bvca
Invested in a better future

Asset Management & Funds Policy team
Financial Conduct Authority
12 Endeavour Square
London
E20 1JN

22 July 2022

Dear Asset Management & Funds Policy team

Re: Review of the UK Fund Regime

The British Private Equity and Venture Capital Association ("BVCA") welcomes the FCA's engagement on how the regulatory regime can be modernised and improved for UK funds.

The BVCA is the industry body and public policy advocate for the private equity and venture capital ("PE/VC") industry in the UK. With a membership of over 750 firms, we represent the vast majority of all UK-based PE/VC firms, as well as their professional advisers and investors. Between 2016 and 2020, BVCA members invested over £47bn into around 3,500 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 over 2 million people in the UK and 90% of the businesses our members invest in are small and medium-sized businesses.

Our industry's key message is that the UK is home to a world-leading PE/VC fund management industry. This is in part due to UK's world-class regulatory standards that investors demand, and these standards must be maintained. However, there are several areas where onshored legislation can be calibrated and UK regulations can be improved to better suit the needs of the UK market, PE/VC investment managers and investors.

Below, we have put forward recommendations to enhance the attractiveness of the UK as a place to establish a PE/VC firm, raise capital and invest in the UK. We recommend changes to the following key areas:

a. **Increase speed to market:** we recommend the FCA make changes to reduce administrative burdens on industry, lengthy waits for application and notification case allocation and processing delays, which are disruptive to industry, particularly when speed to market is critical.
b. **Improve the UK Fund Regime for VC vehicles:** we recommend the FCA make changes to the UK's RVECA regime to help make the UK a more competitive place to establish venture capital funds that invest in innovative growth businesses.
c. **Address unintended consequences on UK PE/VC:** certain of the UK's domestic and onshored regulations were designed for listed securities and traditional asset managers and are not suitable for PE/VC investment managers.
d. **Reduce reporting burdens on UK firms:** we recommend the FCA conduct a review into reporting requirements to reduce or eliminate those onshored from EU law where the resulting information and data is not useful to investors or the FCA.
e. **Ensure effective sustainability regulation in the UK:** the UK's sustainability regulation for private capital investment must be proportionate, whilst being compatible with international frameworks.

Registration number: 01697461 | Registered in England and Wales | Registered Office 3rd Floor, 48 Chancery Lane, London WC2A 1JF
The Association is a private company limited by guarantee without share capital

a. Increase speed to market

Without changing any rules or regulation, the FCA can quickly boost the competitiveness of the UK by improving operational processes and procedures in the supervisory and authorisation teams. The time taken to complete regulatory applications and notifications is a key consideration for investment firms when considering where to locate and invest. While we recognise the importance of maintaining robust and high standards, lengthy waits for case allocation and processing delays are disruptive to industry, particularly when speed to market is critical.

To achieve this, we recommend the FCA make changes to:

- **Increase resource**: more case workers assessing applications and notifications will help to speed up processes, bringing down target processing times and reducing the likelihood of further delays. We also recommend assigning case officers to firms/sectors, to build an industry understanding and improve process efficiency.

- **Automate**: automating simple, low-risk application and notification processes (e.g. through a 'deemed consent' mechanism) would significantly improve processing times and free-up FCA resource to consider higher-risk and more complex casework. Where possible, forms should be pre-populated or streamlined to prevent repetition when requesting information that is already held by the FCA.

- **Simplify**: proportionality should be used to simplify certain processes, such as change of control notifications. Many PE/VC firms invest in businesses which hold consumer credit or insurance intermediation licences to support their core business activities, e.g. dentists, caravan park operators and online car rental companies, etc. The change of control notification process that applies when investing in these businesses is time consuming, often taking between six weeks and three months, and is the same process that would apply when acquiring a controlling stake in a large bank, securities broker, or asset manager. This is disproportionate and adversely affects the flow of investment capital into portfolio companies. We recommend that the UK should simplify the law and streamline its regulatory approach to application and notification processes to introduce proportionality and improve the service provided to industry.

The table below provides the current waiting/processing time for applications and notifications made to the FCA across the investment manager, fund, and portfolio company level. We have suggested targets that will help to improve firms' experience and make the UK a more competitive jurisdiction. We note many of these periods are longer than competitor jurisdictions, such as Luxembourg and Ireland.

Process	Current processing time	Target processing time
Manager level		
New manager authorisation	9 – 12 months +	6 months
Variation of permission	3 – 6 months +	1 month
Approving the appointment of new directors/Senior Management Functions	6 weeks – 3 months	2 weeks
Cancellation of permissions	2 weeks	2 weeks
Fund level (reflecting UK implementation of EU AIFMD)		
Registering a new AIF	1 month	1 week
Registering changes to an AIF	1 month	1 week
NPPR initial filing	1 day	1 day

bvca
Invested in a better future

Portfolio level		
Changes to control process for portfolio companies	3 months+	1 month

b. Improving the UK Fund Regime for VC vehicles

As recognised by the Government and in the comments made by the Rt. Hon. Mel Stride, Chair of the Treasury Select Committee, on the launch of an inquiry into the VC market, "VC has a key role in ensuring innovative UK firms prosper", and it is rightly a priority of the Government to make sure the market is working well.

To help enhance the UK VC ecosystem, we recommend that the FCA should make changes to improve the existing regime for VC managers and fund vehicles to make the UK a more competitive place for VC managers to establish funds, raise capital and invest in early-stage UK businesses.

We believe it is not necessary to introduce a new type of vehicle to achieve this. Instead, this can be achieved through changes to the Registered Venture Capital fund ("RVECA") regime, which is the UK onshored version of the EU's EuVECA. EuVECA is a voluntary fund framework that provides qualifying VC funds with an EEA marketing passport, which means they can market to professional clients, as defined in MiFID, across the EU and to other investors who can commit a minimum of EUR 100k and state in writing that they are aware of the risks associated with the investment. While an EEA marketing passport for RVECAs is not in the gift of the FCA or the UK Government, there are several changes that should be made in order to:

1. make the RVECA more attractive for VC managers as a UK alternative to establishing an EU EuVECA manager;
2. remove a number of obligations that make it less attractive to VC managers than a conventional UK sub-threshold manager; and
3. create a regulatory category that is used by VC fund managers, to which future regulatory change may be either applied or adapted where appropriate in order to support UK venture and investment in early stage high growth UK companies.

To date, there has been low take up of RVECAs due to the regime's rigidity. Amendments should seek to remove unnecessary investment barriers and ease administrative and organisational burdens inherited from the EU regime, while maintaining high regulatory standards. We would like to discuss in particular the following changes to the RVECA regulations:

- **Qualifying investments:** under the current rules, an RVECA must invest at least 70% of its aggregate capital contributions and uncalled capital in qualifying investments. 'Qualifying investments' are limited to:
  - equity and quasi-equity instruments issued by qualifying portfolio undertakings;
  - loans to portfolio companies in which the RVECA is already invested (not exceeding 30% of the RVECAs investible capital); and
  - units or shares in VC funds, providing those VC funds have not themselves invested more than 10% of their investible capital in VC funds.

  The 70% threshold itself is relatively high, we would welcome a reduction to 60%, in line with the current EC proposal to reduce the ELTIF asset threshold from 70% to 60%.

  The requirement on a RVECA to invest more than 70% of its investment capital in equity is unnecessarily prohibitive. Early-stage UK businesses seek and need investment at all levels of

their balance sheet, so greater flexibility for RVECAs to invest in debt would provide greater investment opportunities to VC investment managers and more options and funding for UK SMEs.

- **Qualifying portfolio undertaking:** under the current rules a qualifying portfolio undertaking is an entity that at the time of the first investment by the RVECA fund:
  - complies with one of the following:
    - is not admitted to trading on a regulated market or multilateral trading facility and employs up to 499 persons; or
    - is listed on an SME growth market and is a small and medium-sized enterprise (meaning it had an average market capitalisation of less than €200 million at year end for the previous three calendar years);
  - is not an AIF, credit institution, investment firm or insurer; and
  - is established in the UK, or in another jurisdiction that is not listed as a non-cooperative country by the FATF, and has a dual tax treaty with the UK that complies with Article 26 of the OECD Model Tax Convention and ensures an effective exchange of tax information.

The restriction on investing in AIFs (that are not themselves RVECAs) means RVECA managers are limited in the extent to which they can invest in seed and incubator vehicles. Those vehicles typically invest in seed or pre-seed stage companies, support founders, and help those very early stage companies grow, and are often managed or operated by the same manager, a team within the same group as the manager, or by a third party. They are proving an effective and efficient way to invest in very early-stage businesses in the UK, for VC managers to seed UK companies and a source of capital for the founders of those companies. We would welcome including seed funds and incubator vehicles within RVECA eligible assets.

The restriction on RVECA managers only managing RVECAs is also drawn too narrowly and inhibits RVECA managers' internal fund and co-investment vehicle structuring options. It is common practice for one manager to manage several different vehicles within a single private fund structure, either for the firm's internal structuring reasons (e.g. a carried interest partnership) or to increase optionality for investors (e.g. a co-investment vehicle). It may be impossible for all these vehicles associated with a single fund structure to qualify as RVECAs (e.g. because a carried interest partnership invests uniquely in the main fund vehicle or because a coinvestment vehicle only has one investor). This significantly reduces the utility of the RVECA label. We recommend that the requirement be extended to allow RVECA managers also to manage investment vehicles that are associated with a particular RVECA fund. For example, expressly permitting a registered RVECA manager to manage RVECA funds and (i) one or more vehicles which invest in one or more RVECAs managed by the RVECA manager and only have as their participants individuals connected to the management of the RVECA; and (ii) co-investment vehicles which invest alongside one or more RVECA funds managed by the same RVECA manager.

The exclusion from investing in investment firms and insurers excludes part of the UK fintech sector from being eligible assets. We think it important to re-consider the rationale for excluding those fintech sectors from a source of investment.

bvca
Invested in a better future

We would welcome consideration of whether the Art 26 OECD tax treaty requirement is necessary, or how best to reduce the need for RVECA managers for complex, costly cross-border tax advice which is currently a barrier to establishing RVECA managers (as it is for EuVECA managers).

We recommend the FCA reconsider the need for these investment restrictions.

- **RVECA marketing restrictions:** RVECAs can be marketed to professional clients (as defined in MiFID) and retail investors provided they commit to investing a minimum of EUR 100k and state in writing that they are aware of the risks associated with investing in VC.

  Given the RVECA's minimum investment criteria and risk warnings, we would welcome further review of whether the proposed revisions to the UK financial promotions regime (in FCA consultation paper CP22/2: Stregthening the financial promotion rules for high-risk investments), in particular to high net worth and sophisticated investors, should apply when marketing RVECAs.

  The MiFID definition of a professional investor does not, in our view, reflect the degree of knowledge of investors in PE/VC and unduly excludes certain types of long-term investor from committing capital to unlisted businesses. See section c. below on unintended consequences for our detailed comments on the professional investor definition and our recommendations for change.

- **Bringing the RVECA regime in line with the UK small authorised AIFM requirements:** the most significant example of this is the current difference in regulatory capital requirement of an RVECA manager and of a small authorised AIFM. An RVECA manager is required to have minimum initial capital of €50k, plus own funds which at all times amount to at least one-eighth of the fixed overheads incurred by the manager in the preceding year. Where the value of the RVECA funds managed by the manager exceeds €250 million, the manager must have an additional amount of own funds equal to 0.02% of the amount by which the total value of the RVECA funds exceeds €250 million. The RVECA's high regulatory capital requirement is off-putting to small VC investment firms and we recommend it is aligned to that for small authorised AIFMs, at £5k.

- **Streamline RVECA obligations with market practice:** certain aspects of the RVECA regime could be better aligned with market practice to reduce the regulatory burden on RVECA managers and the barrier to entry for new RVECA managers, without weakening investor protections. For example, some of the information items that are required disclosures under Art 13 RVECA are of limited value to prospective investors, and others overlap to a considerable degree with the Art 23 AIFMD disclosure obligations. RVECA managers that market an RVECA fund into certain EU member states are required to provide Art 23 AIFMD disclosures. So, a review of the Art 13 RVECA disclosure obligations and bringing those that are useful in line with the Art 23 AIFMD disclosure obligations could reduce RVECA managers' need for costly regulatory advice.

c. Address unintended consequences on UK PE/VC

Much of the UK's domestic and onshored regulations were designed for listed securities and traditional asset managers and are not suitable for PE/VC investment managers, which creates costs and challenges and can have unintended consequences. For example:

- **Professional investor definition:** The onshored definition of a 'professional investor' in UK AIFMD does not represent the knowledge and experience needed to invest in private capital and is restricting the ability of otherwise suitable and qualified investors to invest. Annex II of MiFID, which determines what is a professional investor under AIFMD by virtue of the cross reference made to in Article 4(1)(ag), also has wider implications, such as the requirement to produce a PRIIPs Key Information Document (KID) for investors who do not meet the MiFID definition. We believe the approach taken in the UK for defining sophisticated and high-net-worth investors for the purposes of the financial promotion rules is more appropriate and recommend it is extended to UK AIFMD.

  Further, the MiFID elective professional tests are calibrated for MiFID investment services provided in relation to liquid assets such as traded shares. The tests are extremely difficult to satisfy by individuals who invest in long-term PE/VC funds, regardless of their wealth, sophisticated or experience. This is because PE/VC funds make relatively few transactions and the relevant experience is often in business, e.g. as entrepreneurs, rather than financial services. Our members often find that sophisticated and high-net-worth investors, family offices, entrepreneurs, academic endowments, executives, directors, and employees of the firm that are involved in the management of the fund must be treated as retail investors despite having suitable experience and expertise equivalent to institutional investors. We believe these categories of investor should be treated differently in these circumstances and recommend that it is made clear by the FCA that the definition includes "opted-up" investors under the UK standard, which pre-dates MiFID and is more appropriate for investors in PE/VC.

- **PRIIPs regulation:** We welcome some of the FCA's recent changes to UK PRIIPs, including new guidance on the circumstances when a PRIIP is not "made available" to retail investors and the replacement of performance scenarios with a narrative description of performance. However, we believe the requirement for venture capital trusts ("VCT") to be assigned a summary risk indicator of at least 6 is arbitrary and that an assessment should be based on the risks inherent in the underlying assets.

  In advance of HM Treasury's upcoming review into retail disclosure, we would like to draw the FCA's attention to our outstanding areas of concern and make policy recommendations. The requirement to produce a KID has dissuaded some PE/VC managers from marketing to high-net-worth investors and other categories of investor where otherwise permitted under EEA national private placement regimes ("NPPR"). Some of our members have chosen not to market to certain investors that have previously invested in PE/VC funds and who are experienced investors and/or industry experts. To address this, we believe that investors classed as semi-professional investors, introduced as part of the European Venture Capital Funds Regulation, should be outside the scope of the PRIIPs regulation. This is appropriate because all prospective investors are provided with considerable amounts of information and are expert enough to carry out their own due diligence prior to making an investment. They are also required to confirm that they understand the risks involved.

We therefore recommend that the FCA remove the requirement to produce a KID where a fund is distributed on a private placement basis, e.g. to less than 150 retail investors in the UK.

We also note that the requirement to publish a KID on the manufacturer's website potentially cuts across the private placement regimes under which PE/VC funds are typically distributed. It is a key feature of private placement regimes both within the EEA and internationally that there should be no general solicitation of investors or general advertising of the product. A PE/VC firm will therefore typically not make any marketing materials relating to its funds generally available on its website.

- **Prudential rules for investment firms:** We urge the FCA to revisit the regulatory classification and treatment of UK PE/VC MiFID adviser arrangers because the approach puts UK firms at a competitive disadvantage compared to the EU, where similar activities are not always licenced.

  In addition, the UK application of MiFID investment firm standards to AIFM fund managers, as well as AIFMD requirements is disproportionate when compared to the EU, where a lighter touch regime is available. This puts UK CPMI firms at a competitive disadvantage when compared to many EU counterparts, which benefit from both the EU passport and lower capital requirements. For groups with both a UK CPMI firm and an equivalent entity in the EU, the UK regulated firm is subject to more stringent requirements. At a minimum we recommend that the overlap between the IFPR and AIFMD rules should be reduced as far as possible.

- **Other rules for investment firms:** We also urge the FCA to consider the application of other conduct of business rules and systems and controls requirements to UK PE/VC MiFID adviser arrangers. A number of the requirements were not drafted with PE/VC firms in mind; are impractical for such firms; and/or are very unclear in their application. All of this creates real cost and complexity for businesses. We consider that the regulatory aims could still be met by a more thoughtful approach, with real resulting benefits for the UK's PE/VC industry. Examples include the application of the MiFID II inducements regime; the unnecessarily broad scope of the telephone taping requirements when applied to this sector; the complexities of the arrangements needed to be put in place by adviser/arrangers to comply with transaction reporting if they (albeit very rarely) place an order in relation to an in-scope security; the technical application of the product governance regime to "business as usual" activity. There are many other examples which] we would welcome the opportunity to discuss this with you.

- **Solvency II:** The Solvency II framework has incentivised insurers to retrench from more long-term and thus illiquid assets. Over the past few years, insurers' investment in equities have been reduced by half, from 20% to 10% of their total assets. As Solvency II capital requirements made equity investments less attractive, it became part of a general trend that forced insurers to withdraw from this asset class as a whole and disproportionately affected some types of long-term equities.

  The amendment to Solvency II to introduce the Long-term Equity (LTE) category of equity investments only partially addressed this issue. The LTE category complements the one-year VaR view underpinning Solvency II with a long-term investment view (and so in this way recognising the role of insurers as long-term investors). The LTE category essentially "shelters", under certain conditions, illiquid assets (such as investments in venture or growth capital) from an

inappropriate volatility assessment (a volatility assessment being at the core of the SCR equity risk module), so considering to some extent the specific characteristics of those assets.

In our opinion, it is possible to further tailor the criteria for portfolios to fall within a dedicated "long-term" category, which is the best route to increase the ability of insurers to support equity exposures to venture and growth funds. De-coupling the assessment of the risk of such illiquid, long-term equity exposures from a comparison to listed equities held for the long-term, that does not consider the way insurers structure their long-term portfolios and the specific characteristics of holding such illiquid exposures.

For example, the methodologies for the SCR could give more scope for insurers to consider the diversification of their portfolios. We feel that diversification of an exposure within an asset class (rather than simply diversification in different asset classes or types of equities) has not to date been appropriately measured within the Solvency II framework. BVCA (and Invest Europe) studies show that the risk of losing any capital over the entire holding period with a portfolio of just 15 funds is far lower than, for example, the reduced 22% capital charge applying to LTE investments and that a portfolio can essentially be risk free when it contains 25 or more funds.

Similarly, the approach of requiring insurers to take into account volatility of investments in venture or growth capital does not reflect that insurers do not typically sell such interests before the end of the life of a fund. For example, when an insurer makes a commitment to a closed-ended private equity fund, it does so for a fixed ten-year period (often extended by two further years or more). It would be more appropriate to give scope to recognise realisation risk – i.e. the risk that an insurer will lose its capital at the end of its investment. Realisation risk is linked to the long-term performance of the fund (and ultimately the success of the underlying businesses and of the patient capital approach).

In our view, further tailoring the criteria for investments within a "long-term" category, such as venture and growth, would be valid for insurers whether they are on the standardised model or the internal model. The way in which risk weightings are computed under the standard formula also have a huge impact on internal model insurers' calculations. One has to take into consideration that, usually, a private equity portfolio represents only a small fraction of the total assets under management by insurance companies. This means that, for them, investing resources in calculating ex-novo an appropriate risk weight for a private equity portfolio is uneconomic. Therefore, they may rely on the risk weightings proposed under the standard formula and incorporate them in their internal model, maybe with some adjustments (usually even more conservative).

d. Remove unnecessary complexities created by onshored EU rules

Now that the UK has left the EU, we recommend that the FCA, alongside the UK Government, takes the opportunity to review unnecessary complexities created by the overlaying of the EU regimes onto UK laws. These can have a significant impact on PE/VC businesses, among others. Examples include:

- The unnecessary restrictions on the additional activities which can be carried on by AIFMs under article 6 of AIFMD, which mean that firms which want to act as an AIFM and also provide certain additional activities need to establish and run a second regulated entity.

- The layering of the MiFID exemptions in the Regulated Activities Order onto the UK exemptions (under the so-called "MiFID override" in article 4(4) of the RAO) removes the benefit of some valuable UK exemptions from firms carrying on certain activities and makes interpretation of UK law unnecessarily complex, even to the seasoned lawyer. An assessment of the affected provisions should be undertaken against the additional risks guarded against by the narrower EU exclusions and a single set of laws should then be adopted. These are not just legal technicalities – they have real impact.

We would welcome the opportunity to discuss additional examples with you.

e. Reduce reporting burdens on UK firms

Now that the UK has left the EU, we recommend that the FCA takes the opportunity to review reporting requirements to reduce or eliminate those onshored from EU law where the resulting information and data is unduly burdensome for industry to collect or is not useful to investors or the FCA. Examples include material change clearances under AIFMD and Annex IV reporting under AIFMD (detailed in SUP 16.18 and FUND 3.4).

Annex IV presents a major challenge for investment managers in terms of complexity of information, ongoing costs and the significant amount of time required to set up and collect data and coordinate the exchange of information among multiple service providers. These processes are administratively burdensome, provide little, if any, benefit and take valuable time and resource away from industry and the FCA. We think it would be better to free FCA and industry resource to spend time on more productive tasks.

f. Ensure effective UK sustainability regulation

PE/VC firms are well placed and incentivised to integrate climate and broader sustainability considerations into their operations. UK sustainability regulation for private capital investment must be proportionate, whilst being compatible with international frameworks.

The FCA should learn from the EU's approach to SFDR and tailor the UK approach such that it works effectively in a PE/VC context:

- **Labels should be optional "hallmarks"**: a label should be something that managers choose to adopt, not applied by default to certain products based on their approach to ESG. Labels should be made available for socially sustainable as well as environmentally sustainable products. In addition, entry conditions and ongoing requirements for labelled products should be clearly set out to avoid the confusion in the market caused by SFDR categorisation.

- **Labels should describe investment strategy**: labels should imply binding investment rules, not a given composition. PE/VC managers will not be able to guarantee any allocation to sustainable investments as they invest and divest over time and portfolio re-construction is difficult/unlikely to be in consumers interests when investing in illiquid assets.

- **Data availability**: is likely to be an issue for SMEs and non-UK portfolio companies, so the rules will need to be proportionate and incorporate transitional provisions.

Please do not hesitate to get in touch if you have any questions or if you would like to discuss any of the above.

Yours sincerely,

Tim Lewis, Chair, BVCA Regulatory Committee