

February 15, 2017

The UK Modern Slavery Act – A Compliance Primer for Fund Managers

Starting this year, a significant number of fund managers based all over the world will be among the approximately 12,000 companies that will be required to publish an annual statement under the transparency provisions of the UK Modern Slavery Act. The statement is required to describe the steps that were taken during the prior fiscal year to ensure that slavery and human trafficking is not taking place in any of the subject company's supply chains and in its own business. In this Alert, we provide an overview of the MSA and tips for compliance for fund managers. We also discuss how MSA disclosures by fund managers may be used by external constituencies.

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Who Is Subject to the MSA?

The transparency provisions of the MSA have broad applicability. They apply to “commercial organisations” doing business in the United Kingdom that provide goods or services and have annual worldwide turnover of at least £36 million.

Commercial Organisations. “Commercial organisation” is defined broadly. It includes a corporation or partnership, wherever incorporated or formed, that carries on a business or part of a business in any part of the United Kingdom. A “business” includes a trade or profession.

Doing Business in the United Kingdom. The MSA does not contain a bright-line test for determining whether a commercial organisation based outside of the United Kingdom is carrying on a business or part of a business in any part of the United Kingdom. In its Guidance on the MSA, the UK Home Office has indicated that commercial organisations should apply “a common sense approach,” noting that commercial organisations that do not have a demonstrable business presence in the United Kingdom should not be required to prepare a statement.

According to the Guidance, having a UK subsidiary will not, in itself, mean that a parent company is carrying on a business in the United Kingdom, since a subsidiary may act completely independently of its parent or other group companies. However, depending upon their business activities in the United Kingdom, multiple entities in the group, even those that are not primarily engaged in carrying on a business in the United Kingdom, could be required to prepare a statement.

The Turnover Threshold. A commercial organisation doing business in the United Kingdom only will be required to prepare a slavery and human trafficking statement if, for the applicable fiscal year, it supplies goods or services and has total turnover of at least £36 million. The turnover calculation includes the turnover of the subject commercial organisation and its subsidiaries, including those subsidiaries carrying on business entirely outside of the United Kingdom.

Content of the Statement

The statement is required to indicate the steps that the commercial organisation has taken during the preceding fiscal year to ensure that slavery and human trafficking is not taking place in any of its supply chains and in any part of its own business. Alternatively, if the organisation has not taken any steps to eradicate slavery and human trafficking, it is required to indicate that.

The MSA does not require commercial organisations to adopt a human trafficking policy, conduct supply chain due diligence or put in place a compliance program. It is a disclosure-only rule, but the transparency provisions are intended to create what the UK Home Office refers to as a “race to the top,” by encouraging companies to focus on the modern slavery risks present in their business and supply chains and adopt appropriate policies and procedures to manage those risks. The transparency provisions also are intended to enable external stakeholders to evaluate company risk assessments and compliance measures and compare them against those of other companies.

The MSA and subsequent Home Office commentary indicate the following areas that a commercial organisation may wish to discuss in its statement:

- The organisation’s structure, its business model and its supply chain relationships;
- The organisation’s policies in relation to slavery and human trafficking;
- Its due diligence and auditing processes in relation to slavery and human trafficking in its business and supply chains;
- The parts of its business and supply chains where there is a risk of slavery and human trafficking taking place, and the steps it has taken to assess and manage that risk;
- Its effectiveness in ensuring that slavery and human trafficking are not taking place in its business or supply chains, measured against such key performance indicators as it considers appropriate; and
- The training regarding slavery and human trafficking available to its staff, including for supply chain management and the rest of the organisation.

However, these are recommended, rather than mandatory, disclosure topics. Commercial organisations have the flexibility to tailor their statement to their particular facts and circumstances.

The Guidance indicates that a commercial organisation that is subject to the transparency provisions must include in its statement the activities of its subsidiaries, even if a subsidiary does not independently meet all of the jurisdictional requirements of the MSA, if the activities of the subsidiary form part of the business of the parent commercial organisation.

Publication of the Statement

Dissemination. The statement must be published on the commercial organisation’s website, if it has one. If the organisation does not have a website, it must provide a copy of the statement, upon written request, within 30 days after the request is received.

The statement must be in a prominent place on the website’s home page. According to the Home Office Guidance, a “prominent place” may mean a modern slavery link that is directly visible on the home page or part of an obvious drop-down menu on that page. The Guidance indicates that the link should be clearly marked so that the contents are apparent, and it recommends a link such as “Modern Slavery Act Transparency Statement.”

Timing. Statements are required to be prepared annually, for the trailing fiscal year, beginning with fiscal years ending on or after March 31, 2016. Because fund managers typically have a December 31 fiscal year end, this will generally mean that the first statement required to be prepared will be for the fiscal year ended December 31, 2016.

The MSA does not contain a specific date by which a statement must be prepared and posted on the commercial organisation's website. The Home Office Guidance indicates that organisations are expected to publish their statements as soon as reasonably practicable after the end of the applicable fiscal year, and they are encouraged to report within six months of their fiscal year end.

Combined Statements. The Home Office Guidance indicates that, if a parent commercial organisation and one or more subsidiaries in the same group are each required to produce a statement, the parent may produce one statement that the subsidiaries can use to meet their disclosure requirement, provided that the statement fully covers the steps that each of the commercial organisations required to produce a statement has taken in the relevant fiscal year.

Approval and Signature Requirement

The statement must be approved by the board of directors (or equivalent management body) and signed by a director or the equivalent if the commercial organisation is a body corporate. If the entity is a limited liability partnership, the statement must be approved by the members and signed by a designated member. If the commercial organisation is a limited partnership registered under the U.K. Limited Partnerships Act, it must be signed by a general partner. If the organisation is any other kind of partnership, the statement must be signed by a partner.

Getting Started – Observations and Selected Compliance Recommendations

Start by Assessing Applicability. As an initial matter, fund managers should assess whether any of their management companies or other group entities must prepare a statement and, if so, which entities. A significant number of managers have offices in the United Kingdom and will meet the “doing business” requirement of the MSA transparency provisions. In most cases, the statement only will be required to cover a portion of the business activities and operations of managers based outside of the United Kingdom due to the manner in which their global operations are structured. Up-the-chain and sister entities are not required to be included in an MSA statement unless they independently meet the requirements of the MSA. However, some managers will elect to discuss their risk assessment and compliance activities for their entire consolidated group.

Review Existing Policies and Procedures and Consider Whether to Make Enhancements. As noted earlier in this Alert, the transparency provisions of the MSA only require disclosure. They do not require a modern slavery or social compliance policy or particular compliance procedures to be put in place. However, in connection with preparing an MSA statement, among other things, managers should review applicable portions of existing management company and investment policies and pre-and post-investment procedures that address human and labor rights such as modern slavery. These should be reviewed against any publicly disclosed policies and procedures of other managers with comparable strategies, as well as against any limited partner expectations, guidelines and commitments. Managers also should assess the extent to which existing human and labor rights policies and procedures align with NGO guidance and whether they are sufficient to mitigate reputational and other potential risks relating to modern slavery.

Managers that have not yet assessed modern slavery risk or extended environmental, social and governance (ESG) programs to cover modern slavery – which includes most managers – should take a gradual approach. A significant portion of first time MSA statements by managers (and commercial organisations generally) will indicate that their modern slavery risk assessment and the establishment of appropriate compliance procedures remain works in process. External constituencies recognize that it takes time to develop and implement a tailored compliance approach. The Home Office Guidance echoes this view and notes that first statements may indicate how the commercial organisation is starting to act on the issue of modern slavery and its planned actions to investigate or collaborate with other stakeholders to effect change.

Write Your MSA Statement for Limited Partners and NGOs. Strictly from a compliance standpoint, a manager could take a narrow approach in drafting its MSA statement, hewing to the literal requirements of the Act. Unlike manufacturers and sellers of products, fund managers do not have supply chains. In addition, entities in which they invest are typically not considered part of the manager's own business.

However, the consideration of ESG factors at the management company level and in investment decisions and ongoing portfolio management is an increasing area of focus for limited partners, especially European pension fund investors investing in private equity funds and other funds with illiquid strategies. Limited partners are likely to start using MSA statements as part of their ESG assessment. In addition, NGOs already have begun reviewing and ranking MSA statements, and more rankings, including by industry, are expected later in the year. Larger fund managers are the most likely to be included in industry rankings and, to the extent their statements and related compliance efforts are viewed as deficient, targeted for NGO engagement.

For all of these reasons, managers generally will be better served by a more robust MSA statement. For example, managers should consider discussing, to the extent applicable, (1) their principal investment strategies, (2) how human and labor rights, including modern slavery, are addressed in their ESG policies, (3) how modern slavery risk is assessed and (4) any related pre- and post-investment compliance procedures and engagement with companies in which the manager invests. The manager also should consider indicating whether it is a signatory to or otherwise following particular responsible investment or human rights guidelines, such as the UN-supported Principles for Responsible Investment, the Private Equity Growth Capital Council Guidelines for Responsible Investment, the UN Global Compact, the UN Guiding Principles on Business and Human Rights, the IFC Performance Standards on Environmental and Social Sustainability and/or the Equator Principles. It also should consider discussing whether it encourages companies in which it invests to follow particular human and labor rights guidelines and codes of conduct relevant to their industries.

External stakeholder expectations will be greatest for managers of private equity, infrastructure and real estate funds, as well as other managers that make significant illiquid investments, such as some credit fund managers. To the extent that it is not practical for the manager to consider social factors in its investment decisions for some or all of the asset classes in which it invests, the manager should consider discussing that in its statement as well.

Align the Statement with Other ESG Disclosures, Statements and Commitments. At many companies, ESG communications lack consistency. Fund managers are no different in this regard. Managers should ensure that their MSA statements are consistent with ESG guidelines in investment policies, any ESG statements and commitments made to limited partners and other publicly facing ESG statements and disclosures. In addition, for private equity firms and other managers that make control investments, MSA and California Transparency in Supply Chains Act statements published by portfolio companies should be consistent with any ESG guidelines of the manager that are applicable at the portfolio company level.

Approach MSA Compliance as a Process, Not a Project. An MSA statement must be prepared annually. As a recurring requirement, a member of the legal, compliance or operations group should be assigned ongoing responsibility for the statement. Disclosures will evolve as commercial organisations, including fund managers, continue to assess modern slavery risk and implement and enhance their modern slavery compliance procedures. Furthermore, as has been the case with other mandatory and voluntary ESG disclosures, other year-over-year enhancements to disclosures will be made as limited partners, NGOs and other external constituencies publish expectations documents, advocate for specific practices and rank compliance efforts.

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