternative system for approving guidance should be considered and what should the government's role be? Is it important to maintain the principle of providing legal safe harbour to businesses that follow the guidance?***

    The legal safe harbour is extremely important and should be maintained.

    The main problem with the existing JMLSG Guidance regime is the amount of time it takes HM Treasury to approve the guidance. It is unclear to us why the approval process has taken so long and given the subject matter, whether it has been given sufficient priority. Following a consultation on

proposed amendments to the Guidance, the JMLSG publishes a final revised version of the Guidance on its website and notes that the revised Guidance has been submitted to HM Treasury for Ministerial approval. There is often then a long wait before Ministerial approval is granted. By way of example, the latest version of the Guidance was published by the JMLSG on its website on 21 November 2014 but has yet to be approved by HM Treasury. This is now the latest version of the Guidance appearing on the website. It would be natural for businesses to treat this as the current version of the Guidance.

The JMLSG website currently states that, "[a]lthough the amended Guidance will only take over the 'legal' status of the existing Guidance once it has been approved by a Treasury Minister, firms are free to use the provisions of the new Guidance immediately if they wish to do so". It is therefore unclear to firms the point from which they can formally rely on the revised Guidance. Most firms assume that they are able formally to rely on the Guidance once it is published on the website (notwithstanding that the POCA strictly requires a court to take account only of industry guidance that has been approved by a Treasury minister).

It would be helpful if: (1) the JMLSG website could confirm that firms can treat the Guidance as approved once published; and (2) in any event, the period between the JMLSG publishing a revised version of the Guidance and it being approved by HM Treasury could be minimised.

21. ***Should the government produce a single piece of guidance to help regulated businesses understand the intent and meaning of the Money Laundering Regulations, leaving the supervisors and industry bodies to issue specific guidance on how different sectors can comply? If so, would this industry guidance need to be Treasury approved? Should it be made clear that the supervised population is to follow the industry guidance?***

The BVCA would welcome a single source of guidance for firms, as currently many firms perform a gap analysis between the JMLSG Guidance and the FCA guidance to ensure that they comply with both. This is time-consuming, inefficient and exposes firms to the risk that they don't identify all the gaps and fail to comply with all the requirements of both documents. The BVCA considers it essential that it is able to contribute to effective guidance specific to the issues that could arise in the PE sector. For example, generic guidance prepared for large volumes of transactions with individual clients is not well suited to firms dealing with low volumes of transactions with institutional investors. The relationship between a PE firm and a portfolio company is also unique as PE firms do not, in practice, take day to day operational decisions in the same way as ordinary corporate groups and specific guidance is required for this situation to avoid damaging the unique nature of the PE firm/portfolio company relationship.

22. ***Should supervisors be required to publish details of their enforcement actions and enforcement strategy, perhaps as part of the Treasury's annual report on supervisors, or in their own reports? What are the benefits and risks in doing so?***

It is important that this is transparent. The FCA currently does this and should continue to do so.

23. ***Should the government publish more of the detail gathered by the annual supervisor's report process? For example, sharing good practice or weaknesses across all supervisors?***

The BVCA supports measures which would allow different supervisors to understand good practice in a particular sector, to help, for example, some supervisors understand that the AML/CFT risks posed by the PE sector are distinct from those in the retail or commercial banking sectors which may have a different approach to AML/CFT controls.

24. ***Should supervisors be required to undertake thematic reviews of particular activities or sections of their supervised populations, as the FCA currently does? If so, how often should such reviews be undertaken?***

BVCA members form part of the asset management sector which is already subject to regular anti-money laundering thematic reviews (for example, the review 'TR13/9 – Anti-Money Laundering and Anti-Bribery and Corruption Systems and Controls: Asset Management and Platform Firms' published in August 2015) and should not be subject to an additional set of reviews by other supervisors or law enforcement agencies.

25. ***What is the best way to facilitate intelligence sharing among supervisors and between supervisors and law enforcement? What safeguards should be imposed?***

The BVCA's members may file AML/CFT reports with the FCA and NCA. Such reports are received subject to strong confidentiality safeguards. Given that the information provided to these regulators may be price sensitive, it is important that other supervisors and law enforcement agencies have suitable safeguards in place to maintain the confidentiality of this information.

26. ***As one means of facilitating better sharing of intelligence among supervisors and between supervisors and law enforcement, could the government mandate that all supervisors should fulfil the conditions for, and become members of, a mechanism such as FIN-NET? Are there other suitable mechanisms, such as the Shared Intelligence System (also hosted by the FCA)?***

The Consent Team of the UKFIU, on behalf of the NCA, works with other law enforcement agencies and other supervisory partners when arriving at a decision as to whether or not to grant consent for a financial transaction. The BVCA is supportive of initiatives to build information sharing systems that would allow the Consent Team to provide consent for financial transactions more quickly.

27. ***Should the government require all supervisors to maintain registers of supervised businesses? If so, should these registers cover all registered businesses or just certain sectors? Should such registers be public? What are the likely costs and benefits of doing so?***

BVCA members are mostly authorised by the FCA and will appear on the Financial Services Register. While the BVCA can understand the merits of a single register, this should not add further filing requirements or fees to firms which are already heavily regulated. It would be preferable for the single register to draw on information held in regulators' existing registers where possible, particularly where that regulator, like the FCA, takes responsibility for ensuring that there are effective financial crime systems and controls in place in the firms it regulates.

BVCA

28. ***How can credit and financial institutions best be encouraged to take a proportionate approach to their relationships with customers and avoid creating burdensome requirements not strictly required by the regulations?***

The BVCA notes that, to date, AML enforcement actions have largely focused on financial services institutions which are perceived to present the highest risk of facilitating money laundering, such as those providing bank account or payment services. The BVCA considers this focus to be appropriate. However it is vital that banks are sent a consistent message on AML requirements and that they are encouraged to take a proportionate approach through the recognition by supervisors that banks should not be exposed to fines where they have legitimate grounds to explain their approach.

The experience of BVCA members is that banks and large investment firms in particular now feel they have no option but to apply a gold-plated approach to their AML procedures, with more focus on form than substance. This means that the process is bureaucratic rather than risk sensitive. PE/VC firms and other participants engaged in transactions involving banks witness and experience this first hand, with many banks and large investment firms adopting unrealistic and entirely disproportionate approaches.

The thematic reviews carried out by the FCA and their financial crime guide contain some recommendations which do not reflect a risk based approach. The FCA needs to be consistent and not shift the goal posts during the course of its review exercises.

To avoid firms adopting a gold-plated approach to AML procedures, all firms, and in particular large financial services firms, should be given a clear message and mandate which gives them the confidence to ensure a risk-sensitive approach underlies their approach to AML. This, coupled with a consistent supervisory approach, may help redress the balance.

29. ***Does failure of AML/CFT compliance pose a credible systemic financial stability risk? If so, does this mean that the FCA should devote more resource to the largest banks which have the greatest potential to have systemic effects?***

Some types of failure relating to serious crime could pose this risk if they fundamentally undermined the credibility of the UK financial system. However, some breaches of the current standards relating to other types of crime will not be systemic.

30. ***How should the FCA address the perception from evidence submitted to the Cutting Red Tape Review that it is overly focused on process and ensure that its AML/CFT supervision is focused proportionately on firms which pose the greatest risk?***

The BVCA supports the FCA's current focus on bribery and corruption in the financial services sector for the reasons outlined at the start of this letter. Nonetheless, where the FCA has developed a particular regulatory focus, it is important that the supervisory work carried out on a thematic basis is tailored to the specific risks presented by a particular sector so that the regulator does not presume that good practice in one sector, for example retail or commercial banking where there is a high volume of low value transactions and relatively little direct customer interaction, is directly applicable

to another sector, for example the PE industry which relies on complete certainty as to the timing of the completion of deals to allow for often substantial funding to be agreed.

31. ***Is the number of supervisors in itself a barrier to effective and consistent supervision? If so, how should the number be reduced and what number would allow a consistent approach?***

The BVCA considers the FCA to be a strong and effective regulator with which its members have a good working relationship. The BVCA would not support changes that would require its members to build a relationship with a new AML/CFT supervisor.

32. ***If this is an issue, are there other ways to address it? For example, would supervisors within a single sector benefit from pooling their AML/CFT resources and establishing a joint supervisory function?***

The primary regulator for the UK PE industry is the FCA, so the supervision of firms for AML/CFT purposes is already centralised in a single institution.