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

Consultation on Transposition of 4MLD
Sanctions and Illicit Finance Team
1st Floor Blue
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

9 November 2016

Dear Sirs

Re: Response to HM Treasury's ("HMT") Consultation on Transposition of the Fourth Money Laundering Directive ("4MLD")

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 over £27 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 385,000 people and 84% of UK investments in 2015 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 when carrying out merger and acquisition activities. 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 recommendations: preserve JMLSG Guidance and risk based approach

The BVCA is supportive of HM Government's ambition to transpose 4MLD to ensure that the UK's AML/CFT regime is kept up to date, effective and proportionate. One essential part of this effort is to preserve both the central risk based approach to implementation and the role of industry in setting tailored standards, co-ordinated through the Joint Money Laundering Steering Group ("JMLSG"). We urge HM Government to continue to support its work and to maintain the current status of the JMLSG Guidance for the UK Financial Sector ("Guidance").

Industry practitioners are familiar with the details of their business practice and we believe are uniquely placed to develop effective and practical guidance. This was the genesis of the JMLSG

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Guidance and it has proven extremely effective. As noted in the BVCA response to the AML/CFT Action Plan, dated 2 June 2016, it is important that industry tailored standards remain following the transposition of 4MLD into national law.

The FS industry is not homogenous. The practical application of the AML/CFT requirements to banks when opening new current accounts is very different to its application to private equity firms when engaged in fund raising and M&A transactions. It is vital that these fundamental differences continue to be acknowledged and that, where the FS industry is concerned, this continues to be reflected in the tailored JMLSG Guidance, enabling types of firm to comply with their obligations in a risk-based way that is most appropriate to their specific circumstances. Furthermore, the JMLSG sectoral guidance ensures consistency of approach across a wide range of financial sub-sectors and avoids firms duplicating efforts to analyse the impact of the law on their sector.

Although we are of the firm view that the continued use of the JMLSG Guidance should be maintained, it is important that the authorities tasked with reviewing the industry-developed standards do so promptly in light of the changes envisaged by 4MLD. It is now over 18 months since the latest version of the JMLSG Guidance was submitted to HMT for review, but this has not yet been approved. This gives rise to unnecessary cost and uncertainty for firms.

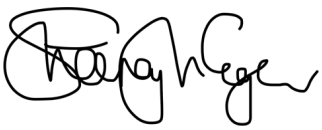
Finally, it will be important that the UK ensures that a proportionate and risk-based approach to AML/CFT is indeed delivered in its implementation of 4MLD. Over-implementation of 4MLD could result in significant duplication of effort when carrying out AML checks, or unnecessary levels of checks being required, for example on low risk counterparties such as other financial services entities regulated in low risk jurisdictions. This would result in significant additional 'red tape' with no clear benefit for the UK and risks putting UK businesses at a competitive disadvantage.

Responses to questions in consultation document

In Appendix 1 to this letter the BVCA has responded to those questions posed in Annex A 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

Appendix 1

Response to questions posed in 'Annex A: Full list of consultation questions' of the consultation paper

Chapter 4 – customer due diligence (CDD) measures

Question 3: When do you think CDD measures should apply to existing customers while using a risk-based approach?

Question 4: What changes to circumstances do you think should warrant obliged entities applying CDD measures to their existing customers? E.g. name, address, vocation, marital status etc.

In respect of question 3 and question 4, it is not possible to be prescriptive on the measures which should be applied to existing customers as this is dependent on the individual circumstances of the customer using a risk-based approach. In a PE context, our members would expect there to be a material change to the customer which in turn resulted in a heightened AML/CFT risk before further CDD measures were applied to that existing customer. This would be assessed on a case-by-case basis. The matters listed in question 4 would typically not be considered material enough in a PE context to warrant the re-application of CDD measures and are generally more pertinent to banks/bank accounts.

Chapter 4: simplified due diligence (SDD) measures

Question 7: Do you agree that the government should remove the list of products subject to SDD as currently set out in Article 13 of the Money Laundering Regulations (2007)? If not, which products would you include in the list? Please provide credible, cogent and open-source evidence to support inclusion. What are the advantages and disadvantages of retaining this list? What are the risks in removing the consent regime, and how could these be overcome?

The BVCA supports the continued existence of the concepts contained in Article 13 Money Laundering Regulations 2007 ("MLRs"), particularly the continued existence of simplified due diligence being automatically available for credit or financial institutions that are subject to the money laundering directive or credit or financial institutions which are situated outside the EEA but who are supervised in compliance with the requirements of the money laundering directive.

Article 15 allows Member States to specify certain areas as low risk (and Article 16 and Annex II make it clear that the 'potential low risk situation factors' in Annex II are "non-exhaustive"). We encourage the Government to make full use of this power to continue Article 13 of the MLRs. This should reduce inconsistency of treatment by financial services firms. Perhaps more importantly, it will reduce needless duplication of effort which would otherwise be needed by firms determining for themselves that a situation is low risk and documenting this. Why require thousands of financial services firms to spend time doing this when the UK has done this centrally for years?

All PE firms transact with credit and financial institutions. Any removal of the opportunity to apply simplified due diligence to these counterparties without further consideration would result in firms needing to spend time and money carrying out a risk based analysis to determine whether simplified

due diligence is appropriate and would likely ultimately lead to much additional customer due diligence being carried out simply to "tick a box". There is no benefit to requiring or duplicating effort in this way, when government can centrally take the decision. It should not be necessary to have countless investment managers document in their reasons as to why (say) UK banks are lower risk. They should be permitted to take this as read.

The BVCA further notes that it would be an unsatisfactory result should EEA listed entities be automatically considered lower risk but unlisted, PRA/FCA regulated UK firms which are themselves subject to 4MLD not benefit from that treatment.

The BVCA would therefore request that HMT preserve at least the provisions of Article 13 of the MLRs dealing with credit, financial and equivalent firms when transposing 4MLD into national law.

Chapter 4: enhanced due diligence (EDD) measures

Question 15: What EDD measures do you currently apply to clients operating in high-risk third countries, including those on FATF's black, dark grey and grey lists?

It is currently open to PE firms to apply a range of measures, taking a risk based approach which allows them to tailor the measures accordingly. The BVCA would strongly encourage HMT to retain this flexibility. Were mandatory measures to be introduced, this could result in unnecessary administration being carried out in addition to the necessary risk based measures, which could add additional cost without commensurate benefit.

Chapter 4: Reliance on third parties

Question 19: If you are a financial institution, are there any additional institutions or persons situated in a Member State or third country that you think could be relied upon in order to help reduce the regulatory burden on businesses – e.g. third party applied due diligence and record-keeping requirements and are also appropriately supervised in accordance with the directive?

We do not fully understand the reasoning behind this question. Article 26 4MLD defines a "third party" to include "other institutions or persons situation in a Member State or third country that: "(a) apply customer due diligence requirements and record-keeping requirements that are consistent with those laid down in the Directive; and (b) have their compliance with the requirements of this Directive supervised in a manner consistent with Section 2 of Chapter VI". Provided these conditions are met, and the third party is not established in a high risk third country, 4MLD says that Member States may permit obliged entities to rely on third parties to meet the CDD requirements. BVCA would support the UK implementing 4MLD accordingly to avoid unnecessary and costly gold-plating.

Chapter 4: assessment of risks and controls

Question 21: Should the government set a threshold of the size and nature of the business for the appointment of a compliance officer and employee screening? If so, what should the government take into account?

We note that MiFID, AIFMD and FCA rules already require the appointment of a compliance officer. We note that these directives and rules also specify circumstances in which an internal audit function is required. The FCA periodically gives guidance to firms about the types of firm which they expect to use internal audit. In order to avoid duplication and potential inconsistency for affected financial services firms, we recommend that any threshold for compliance officers and internal audit should not apply to these types of entity. We note that the relevant 4 MLD requirements are to be implemented in a proportionate way ("where appropriate with regard to the size and nature of the business") and our suggested approach is therefore consistent with this.

We note that the employee screening requirement is new. We assume that it is intended that this requirement apply only to larger institutions carrying out higher risk business. Again, the proportionate wording of 4MLD supports this.

Chapter 9: politically exposed persons (PEPs)

Question 51: Under the terms of the directive, all PEPs are considered to be high risk. However, obliged entities may use a risk-based approach to both the identification of a PEP and the depth of EDD measures that are applied to them. What risk factors do you think are relevant when deciding how to identify a PEP and adapt EDD measures to them? Would more clarity in guidance be helpful to avoid the disproportionate application of EDD measures to low-risk groups and their families?

The BVCA strongly support a risk-based, proportionate approach to the assessment of PEPs and the level of due diligence which should be applied to them. Experience of our members highlights the importance of this when involved in private equity transactions involving PEPs and we agree with the Government's interpretation of 4MLD in this regard. Although the BVCA would find further guidance on avoiding the disproportionate application of EDD to low-risk groups helpful, it is not immediately clear how realistic a proposition this is, and we certainly would not want it to be at the expense of a clear indication that the identification of PEPs, and the EDD to be applied to them, should continue to be fundamentally risk-based and proportionate and not unhelpfully prescriptive.

Question 54: Does the extent of EDD on the family members of PEPs and individuals who are known to be close associates of PEPs correspond with the measures that are appropriate for the PEP themselves? Which risk factors do you think are relevant?

Question 56: Is the guidance sufficiently clear about how EDD should be applied to PEPs, their family members and their known close associates? If not, what should the guidance include to provide clarity? With regard to financial institutions, are there specific changes that could be made to the Financial Crime Guide or the JMLSG guidance to clarify the treatment of PEPs? What specific changes could be made to the guidance in other regulated sectors?

In relation to question 54 and 56, it is the BVCA's view that it would be disproportionate (and often unrealistic) to automatically apply the same measures which are deemed appropriate for the PEP themselves to the family members or close associates of PEPs. Firms should be free to assess, on a case-by-case basis, whether it is appropriate on a risk-based approach to apply EDD measures to the family members or close associates of a PEP. In some scenarios, firms may decide it is necessary to apply EDD, but there may be many circumstances, having regard to proportionality, where it is likely

that it will not be necessary on a risk-based approach to apply EDD to the family members and/or close associates of PEPs. This is an areas where a proportionate, risk-based approach is key.

The BVCA further notes the importance of the JMLSG and its industry specific guidance on such matters. The better approach would be for HMT to implement the risk-based approach in respect of PEPs and their family members/close associates and allow the JMLSG to provide industry specific guidelines on how to deal with the assessment of family members and the close associates of PEPs in a PE specific way, having provided a clear indication in advance that this is the Government's interpretation.

Chapter 11: data protection

Question 67: The government would welcome your views on retaining documents necessary for the prevention of ML/TF for the additional 5 years. What do you think the advantages and disadvantages are of doing so?

The BVCA would oppose a blanket additional requirement to retain ML/TF documentation for a further five years after the end of a business relationship. In a PE context this could be an extremely long retention period. For instance where a fund has a life of 10 years, firms are already obliged to maintain investor documentation for 15 years (the 10 year life of the fund – the business relationship – plus 5 years).

Chapter 13: further views

Question 87: Do have any further views not specifically requested through a question in this consultation that would help the UK provide effective protection for the financial system? Please provide credible, cogent and open-source evidence to support your views, where appropriate.

The BVCA strongly supports the maintenance of the risk-based, proportionate approach to AML/CFT in the United Kingdom and understands the need to keep the UK's AML/CFT regime up to date. In order to ensure there is appropriate and effective AML/CFT checks in the PE industry without unnecessary administrative and due diligence burdens on firms, it is the BVCA's view that it is vital for HMT to transpose 4MLD with this central tenet in mind. We are very concerned that obliged entities will otherwise move ever closer to a "box-ticking" approach and this will, rather than bolster the UK's AML/CFT regime, serve to dilute its effectiveness in the long term. There are already examples of this, and it is our view that the transposition of 4MLD is crucial in this regard.