Department for Business, Energy and Industrial Strategy (BEIS)
1st Floor
1 Victoria Street
London
SW1P 0ET

By email: ReviewofLimitedPartnershipLaw@BEIS.gov.uk

23 July 2018

Dear Sir, Madam

Re: BVCA response to the BEIS consultation paper - Limited Partnerships: Reform of Limited Partnership Law

We are writing on behalf of the British Private Equity and Venture Capital Association ("BVCA"), the public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 700 firms (including over 130 investors), the BVCA represents the vast majority of all UK based private equity and venture capital firms, as well as their professional advisers. Our members invested over £27 billion in nearly 3,900 UK-based companies over 2012-2016. Companies backed by private equity and venture capital in the UK employ around 448,000 people, and 87% of UK investments in 2016 were directed at small and medium-sized businesses.

Executive summary

The BVCA welcomes the opportunity to respond to this consultation on limited partnership law reform (the "Consultation"); because UK limited partnerships are the legal bedrock of the UK's venture capital and private equity industry and one of the reasons why the UK is the second biggest global market after the US.

We support the Government's aim of preventing money-launderers from using UK business vehicles. However, we think the evidence suggests that the Government, with help from the EU's fourth Anti-Money Laundering Directive, has already achieved this goal in relation to Scottish limited partnerships (whose misuse was the genesis of this Consultation), and believe that further changes of any nature are therefore unnecessary.

If the Government feels further changes still need to be made, some of the proposals might further deter the use of limited partnerships for criminal activity, without also causing any significant damage to the investment funds industry. In particular, we believe that introducing a requirement for an annual confirmation statement and for presenters to demonstrate that they are appropriately supervised (and subject to the UK's stringent anti-money-laundering rules) will not be overly burdensome.

However, we believe that a number of the proposals will not support the policy aims behind the Consultation, but may damage the UK's private funds industry by making UK limited partnerships - and therefore the UK itself - less attractive to investment firms, at a time when the industry is facing mounting uncertainty at home and intense competition from abroad. The competitive advantage of the UK limited partnership depends to a significant extent on its flexibility to choose a principal place of business outside the UK. Were the Government to remove this flexibility, for existing partnerships in particular, we believe that many investment firms would look to use partnerships based elsewhere. In addition, both this proposal and any imposition of a requirement to file statutory accounts at Companies House would do nothing to counter any criminal activity.

Significant damage to the competitiveness of the UK limited partnership would have a particular impact on venture capital firms, regional firms and start-up firms/small with a few investors. All of these firms tend to use UK limited partnerships as their fund structures, as they are relatively straightforward and inexpensive to establish compared to vehicles in Luxembourg and other jurisdictions, which typically need input from law firms with a network of international offices. Start-up investment firms targeting early stage businesses, in particular need to launch using a simple and inexpensive UK fund structure based on a UK limited partnership. It would be a shame if firms with strong economic growth-driving potential were prevented from starting up in the first place by the absence of a dependable and competitive UK limited partnership fund vehicle. This would also be inconsistent with the Government's work on Patient Capital and the Investment Management Strategy II – both of these initiatives refer to the importance and need for UK (rather than offshore) fund structures.

We welcome the ongoing dialogue we have had with BEIS on these proposals. We have set out our responses to BEIS' specific questions below and cross refer to our previous papers submitted to BEIS in the appendices.

Q1. Can you provide any additional evidence to help explain the trends in registrations of limited partnerships across the UK in recent years?

In relation to the rapid *increase* in Scottish limited partnership registrations between around 2011 and June 2017, BVCA members whose businesses involve registering SLPs reported a steady increase, with a particular spike following the implementation of the Alternative Investment Fund Managers Directive. We therefore note that while a small number of presenters were implicated in recent money laundering investigations, caution should be taken in assuming that the entire increase in registrations prior to June 2017 related to SLPs established to facilitate illegal or inappropriate activities.

In relation to the even more rapid *decrease* in SLP registrations since June 2017, we believe this is the direct result of the extension to SLPs of the rules applicable to private companies and limited liability partnerships on the public disclosure of beneficial ownership, which came into force in June 2017. Those rules create a significant barrier to people wishing to use SLPs for criminal purposes but are workable for most legitimate businesses such as investment funds.

The Consultation suggests that Luxembourg's modernisation of its own limited partnership regime (in direct and deliberate competition with the UK private funds industry), may have made a material contribution to the decline in SLP registrations. We consider this highly unlikely, as the relevant competitor vehicle (the "SCSp") was introduced in 2013, not, as the Consultation mistakenly states, in summer 2017.

We understand that the rate of establishment of SLPs for use as investment fund vehicles has remained steady since June 2017. However, our members have witnessed some decline in the use of English limited partnerships as private fund vehicles in recent years because of Brexit uncertainty and increased competition from other jurisdictions (see Appendix 1). This does imply a slight indirect decline in the use of SLPs associated with ELP funds, as the two vehicles are often used together as complementary elements of the UK fund-structuring toolkit. However, this is a gradual, longer-term trend that has no connection to June 2017, and seems primarily to apply to ELPs used as venture capital and private equity fund vehicles (and any associated SLPs that would otherwise form part of those structures). SLPs more broadly remain a popular investment vehicle, used in many private fund and many other investment structures globally.

Q2: Do you agree that presenters should be required to demonstrate they are registered with an AML supervisory body? Please explain your answer, and provide evidence on its potential impacts.

Subject to our response to Q3, we are comfortable with this proposal and agree that it should assist in reducing the number of partnerships being established for illegal purposes, without creating any additional burdens on legitimate presenters.

In our experience, UK limited partnerships established for the investment funds industry are often established by presenters of the types set out in Annex B of the consultation document, primarily firms of lawyers and accountants. Such firms are regulated by one or more of the UK's supervisory authorities, and are obliged to conduct anti–money laundering checks on their clients (typically the general partner or an affiliate). UK limited partnerships are sometimes also directly established by the FCA-regulated investment firms themselves.

Supervisory authorities, such as the FCA and the SRA, usually allocate a registration number to presenters under their authority. It should be straightforward for most presenters in our industry to provide that number as part of the limited partnership establishment process (on Forms LP5 and LP7).

Q3: How should this measure be applied to registrations from overseas?

Because investment firms that are not regulated in the UK by the FCA may also sometimes present applications themselves rather than via external lawyers and accountants, we suggest that the list of presenters be extended to persons that are regulated and supervised in other jurisdictions and are subject to AML obligations of a similar standard to those in the UK. This would primarily be beneficial for larger investment managers that are regulated in other jurisdictions (e.g. the US, France or Germany) who may have administrative offices in the UK and do not require FCA regulation. EU-based managers of alternative investment funds structured as limited partnerships are relatively common, and we see no reason that they should no longer be able to establish a UK limited partnership.

Q4: Would it be better to require a limited partnership's principal place of business (PPoB) to remain in the UK, or alternatively to allow the PPoB to be based anywhere but require a UK-based service address? Please evidence your answer, including if possible, an assessment of the likely costs of compliance.

We support the proposal that a limited partnership be required to have a UK-based service address but strongly believe that there should be no restrictions on maintaining a PPoB outside the UK. This approach would achieve the Government's objectives and ensure an ongoing connection to the UK, while at the same time avoiding costly disruption for existing businesses. It would also preserve an important element of flexibility for the future, which could be doubly critical for our industry once the UK has left the EU.

Address for service of documents

We agree that this requirement meets the Government's aim of having a place in UK where legal proceedings can be filed and which can be used as a route through which competent authorities can contact the limited partnership. Used in tandem with a proportionate power to strike off unresponsive partnerships, it will also constitute an effective enforcement tool (see our response to questions 9-11 below). It would be clearer to refer to this concept as an 'address for service of documents' rather than a 'service address'.

In practice, most general partners of UK limited partnerships used in the investment funds sector are likely either themselves to be UK-based or to have an existing UK-based affiliate that could provide an address for service of documents. We believe that those without such an existing address would be able to work with an agent to provide one. As a result, the disruption and cost to businesses of this proposal would be limited.

Appendix 4 contains a note we previously provided to BEIS, as well as setting out some of our concerns on changes to a PPoB, it explains the preference for having an 'address for service of documents' rather than a 'registered office'. In our view, an address for service of documents is not the same as a registered address and no other requirements should be placed on it. If there is to be an address for service of documents, it would be important that this information is required in addition to - and not in place of - the PPoB.

Principal place of business

We strongly disagree with the proposal to restrict the PPoB to a location within the UK. Businesses are by their nature becoming increasingly international, and require flexibility to manage themselves in a flexible manner across jurisdictions. Other UK entities (companies, LLPs etc.) do not have the formal concept of a PPoB, and as a result there is no restriction on any of these entities maintaining their 'principal place of business' outside the UK. This flexibility is an important characteristic of all UK corporate vehicles, and we see no reason to create a restriction on UK limited partnerships to carry on the majority of their business in the UK. We consider this to be an unnecessary and inflexible proposal.

Taken together, we think that the other proposals that we identify in this response as being appropriate will give the Government added confidence that non-UK undertakings will no longer be attracted to use Scottish (or other UK) limited partnerships for illegal activities (and that the proposals give the Government the necessary enforcement powers, if it chooses to use them). Given this suite of proposed other measures and the strong evidence that the new beneficial ownership register has already 'done the job' in terms of dramatically reducing the number of SLP registrations anyway, we see no additional benefit in reducing the appeal of UK limited partnerships to the global investment funds industry by imposing the requirement for a PPoB in the UK.

If the Government were to take the highly regrettable decision to implement this proposal, full 'grandfathering' provisions (i.e. an exemption) for existing structures would be essential, as the disruption that a change would cause for businesses set up in reliance on the existing rules would be enormous.

A large number of existing investment funds are currently using UK limited partnerships that have a PPoB outside the UK and accordingly have registered such funds as non-UK alternative investment funds (AIFs) under the Alternative Investment Fund Managers Directive (AIFMD); the PPoB of the UK limited partnership being the key factor in determining where a fund is established for the purposes of the AIFMD. These structures were established, as part of legal and appropriate structures, with the legitimate expectation that the current rules would continue to apply. In some cases, these funds are investing billions of pounds on behalf of hundreds of sophisticated professional investors (including large pension funds, insurance companies, endowments and foundations). If these existing funds were required to move their PPoBs back to the UK, in most cases this would require the consent of those investors and mean the re-categorisation of the fund under AIFMD from being a non-UK AIF to being a UK AIF (a development that would cause disruption, and have significant cost implications, for affected fund managers). If the managers of these funds were unable for whatever reason to obtain consent from investors to move the PPoB back to the UK, their funds would need to be restructured, at significant cost (and these will vary depending on the size of the fund and the number of investors in it). International investors from around the world would view this development extremely negatively, and the effect would be a reduction in the attractiveness of UK as a place to do business. This is not the message we would like the UK to be sending to international investors, especially during the current climate of uncertainty and increased competition (see Appendix 2).

Q5: If a new requirement of a UK-based service address were introduced, but existing operation of the PPoB retained, what, if any, transparency requirements should be put in place relevant to the PPoB?

As per our response to question 4 above, there are no restrictions on UK companies, LLPs etc. maintaining places of business outside UK, and no transparency requirements relating to the location of the business conducted using these entities. We see no reason why there should be a more stringent regime for limited partnerships, beyond the proposed annual confirmation statement. As noted in our response to question 4, the registration of information on the address for service of documents would be in addition to - and not in place of – details on the PPoB.

Q6. Should all limited partnerships be required to file an annual confirmation statement?

We disagree with the Consultation's assertion that UK limited partnerships have lower reporting requirements than companies do. The requirements for limited partnerships are different to other UK corporate vehicles and in some ways more stringent. For example, a limited partnership must make a public filing every time there is a change in limited partner, or even following a change in name of a limited partner. This is more rigorous than the position for a company, which merely has to disclose its shareholders once a year. We also note that the existing transparency requirements for UK limited partnerships are greater than for limited partnerships in other EU jurisdictions (e.g. in France and Luxembourg there is no obligation to maintain a public record of limited partners), and that SLPs are already required to file an annual confirmation statement under the PSC rules.

Nevertheless, we share the Government's concerns as regards limited partnerships established for illegal purposes, and support the idea of an annual confirmation statement. In our view, the annual confirmation statement could replace the current ad hoc 'Form LP6' filing requirements (other than perhaps for the change of a general partner, which remains a key piece of information for third parties dealing with the partnership).

We believe this would provide an accurate, user-friendly and consolidated annual snapshot of all the information that limited partnerships must disclose under the Limited Partnerships Act 1907. The current rules have led to irregular, ad hoc 'Form LP6' filings, and left a messy register that requires considerable effort and some expertise to analyse. The annual confirmation statement, if it replaced the current practice of ad hoc filings, would enhance transparency by making it clearer and easier for a member of the public to review and, crucially, understand the ownership and other information that is already available on the limited partnership register.

Q7: If you are in favour of an annual confirmation statement, what information should be included and who should file it? Please consider whether that should be for the whole partnership or the difference in requirements for general partners against limited partners - including corporate partners.

We believe that the annual confirmation statement should be filed by or on behalf of the general partner and should confirm ("to the best of the General Partner's knowledge") the information that must currently be disclosed under the Limited Partnerships Act (currently via the initial Form LP5/LP7 and ongoing Forms LP6). We note that there are existing differences for private fund limited partnerships. These were recently agreed with the Government as being appropriate for PFLPs, and we do not believe that the position should be changed. We believe that the private fund regime is not tainted or implicated by the concerns over the misuse of SLPs, as PFLPs are not similarly susceptible to misuse because they must fulfil the private fund conditions under the amended 1907 Act.

Q8: Is there a case for limited partnerships to have to prepare accounts and reports in line with the requirements for private companies, as is already the case for qualifying partnerships?

We cannot see a public policy justification for this suggestion as it will not result in added ownership transparency. We strongly believe that introducing such requirements for limited partnerships is unnecessary for achieving the Government's objectives, and would in fact significantly reduce the use of the UK as a jurisdiction in which to establish private investment funds and as the location of fund managers.

The enhanced transparency measures suggested elsewhere in the Consultation (i.e. the annual confirmation statement and AML registration for presenters) already propose appropriate deterrent and enforcement tools, without further requirements being necessary. Annual reporting of statutory information including the identity of limited partners, together with the existing public disclosures required by the new beneficial ownership rules, should destroy any remaining appeal of SLPs to criminals. The Government would be able to enforce compliance with the new transparency rules by holding presenters to account through the AML registration route, and through a new power to strike off non-compliant partnerships (see below for further comments on this). Detailed public disclosure of limited partnerships' financial affairs, or other Companies Act reporting requirements, would not add anything valuable to these new transparency requirements.

Nor does there seem to be, in itself, any logic in applying Companies Act financial (as opposed to ownership) transparency requirements to limited partnerships. Companies benefit from limited liability and, as a result, have a concomitant obligation to file accounts in accordance with UK GAAP/IFRS. A limited partnership differs from a company in that it (as opposed to its limited partners) does not benefit from limited liability, and must have a general partner whose liability for the debts and obligations of the partnership is unlimited. This puts third parties in a legally stronger position in the event of claim against a limited partnership than against a company, which explains the absence of a concomitant liability for limited partnerships to file accounts in public. This is an adequate level of protection for third parties and fits well with established corporate law principles. In any case, increasing third party protections does not seem to be the objective of the other changes proposed in the Consultation, and looks out of place here.

Further, there is no need for additional financial transparency vis-a-vis the authorities or investors. Limited partnerships are necessarily tax transparent (to avoid the double taxation of investors and the penalising of collective investment), and the financial information that is of interest to HMRC and other tax authorities is already available through limited partners' individual tax returns. As regards ensuring transparency for limited partners, venture capital and private equity financial reporting has developed to a sophisticated level to satisfy the requirements of institutional and professional investors. The general partner/manager is able to agree on a contractual basis to provide financial statements containing comprehensive financial information that is meaningful to an often-international limited partner base. Replacing this with a requirement to file accounts prepared in accordance with the UK Companies Act / qualifying partnership rules would end this flexibility and further adversely affect the UK limited partnership's appeal as an international fund vehicle.

It is worth remembering that the UK limited partnership regime already imposes more burdensome filing requirements than those of many of its competitor jurisdictions (see Appendix 3). Imposing additional burdens would give the impression to international institutional investors and global fund managers that the UK is not as "open for business" as it has been, thereby reducing the UK's competitiveness at this crucial juncture. We believe that the annual confirmation statement and service address proposals already constitute an effective and proportionate response to the current transparency concerns, and are vastly preferable to the imposition of a greater financial reporting burden with less flexibility. Appendix 3 also includes information about the extent to which competitor jurisdictions require limited partnerships to file annual accounts. In general there is no such requirement and we are not aware of any evidence that these jurisdictions have had a material problem with limited partnerships being established to facilitate money laundering/criminal activities.

Q9: Do you agree with the proposal to give the Registrar a power to strike off partnerships from the register of companies?

We can see benefits in having a mechanism to allow the Registrar to strike of partnerships in a similar manner to the existing regime for companies. However, if there were a strike-off procedure, there would need to be certainty that the striking-off of a limited partnership would not result in the creation of a general partnership and/or the loss of limited liability for limited partners (see also our response to question 11 below).

It is important to note that Partnerships are fundamentally different entities to companies (an extract from "Lindley & Banks on Partnerships" is set out in the footnote below).[1] Given these intricacies, we would not propose that BEIS make material changes to the rules relating to strike-off/liquidation of limited partnerships (beyond the proposal to allow the Registrar to strike off recalcitrant partnerships) unless they propose spending significant time, ensuring the proposed regime works well for all limited partnerships.

One option would be to include a tick-box in the annual statement requiring a limited partnership to state whether it had reached the end of its term. This would have the advantage of (i) putting third parties on notice that the nature of the partnership had changed (ii) act as an end to the obligation to file annual statements (unless limited partner transfers are expected) while not materially changing the existing position re: termination/liquidation of partnerships.

Q10: Are there any other factors or criteria that the Registrar could consider in order to conclude that the partnership is not carrying on a business or in operation?

We do not believe there are other relevant factors or criteria.

Q11: What operational and legislative procedures could be put in place to mitigate concerns of strike off done in error?

There is not currently a regime for striking off a limited partnership from the register. However, if there were such a regime, on the face of it, this would result in an unregistered partnership, which would be a general partnership (and therefore unlimited liability for all of the partners).

The key requirement of an investor in an institutional investor fund is that it has limited liability for the debts and liabilities of the partnership. Losing limited liability would have a material adverse impact on the limited partner – they would not just be liable for their share of the partnership's liabilities (which they would have if they had invested directly in the relevant assets), but they would potentially have liability, on an uncapped basis, for every other investor's share of the partnership. Losing limited liability is simply not a risk that institutional investors would be prepared to take. If there were to be a material risk that a fund investor could lose its limited liability for a reason that is outside their control, then they would not be prepared to invest in that vehicle.

This is to be contrasted with the situation of a struck-off company, which does not result in unlimited liability for its shareholders.

In any event, we think it is paramount that the law is clear that there is not a scenario where limited partners have unlimited liability for the debts and liabilities of partnerships, either during

[1] Lindley & Banks on Partnerships (24-01) *"What is meant by the "dissolution" of a partnership is often misunderstood, not only because that word is used in two distinct senses but also because it has a very different meaning when applied to a company or limited liability partnership. In the case of a partnership, it invariably refers to the moment of time when the ongoing nature of the partnership relation terminates, even though the partners may continue to be associated together in a new partnership or merely for the purposes of winding up the firm's affairs. Indeed, the outward appearance of a partnership immediately prior to and immediately following a dissolution will frequently be unchanged. For a company or LLP, on the other hand, dissolution marks not the commencement of the winding up but its conclusion, i.e. the moment of extinction"*.

the dissolution process or following full liquidation (and whether this is pursuant to the strike-off procedure or otherwise).

In relation to companies, s1000 of the Companies Act 2006 states that:

"..the liability (if any) of every director, managing officer and member of the company continues and may be enforced as if the company had not been dissolved…."

We would propose that similar wording is included to make it clear that the strike-off a limited partnership does not result in unlimited liability for the limited partners.

We would also propose a mechanism for the general partner to apply to the courts to have the limited partnership returned to the register (similar to the current regime for a registered company). As for a registered company, any limited partnership restored to the register should be deemed to have continued in existence as if it had not been struck off. Unlike for companies we do not think that there should be a time limit on an interested party being entitled to apply to the courts to restore a limited partnership to the register. We also do not think that the assets of a struck off partnership should be 'bona vacantia'.

The BVCA is grateful for the ongoing dialogue we have had with BEIS and HMT on these proposals. Given the uncertain environment in which our members are operating, it is essential that any changes made are fully justifiable from a policy perspective and not disruptive to the funds industry. We look forward to discussing our feedback further with you.

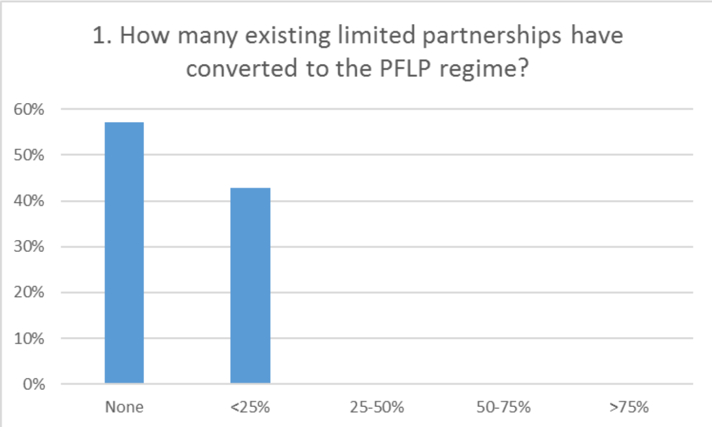
Yours faithfully,

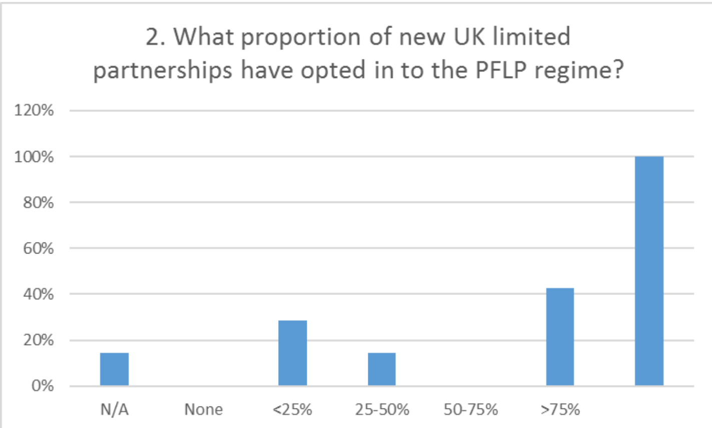
Amy Mahon
Chair, BVCA Legal and Accounting Committee

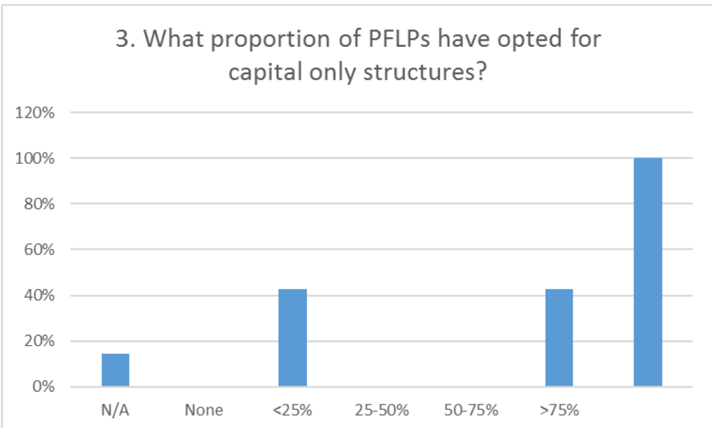
Appendix 1

Responses to a BVCA questionnaire to a selection of law firms involved in the establishment of UK limited partnerships (November 2017)

This survey was carried out to understand the impact of the Brexit referendum result on the establishment of new fund structures in the UK (PLFPs are specifically referred to below but should be taken to cover English Limited Partnerships and Scottish Limited Partnerships).







Feedback on the increased use of other jurisdictions is highlighted in yellow.

4. What do you think are the reasons for your answers to the three questions above?

"We have not established any English limited partnerships as fund vehicles or PFLPs in 2017. While the UK has previously provided an attractive regime, it has become very unattractive due to Brexit-related uncertainty. Indeed, at the moment it offers the worst of all worlds: full AIFMD compliance with no certainty that the benefits of AIFMD will continue to apply. Clients wishing to take advantage of AIFMD are generally going to Luxembourg, and clients wishing to stay outside are generally going to the Channel Islands for their funds structures."

"For the PFLPs we have set up, this would be: simpler regime, much better to be able to adopt an all-capital structure. Benefit of the white list for LPs. Market practice. However, it is important to note that we have not actually set up very many ELPs (PFLP or otherwise) during the course of this year. We are finding that managers are looking to other jurisdictions (particularly Luxembourg) due to Brexit."

"A lot of our clients prefer offshore structures."

"GPs seem to be doing conversions only if requested by investors; very few requests to date. Easier admin."

"No significant perceived gain to switch existing structures to PFLP but sufficient to establish new limited partnerships as PFLPs."

"The existing LP regime works well so clients don't see much point in changing it for funds. For joint ventures, most control happens in the GP so again little need to change."

"We find that the key drivers for using English limited partnerships tend to be (i) institutional precedent / preference and (ii) the pursuit of certain specific types of investment strategy (e.g. real estate and certain PE buy-out funds). In our recent experience, there has been more interest in other jurisdictions for sponsors forming illiquid funds which are seeking to access European/global capital."

5. Do you or your clients have any further observations on functioning of the PFLP regime?

"So far, so good. No real comments other than we have not had many clients express any desire to go through the effort of redesignating their funds as PFLPs. We have helped some clients who have received queries from investors, where investors have received a notice from a GP regarding a re-designation."

"Easier admin. Some LPs concerned that the limited liability formulation is less clear than under the "old" regime (i.e. liability is not limited on an LP-by-LP basis to a segregated capital contribution, but to the wider pool of partnership assets)."

"We very much welcome the progressive changes made under the PFLP regime and hope they serve to stimulate renewed interest in the English limited partnership as a fund vehicle.

It has been noted by clients that there is a perception that the changes are somewhat overdue, and that England remains much more a manager/sponsor jurisdiction than a fund product jurisdiction - managers and investors have become much more comfortable using e.g. Cayman / Channel Islands limited partnerships.

Furthermore, in light of Brexit uncertainty and ongoing consultation regarding changes to transparency requirements (which have already taken effect under Scottish law), we do see a challenging backdrop for the PFLP."

Appendix 2

BVCA submission to BEIS and HMT on the competitiveness of UK limited partnerships (November 2017)

MAINTAINING THE COMPETITIVENESS OF UK PRIVATE EQUITY AND VENTURE CAPITAL FUNDS

Introduction

Competition from other European jurisdictions for the business of establishing and running private equity and venture capital funds ("PE/VC business") has been mounting since before the Brexit referendum, but now has particular relevance because of the regulatory uncertainty caused by the UK's future departure from the EU.

In this context we are deeply concerned by BEIS' proposal to subject the UK environment for PE/VC business to further uncertainty by launching a consultation that calls into question the legal foundation of the industry (the UK limited partnership regime).

We call upon the Government to state clearly and urgently that, whilst acting firmly (and with the BVCA's full support) against any continuing criminal abuse of Scottish limited partnerships (SLPs), it will not in any way change the current law governing the legitimate use of UK limited partnerships for institutional investment funds. This will provide global investors and UK-based fund managers with some timely certainty regarding the UK's desire to remain an attractive location for PE/VC business.

This paper demonstrates how the current context of Brexit already threatens the UK's success in attracting PE/VC business, suggests that the changes to UK limited partnership law that BEIS is currently considering are unnecessary, details how other jurisdictions are competing to entice PE/VC business away from the UK, and explains why all this matters for the UK economy.

Brexit uncertainty already threatens a successful model

The UK's venture capital and private equity industry has thrived over the past 30 years to become the second biggest global hub outside of the US. This has happened largely because of deliberate, strategic and effective policy intervention by the Government in this area, which began in 1987 and was in evidence as recently as this year, when HM Treasury introduced the Private Fund Limited Partnership.

This concerted policy drive has resulted in the UK being highly successful in both attracting fund managers to base themselves here, <u>and</u> in creating an environment that allows them to establish and manage UK fund structures that provide managers and investors with increased synergies. Although this paper deals mainly with the latter[2], both of these investment-attracting factors are being challenged by a combination of uncertainty caused by Brexit, increased competition from other European jurisdictions (which are basing their reforms on the UK's model for success in this

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[2] The BVCA has separately provided detailed submissions on the former to HM Treasury in our 2017 Budget representations and elsewhere.

space), and a broad range of actual and potential changes to the legal and tax landscape (covered in our 2017 Budget representations).

The current vulnerability to increased regulatory competition of the UK's environment for PE/VC business is covered in this this Oxford University Business Law Blog. The following extract is particularly relevant when considering this industry's mobility:

> *"**If regulatory, tax, or any other changes make UK-based Private Equity significantly less attractive, guess what: those UK-based Private Equity funds will simply de-camp and move their operations elsewhere. These funds are not like big investment banks and retail banks: they employ relatively few back-office staff** … indeed, many London-based Private Equity funds already have offices and established operations elsewhere in Europe [and] are already contingency planning for this. They tell us that, based on the current Brexit timetable, they need to decide what to do in around six months' time so that, if necessary, they can transition away from the UK with minimal disruption to their businesses. If the post-Brexit landscape for PE is not clear by then, surely the business imperative will be to seek greater certainty by leaving the UK … behind."*

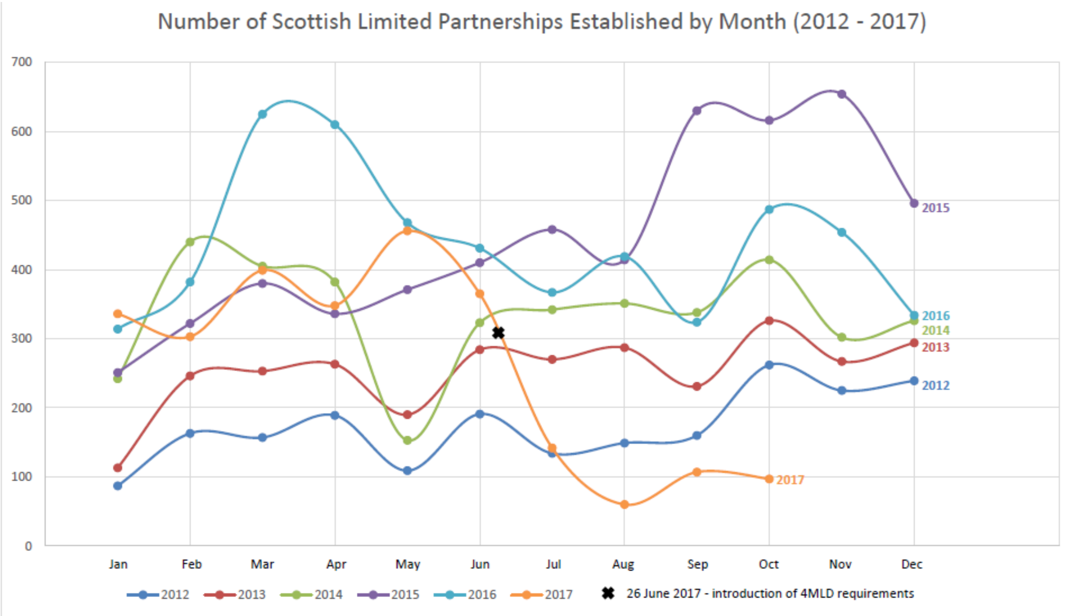
The reduced attractiveness of the UK to PE/VC business that medium term regulatory uncertainty is already causing must not be unnecessarily compounded by any injection of further uncertainty into the UK's legal framework for investment funds.

Recent reforms make further changes to the UK limited partnership regime unnecessary

The Government is considering subjecting a key element of the UK investment funds framework - the Scottish limited partnership (and potentially also the English limited partnership) - to a consultation regarding new requirements that if enacted would seriously undermine long-accepted and widely adopted UK investment fund structures.

At the same time, there is increasing evidence to suggest that recent changes implemented under the Fourth Money Laundering Directive ("4MLD") are already having an impact on the use of SLPs for criminal purposes, making further changes unnecessary.

In June 2017, the 4MLD rules significantly increased the public disclosure requirements for SLPs as regards their ownership and control by bringing them within the scope of the register for people with significant control over UK companies (the "PSC" rules). This in itself seems already to be deterring people from using SLPs in connection with criminal activity. An investigation of the register by Scottish Law firm Burness Paull (a leader in the formation of SLPs) showed that the extension of the PSC rules to cover SLPs in June 2017 was followed by an immediate drop in SLP registrations of more than 60% in July, down to a mere 16% of June's number of registrations in August (see Burness Paull's graph below). There was no similar drop in the number of registrations during the summer months in any previous years since at least 2012. Registrations have since flat-lined. This constitutes strong evidence that 4MLD has already done the job and persuaded legitimacy-seeking criminals to stop establishing SLPs for criminal purposes.



Source: Companies House basic company data file (1 November 2017)

Simply continuing to allow 4MLD (apparently) to reduce drastically the utility of SLPs for criminal activity, would have no impact on legitimate business, including private equity and venture capital, whilst allowing Government resources to be deployed effectively.

If further measures were nonetheless required, then an effective and harmless solution would be to require the provision of a money laundering registration number before a Scottish partnership can be registered as a limited partnership (except in cases where the person registering the limited partnership registers less than a de minimis number (e.g. 10) of limited partnerships per year).

Increased competition from EU27 jurisdictions

The timing of the increased legal uncertainty caused by the BEIS Call for Evidence and proposed consultation on limited partnership law, which that law firms are already reporting is already influencing decisions not to base PE/VC business in the UK, could not be worse. This is because the UK is surrounded by certainty-bearing pretenders to the UK's PE/VC business crown.

The contenders

Frankfurt has professed itself a contender for PE/VC business. However, it seems that Germany would need to enact significant changes to its tax and regulatory environment in order to entice a serious amount of PE/VC business to relocate to Frankfurt or any other German city. At present, it is often necessary to incorporate Luxembourg vehicles into Germany-based private equity fund structures in order to make them work effectively. Frankfurt also seems to be concentrating more on attracting UK-based banks.

Dublin is also in the running for PE/VC business, although Luxembourg is already far ahead of Dublin in its reputation, understanding and development of structures suitable for PE/VC business. Ireland is not currently well known for PE/VC business, although it has a strong reputation and well-developed market for UCITS. We are, however, aware of increased interest in

Ireland and know that at least one well-known global private equity firm has begun basing its fund structures in Dublin.

Paris does not currently seem to be a serious contender for UK-based PE/VC business for various reasons. However, Mr. Macron (whilst a minister in President Hollande's government) followed Luxembourg in adjusting the French legal and regulatory environment to allow a new, French limited partnership vehicle suitable for private equity funds (copy this link into a browser for more information: https://www.ashurst.com/en/news-and-insights/legal-updates/france-the-new-special-limited-partnership-regime/), so this may change in the near future.

However, feedback from BVCA members and extensive media coverage demonstrates that some of the largest global private equity firms have started increasing the amount of their PE/VC business that is conducted in Luxembourg. The rest of our analysis will therefore focus on Luxembourg, which is by some margin the main contender against the UK for PE/VC businesses planning to move some or all of their activity to within the EU27.

Luxembourg

Both the Luxembourg authorities and market participants are actively promoting Luxembourg as an alternative destination for currently UK-based PE/VC business. Their language tends to stress that Luxembourg combines a reputation for being "stable", "innovative" and "flexible" with a record of strong regulatory oversight, a focus on investor protection and a favourable tax environment for private equity and venture capital executives.

Below are some recent examples of this promotional activity:

- Luxembourg's regulator (the CSSF) describing how it welcomes fund managers (link).
- The Association of the Luxembourg Funds Industry (ALFI) pitching to private equity (link).
- The Luxembourg Government's ambitious agenda to attract PE/VC business (link).
- KPMG: "Luxembourg: The Private Equity Hub That Asset Managers Deserve" (link).
- Asian PE investors being encouraged to use Luxembourg-regulated vehicles (link).
- EY encouraging Middle Eastern PE investors to use Luxembourg-regulated vehicles (link).
- ING encouraging PE fund managers to use Luxembourg-regulated vehicles (link).

The promotion of Luxembourg has intensified since the referendum but is not completely Brexit-driven, as the Luxembourg authorities have deliberately targeted UK-based PE/VC business for the last few years. A key part of Luxembourg's strategy in this regard has involved amending Luxembourg's legal and regulatory regime to introduce bespoke, PE/VC-friendly investment vehicles.

Luxembourg's "SCSp" and "RAIF" vehicles deliberately mirror the "Anglo-Saxon" limited partnership in order to appeal to the distinctly "Anglo-Saxon" DNA of PE/VC business, but without the problems associated with the UK's 1907 limited partnership vehicle (copy this link into a browser for more info: https://www.ashurst.com/en/news-and-insights/legal-updates/luxembourg-an-introduction-to-luxembourg-limited-partnerships/). HM Treasury's recent introduction of the PFLP regime was designed to bring increased legal certainty to the UK regime and allow the UK to keep pace with this competition. The proposed BEIS consultation would re-kindle uncertainty by its very announcement, whilst the proposals themselves, if enacted, would take the UK regime back to square one, effectively negating the modernisation and increased competitiveness that HM Treasury achieved through the PFLP legislation.

Luxembourg's strategy of mirroring the UK limited partnership (whilst improving it) is important because it hugely reduces the pain of a PE/VC manager's shift from using a UK limited partnership and being based in London, to using a Luxembourg vehicle and being based there. This is because private equity and venture capital investors are already familiar with the shared legal concepts and structures, and previous UK fund documents do not need significant amendments for new Luxembourg funds. This means that if a manager moves its fund from the UK to Luxembourg its negotiations with investors are easier and costs are kept down. Unsurprisingly, therefore, our experience is that some European investors have started requesting that managers use Luxembourg vehicles in their fund structures. Luxembourg also has introduced a more favourable tax regime for executives than that in the UK (which has moved in the other direction, as well as becoming more complex and unclear, as described in detail in the BVCA's 2017 Budget submission).

Luxembourg's strategy has already been very successful, with over 1000 SCSp vehicles established in under two years (link). We do not have reliable statistics for the newer RAIF vehicle, but at the very least it demonstrates how the CSSF listens carefully to the PE/VC market and actively seeks to increase Luxembourg's market share specifically in private equity, venture capital and other alternative investment funds (link).

These co-ordinated regulatory and policy initiatives aimed at attracting more PE/VC business to Luxembourg, constitute strong arguments against the introduction of any further uncertainty into the UK's legal regime for investments funds. Our members are already reporting that they are increasingly using non-UK fund structures given the legal risk associated with using UK limited partnerships. The BEIS consultation injects further risk and uncertainty, regardless of its eventual outcome.

Why this matters for the UK economy

The UK's venture capital and private equity industry supports a much broader ecosystem than managers and investors alone, one that has allowed lawyers, accountants, consultants, corporate finance firms and fund administrators to flourish. This creates employment, both directly, via the fee income generated from fund sponsors and investors in connection with the industry's fundraising, investment and divestment activities, and indirectly, by those engaged in private equity and venture capital-related activities. The success of this ecosystem increases GDP and employment in the UK. A study[3] from TheCityUK demonstrates how and where the UK's financial and related professional services industry has evolved since the financial crisis, stating that over 200,000 jobs have been created within the sector since 2010. About **2.2 million people** now work in the financial and related professional services industry in the UK, two thirds of them outside London.

The BVCA has over 200 professional services firms as members, which rely on and support the venture capital and private equity industry in the UK. The last study we carried out on their impact on the ecosystem was in 2006, when approximately **£5.4 billion** of fee income was

[3] UK-based financial and related professional services: enabling growth across the UK, report available here

generated by the UK financial, professional and business services sectors. This equated to more than 12% of the total annual turnover of the UK financial services industry. It is reasonable to assume this figure had increased since the date of that study.

If the private equity and venture capital industry were to move from its European hub in the UK (which, given its relative mobility, is a lot more likely to do than the banking industry), there would be a huge impact the financial services ecosystem, particularly in circumstances where banks and other UK financial services market participants moved to other European centres (such as Luxembourg, Ireland and Germany). The information above demonstrates how other European financial centres, regulators and the advisory community in such centres, notably Luxembourg, are already eagerly preparing for this move. We are concerned about the long-term impact of this trend and believe the Government can and must act immediately and decisively to reduce the legal uncertainty caused by the recent Call for Evidence on limited partnerships. We have submitted a more detailed paper on some proportionate and sensible alternative measures that would be workable for PE/VC business. Anything beyond those will harm the UK limited partnerships regime, thereby further damaging a highly successful private equity and venture capital industry that has been carefully cultivated by UK Government policy over several decades. Given that any remaining criminal use of SLPs can be dealt with in ways that do not damage our industry, that would be a needless act of national self-harm.

Appendix 3a - table of competitor jurisdictions' filing requirements

Jurisdiction of Limited Partnership	Does a limited partnership have to register the names of its limited partners on formation (or following their admission) with a local registrar?	If so, is that list available to the public?	Does a limited partnership have to notify the registrar of changes in the identity of limited partners (i.e. on transfer)?	Does a limited partnership have to register the amount of capital contributed by its limited partners	If so, is that available to the public?	Do local tax authorities require information from limited partnerships or their partners allowing them to identify limited partners?	Do local tax authorities require non-resident limited partners to file tax returns?
UK	Yes	Yes	Yes	Yes	Yes	Yes	No
France	No	N/A	No	No	N/A	Yes, in case of tax investigation	No
Luxembourg	A non-public LP register must be kept but is not provided to the registrar.	No	No	Info recorded in the non-public LP register.	No	Yes, in case of tax investigation	No
Canada - Ontario	No. A non-public LP record must be kept at the principal place of business of the limited partnership in Ontario, but is not provided to the registrar except on request.	N/A. However, any person has the right to inspect the LP record and make copies.	No. The LP record must be kept up to date.	No. The information is recorded in the LP record.	No. However, any person has the right to inspect the LP record and make copies.	Only if the limited partnership carries on business or owns real estate in Canada, or has partners resident in or with an establishment in Canada	Only if the limited partnership has taxable income from carrying on business in Canada allocated to limited partners or disposes of taxable Canadian property
Canada - Quebec	Yes. The name / domicile of each GP and of the three largest LP contributors to the partnership is filed. A non-public LP record must be kept at the principal place of business.	Yes. The information filed with the registrar is public.	No. Except in the case where there is a change to the top three limited partners.	No. The information is recorded in the LP record.	N/A	Only if the limited partnership carries on business or owns real estate in Canada / Quebec, or has partners resident in or with an establishment in Canada / Quebec	Only if the limited partnership has taxable income from carrying on business in Canada / Quebec allocated to limited partners or disposes of taxable Canadian / Quebec property
Ireland (1907 Act limited partnership)	Yes	No	Yes	Yes	No	Unclear. In local counsel view, if the limited partnership has Irish source income or gains, it would be obliged to deliver such information.	Only if they have Irish taxable income (the limited partnership has invested in Irish assets).
US - Delaware	No	N/A	No	No	N/A	Broadly only where there is Delaware source income.	Broadly only where there is Delaware source income.

Appendix 3(b) table of competitor jurisdictions' accounts filing requirements

Jurisdiction of Limited Partnership	Does a limited partnership have to file its annual accounts (or other similar financial information) with a local company registrar?	If so, are those accounts/financial information available to the public	Does a limited partnership have an obligation to make its annual accounts/financial information publicly available in any other way (e.g. for inspection at its registered office, appended to the filed accounts of its general partner etc?)
France (SLP)	The SLP has no obligation to file its annual account to the registry of trade and companies. However, the annual report of the SLP which contains a summary of the annual accounts shall be disclosed to the French regulator (Autorité des Marchés Financiers) upon request.	N/A	In addition to the disclosure to the French regulator, the annual report of the SLP must be made available to the investors.
Luxembourg (SCSp)	There is no basic obligation on an SCSp to make any filing of its annual accounts. Depending on the regulatory status of the SCSp it may be required to file an annual report with the Luxembourg regulator (CSSF), but this annual report is not available to the public	N/A	Accounts are available to the LPs (not the public) at their request at the registered office of the SCSp.
Canada - Ontario	A limited partnership does not have to file its annual accounts/financial information with a local registrar, nor must it make its annual accounts/financial information available to the public	N/A	In Ontario, a limited partner of the limited partnership has a right to inspect and make copies of the limited partnership books at all times. A limited partner also has the right to inspect copies of the following documents, which do not contain financial information: (1) the limited partnership agreement, (2) the partnership declaration, (3) any court order for compliance and (4) any powers of attorney. Any third party that is in a business relationship with the limited partnership may also inspect any of documents #(2)-(4).
Canada - Quebec	A limited partnership does not have to file its annual accounts/financial information with a local registrar, nor must it make its annual accounts/financial information available to the public	N/A	In Quebec, a limited partner may request the partnership's financial information, but this cannot be requested by a member of the public.
Ireland (1907 Act limited partnership)	For a Limited Partnership (LP), the partnerships is obliged to file its annual accounts with the company registrations office For an Investment Limited Partnership (ILP).its annual accounts must be filed with the Central Bank but it is not required to file with any public registers (such as the company registrations office) – the accounts filed with the Central Bank are not available to the public	Yes for an LP. No for an ILP	For an ILP, it is obliged to make its accounts available (upon request and free of charge) to its investors (but not a member of the public).
US - Delaware	No	N/A	Partners have a right to inspect the books and records

Appendix 4

BVCA Submission to BEIS on the relevance of the principal place of business concept (January 2018 and updated for subsequent discussions)

UK Limited Partnerships – Principal Place of Business

1. **BVCA feedback on why there must be an option to have the Principal Place of Business outside of the UK and the impact of requiring a Limited Partnership to maintain a registered office in the UK**

There is a direct benefit in making UK limited partnerships flexible in this regard, as it provides work for UK-based formation agents, accountants, administrators, lawyers and other service providers. Fund managers from jurisdictions such as the US prefer to use common law established entities, it being a system they understand and trust. They also tend to view UK limited partnerships as more marketable to US investors due to their relative familiarity with the UK over jurisdictions such as Luxembourg.

However, even more importantly, the flexibility of limited partnerships in this regard has been one of the reasons why the UK has become a hub for private equity and other private fund managers creating significant economic benefit (please see our most recent submissions to the Industrial Strategy and Patient Capital Review). In other words, the overall benefit to the UK is provided by the industry as a whole, not necessarily on a partnership-by-partnership basis.

Moreover, we are already concerned that the effect of Brexit will be to push the funds industry towards Luxembourg or Ireland (for fund managers who want their funds to be 'in Europe') or towards the Channel Islands (for fund manager who want their funds to remain 'out of Europe'). We would therefore be extremely wary of any steps that were taken that made the UK appear a less attractive jurisdiction for fund managers.

We have a specific concern in respect of adding a "UK registered office" concept in respect of UK limited partnerships. The FCA has given guidance as to the applicability of the AIFMD to UK limited partnerships with a principal place of business outside the UK, which relies on the fact that UK limited partnerships do not have a registered office.

If UK limited partnerships were to need a UK registered office, this could immediately change the regulatory status of a large number of private funds (i.e. it could change a fund from being a non-EEA Alternative Investment Fund ("AIF") to an EEA AIF. This could create significant uncertainty and cost for the funds' investors, and would have a material adverse effect on the attractiveness of the UK.

The FCA guidance can be viewed at the following link ("AIFs in the form of limited partnerships"): https://www.fca.org.uk/firms/aifmd/updates and a section is copied out below

AIFs in the form of limited partnerships

We have been asked by various stakeholders how they should determine where an AIF in the form of a limited partnership is established. Specific enquiries on AIFs include:

- *a Guernsey limited partnership with its registered office in Guernsey and its principal place of business in the UK, and*

- *a UK limited partnership with its principal place of business on Guernsey*

The Glossary definition of 'established' means, for an AIF, being 'authorised or registered' in a given country or, if the AIF is not authorised or registered, 'having its registered office' in a given country. So, for an AIF that is not authorised or registered anywhere in the EEA and that has a registered office, we consider its place of establishment to be the country or territory where that office is located. An AIF is not authorised or registered unless it is authorised or registered as a fund, which would not be met, for example, by a registration at Companies House. In the first example mentioned above of a Guernsey limited partnership, the AIF has its registered office in Guernsey and is in our view a non-EEA AIF.

A UK limited partnership does not have a registered office as such but is required to register its principal place of business and we regard that as the equivalent of a registered office for these purposes. Accordingly, in the second example above, the AIF is in our view also established in Guernsey and is therefore a non-EEA AIF.

Where there is no registered office, the location of the head office of the AIF is relevant in determining its place of establishment.

These views reflect our understanding of the effect of the AIFM Regulations 2013 (SI 2013/1773).

2. BVCA feedback on why requiring all limited partnerships to have a UK registered office will be damaging and an alternative solution

A UK address would facilitate the service and inspection of documents. However, requiring all limited partnerships to have a UK registered office would greatly impact the UK's private equity and venture capital fund market as explained above.

This would have enormous consequences on confidence in the UK as a jurisdiction in which to establish private funds. Reducing the flexibility of the UK's fund structuring environment would likely exclude certain institutions from investing in UK private fund structures in the first place. At the same time, the increased costs of the more complex structures required to deal with the UK regime's newfound rigidity would discourage others. The inevitable response from fund managers would increasingly be to offer non-UK fund structures to investors, established in jurisdictions that maintain the requisite flexibility and certainty, as well as the desire to attract a greater share of the global private funds industry.

At the very least, if a UK registered office requirement is introduced for limited partnerships that are established in the future, the same requirement should not apply to existing limited partnerships, as the costly restructuring required would severely damage the UK's reputation as a stable and certain jurisdiction for private fund structures.

However, there are other ways of maintaining a closer connection with the UK that could effectively assist with enforcement and reduce the appeal of UK limited partnerships to criminals. It should be easy to require the inclusion on Forms LP5 and LP5(s) of the address for service of documents, as a precondition to its registration as a UK limited partnership.

This approach would achieve the government's objectives and ensure an ongoing connection to the UK, while at the same time preserving the status quo, and avoiding costly disruption, for existing structures. It also preserves a level of flexibility, which could be even more important once the UK is no longer a member of the EU.