Private Equity

Final Report

TECHNICAL COMMITTEE
OF THE
INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS

MAY 2008

CONTENTS

Introduction

In November 2007 IOSCO published a Consultation Paper prepared by the Technical Committee in relation to Private Equity. The paper had two objectives. Firstly to identify those issues generated by the activity of the private equity industry which potentially create risks that impact on IOSCO's objectives and principles. Secondly, having identified these relevant issues, it set out the next steps IOSCO proposed to take.

This Final Report reports on the feedback received during the consultation period and the next steps that IOSCO will be taking as a result. The report is structured into the following sections:

- A feedback statement outlining the responses received to the consultation and IOSCO's reaction to these points;

- The final version of the private equity report; and

- Non-confidential responses received during the consultation (Appendix 2).

Feedback Statement

Non-confidential responses were submitted by the following organisations to IOSCO Technical Committee (TC) consultation entitled *Consultation Report: Private Equity*. The deadline for comments was 20 February 2008.

Association Française de la Gestion financière (AFG)

Association of Investment Companies (AIC)

British Private Equity and Venture Capital Association (BVCA)

European Association of Public Banks (EAPB)

European Private Equity and Venture Capital Association (EVCA)

International Banking Federation (IBFed)

International Investment Funds Association (IIFA)

University of Bristol

Zentraler Kreditausschuss

These responses can be viewed in Appendix 2 of this document.

The Technical Committee took these responses into consideration when preparing this final report. The rest of this section reports on the main points raised during the consultation.

Comments received

In general, responses to the consultation paper were supportive of the TC's work and were broadly in agreement with the findings and conclusions of the report.

Identification of issues posed by private equity markets to capital markets in general and IOSCO's stated aims and objectives. The responses received generally agreed that the consultation report had appropriately identified seven issues[1] arising from private equity business which merited consideration against IOSCO's objectives. No significant new issues were raised by respondents for inclusion within the final report.

Respondents also generally agreed with the report's analysis that six[2] of the issues identified could be considered of relevance to IOSCO's stated objectives and principles of securities regulation.

Based on the responses received the TC does not propose to make amendments to its report with respect to the issues it considers are posed by private equity to capital markets in general or which of these it considers are relevant to IOSCO's objectives and principles.

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[1] Increasing leverage, Market abuse, Conflicts of interest management, Transparency, Overall market efficiency, Diverse ownership of economic exposure, Market access.

[2] Whilst overall market efficiency was considered relevant to IOSCO's objective to ensure markets are efficient, the TC did not find it of pertinence to any of IOSCO's 30 principles of securities regulation.

Consideration of future work on private equity for IOSCO's future work programme. The report identified two pieces of work that the TC proposed to take forward. These are a survey of the complexity and leverage of capital structures employed in leveraged buyout transactions; and the analysis of conflicts of interest which arise during the course of private equity business.

Several responses commented that a number of the issues identified were also pertinent to other areas of capital market activity, an issue that the TC had highlighted within its report. Respondents therefore agreed with the TC that it should be mindful of work already conducted within IOSCO and other regulatory organisations so as not to duplicate effort or create unnecessary burden in these areas. However, the majority of responses were broadly supportive of the two pieces of work identified and agreed these were appropriate to take forward.

A number of respondents offered to assist IOSCO in its future work on these issues.

Based on these responses, the TC plans to include both pieces of work for prioritisation in its future work programme. The TC is also grateful for offers of assistance from respondents and will bear these in mind as these initiatives develop.

The distinction between private equity and hedge funds. A number of respondents stressed the need to clearly distinguish between the activities of private equity and hedge funds as they felt that public discussion has sometimes confused the two. Whilst both are often described under the 'alternative investments' banner, respondents were keen to impress that their business models varied significantly and therefore they posed distinct issues for securities regulators.

The TC acknowledges these concerns and notes the interlinkages that exist between private equity business and other private capital vehicles that intersect with securities markets. The TC also acknowledges that significant work on areas such as hedge funds has already been completed within IOSCO, and other regulatory organisations, and has focused this report solely on the activity of participants in private equity markets. The TC considers this is made clear within the report.

The potential benefits of private equity business. A number of respondents commented that the report had focused on the potential negative aspects of private equity business and had not outlined any of the benefits that this sector offered to capital markets. Potential advantages put forward included: investment diversification; the elimination of market inefficiencies; and beneficial effects on economic growth.

The TC acknowledges that private equity, like many other forms of investment, offers potential benefits to capital market participants. However, this report is intended as an objective assessment of the impact of private equity on securities market regulation. The TC therefore considers that the report should focus solely on the identification of regulatory issues.

Conclusion and Next Steps

In view of the comments received during the consultation the TC does not believe changes are merited to the original report. The TC therefore considers the Private Equity Report, as contained in the remainder of this paper, to be final.

The TC will, as outlined in the report, incorporate the proposed workstreams into its future work plans. Progress on these will be reported, as appropriate, through standard IOSCO channels of communication.

Executive Summary

In its 2007 work programme, the IOSCO Technical Committee mandated a Task Force on private equity to conduct a preliminary review of private equity markets with a view to identifying any suitable issues which could be addressed through future IOSCO work. The Task Force approached this by: identifying a set of issues which private equity markets may pose to capital markets; analysing which of these issues may be pertinent to IOSCO's stated objectives and principles; and forming recommendations for the Technical Committee as to what further work might be considered within the IOSCO and international regulatory framework.

This analysis has identified seven specific issues relating to private equity markets that have been raised as potential risks to financial markets, of which six are relevant to IOSCO's objectives. These are outlined in detail in the main section of this report. In considering further work, to avoid any duplication due regard have been given to work that has already taken place in IOSCO and other international fora. The Technical Committee has therefore agreed to pursue the following two pieces of work in future work programmes:

> A survey of the complexity and leverage of capital structures employed in leveraged buyout transactions across relevant IOSCO jurisdictions. This would allow assessment of the potential impact that the default of large private equity portfolio companies could have on the efficient operation of related public debt securities markets and any systemic issues which may arise as a result. As this work would involve input from leveraged finance providers and will include issues of interest to banking regulators, the Technical Committee will recommend this work for consideration within the Joint Forum; and
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> Analysis of conflicts of interest which arise during the course of private equity business and the controls utilised across relevant IOSCO member states which aim to provide appropriate levels of investor protection. Key areas of focus will be public-to-private transactions and the listing (or subsequent re-listing) of private equity portfolio companies. These situations potentially have a heightened impact on public securities markets and investors. This work will incorporate both private equity firms and market intermediaries and will focus on identifying conflicts which are present, or are unique, within the context of private equity transactions as they relate to public markets. When defining this work, due regard will be given to existing IOSCO work in areas such as disclosure[3], corporate governance[4], debt market transparency[5] and

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[3] International Disclosure Principles For Cross-Border Offerings And Listings Of Debt Securities By Foreign Issuers; IOSCO International Disclosure Standards For Cross-Border Offerings And Initial Listings By Foreign Issuers; General Principles Regarding Disclosure of Management's Discussion and Analysis of Financial Condition and Results of Operations.

[4] Board Independence Of Listed Companies - Final Report, Report of the Technical Committee of IOSCO (March 2007)

Report on protection of minority shareholders from dominant shareholders or changes in control (due early 2008)

[5] IOSCO Report on Transparency of Corporate Bond Markets (May 2004).

conflicts of interest[6], in order to avoid duplication of previous efforts. The Technical Committee has also mandated that consideration will be given to participation by industry and investors throughout this process.

[6] Market Intermediary Management of Conflicts that Arise in Securities Offerings, Report of the Technical Committee of IOSCO (Feb 2007) – Final Report expected Q4 2007

Background

At the meeting of the IOSCO Technical Committee on 7 February 2007 it was agreed that a Task Force would be assembled in order to conduct a preliminary review of the private equity sector. This was communicated externally via the publication of the Committee's work program[7] in March 2007. This decision reflected the growing importance and influence of private equity within global capital markets. The purpose of the Task Force was outlined as being to assess the issues posed to securities markets by private equity, determine which are relevant to IOSCO's mandate, and recommend appropriate work that could be taken forward within the IOSCO framework.

Scope

The purpose of this memo is to present the conclusions of this work. This document is split into three discreet sections:

An overview of issues the Technical Committee considers are posed by private equity to capital markets in general (Section 1);

Analysis of which issues are relevant to IOSCO's stated objectives and principles and therefore merited consideration for further work (Section 2); and

An overview of the work that the Technical Committee will be including in future work programmes on these issues as a result of this report (Section 3).

The description 'private equity' is used throughout this paper to encompass the activities of venture capital and private equity businesses and therefore incorporates leveraged buyout (LBO) transactions. Definitions of private equity can differ substantially by jurisdiction, and in many cases the scope of some firm's activities makes it very difficult to define a clear set of 'private equity market participants'. It is also noted that the scope of some participant's business means they may not be subject to registration or supervision by securities regulators within their domestic jurisdiction. The scope of this report has therefore been limited solely to activity which typically falls within the remit of securities regulators.

For the purposes of this document the following definitions to describe private equity market participants are used consistently throughout:

Private equity firm – a firm, that operates, manages or advises funds which undertake private equity or venture capital business;

Private equity portfolio company – a target company in which private equity firms invest on behalf of their funds;

Market intermediaries – the banks, including investment banks, that originate debt for private equity transactions and can also act as advisers to private equity firms and target portfolio companies; and

Investors – participants who commit capital, often as Limited Partners in a limited partnership structure, to funds operated by private equity firms.

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[7] Consultation Report: An Overview of the work of the IOSCO Technical Committee (March 2007)

It is recognised that some of the topics focus on the bigger firms and transactions, and not the bulk of venture capital and smaller deals which form a large portion of activity in this sector. However, regulatory risk may be more visible in such transactions and this report considers it proportionate to assess them in this context.

The Technical Committee has also noted that linkages exist between private equity business and other private capital vehicles that intersect with securities markets (e.g. hedge funds). It is acknowledged that significant work in such areas has already been conducted within IOSCO and, therefore, this report focuses solely on private equity business.

Section 1 - Overview of issues posed by private equity to Capital Markets

This section outlines a number of issues posed by private equity markets that are considered pertinent to capital markets in general. The following section will consider their relevance to IOSCO's objectives.

Increasing leverage: A relatively benign economic environment in recent years until the middle of 2007, specifically with low global interest rates and narrow credit spreads, appears to have encouraged a growth in lending associated with leveraged buyout (LBO) activity. Empirical evidence from certain jurisdictions has suggested that leverage levels employed in such transactions in those jurisdictions are increasing.[8] Where such leveraged activity is growing, it may place increased pressure on the future capacity of the companies involved to service their debt. Under certain conditions, this may increase the probability of these companies ultimately experiencing financial distress and default. Given that this topic is typically associated with larger LBO deals, and therefore bigger portfolio companies, this may have negative implications for lenders (particularly before distribution), purchasers of the debt (specifically where these positions are concentrated or leveraged), orderly markets and conceivably, in extreme circumstances, financial stability. In some circumstances, public securities markets may also be affected as, following a public to private transaction, some firms retain the listing of previously issued debt securities. It is also likely that any disorderly market behaviour as a result of defaults in private equity backed transactions will be felt in both public and private markets.

Market abuse: The significant flow of price sensitive information in relation to private equity transactions, as with other merger and acquisition (M&A) activity, creates potential for market abuse. In some markets, this flow may increase with greater size and complexity in transactions and when more parties become involved. If a jurisdiction does not have sufficient market abuse oversight mechanisms in place, market abuse can undermine investor confidence in a market and affect the liquidity investors are willing to provide to issuers in the future.

Conflicts of interest management: Private equity transactions can present material conflicts for a number of parties including private equity firms, investors, target portfolio companies and market intermediaries, many of which are present in other types of M&A activity. Some parties can, and do, take on multiple roles with respect to the same transaction, and there also may exist conflicts between these parties' advisory and proprietary activities. For example, in a Management Buy-out (MBO), current management in the process of taking ownership of a company may not always have an incentive to act in the best interests of existing shareholders by recommending a sale at the highest possible sale price, despite a fiduciary duty to do so. Where public companies are involved, regulators and investors therefore emphasise the controls that firms have in place (e.g. Limited Partnership Agreements, Chinese walls, special committees of outside directors, etc.) to ensure that these potential conflicts do not undermine investor confidence in the marketplace.

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[8] A 2006 ECB survey of leveraged buyout activity demonstrated that leverage levels were rising steadily in larger transactions in Europe (typically > €1bn). However, the picture is less clear outside of the EU where limited quantitative data is publicly available. Moreover, following the recent financial market turmoil, a number of high profile, large PE transactions are being repriced or challenged owing to material adverse change.

Transparency: Current and prospective private equity investors typically receive a substantial level of disclosure from private equity firms. However, critics have raised a number of issues regarding transparency related to PE firms:

Standardisation of valuation and performance reporting – Industry standards, such as the International Private Equity and Venture Capital Valuation Guidelines, exist and, whilst widely used, have not been adopted consistently across the industry. Currently, it can be difficult for investors to make objective comparisons across private equity firms in order to determine their optimal investment strategy. While this issue does not touch on the regulation of public markets, it has been argued that a lack of consistency might undermine investor confidence in private equity firms;

Disclosure to wider stakeholders – Investors in private equity transactions demand detailed and commercially sensitive information. However, the wider market receives relatively little information on the activities and performance of funds, portfolio companies and private equity firms. While this asymmetry of information is topical in certain jurisdictions, this report does not consider it to be an issue specifically relevant to the regulation of securities markets at this time; and

Retail involvement – Private equity is currently a wholesale focused sector in the majority of jurisdictions. If direct retail investor access is sought, then securities regulators in individual jurisdictions will need to assess the adequacy of their regulatory environment to deal with this type of business.

Overall market efficiency – As with most investors, the private equity sector naturally targets firms with the highest expected return on invested capital. Once significant gains have been realised, firms look to exit their investments either via an initial public offering, a secondary buyout by another private equity investor or a strategic corporate merger. Therefore private equity ownership can form an important part of the development lifecycle of a firm. However, it has been argued that this trend has the potential to create issues for some public securities markets including:

> Public investors losing access to firms during the period of their development when they are subject to maximum growth before they are returned to public ownership. This has the potential to result in a public market consisting of mature companies or volatile and risky firms in which private equity firms are not interested. It can also be noted that private equity investors tend to focus on acquiring “undervalued” or poorly performing issuers, and thus private equity acts as a powerful mechanism for ensuring that managers of public companies are competent and seek to maximize shareholder value;
>
> In some jurisdictions, concerns exist that high volumes of private equity activity may have a detrimental effect on the quality, size and depth of public markets and, potentially, the fair and efficient operation of those markets; and
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> Governance in public firms focusing on short term share price levels, not long term strategic growth, in order to protect against becoming a take-over target.
>
> Others note that private equity practices provide distinct benefits to a capital market. These benefits include widening the availability and source of capital, increasing the accuracy of company valuations (factoring in their growth potential), enhancing the

efficiency of corporate capital structures and facilitating corporate development. On a more micro level, benefits could also include avoidance of bankruptcy or other legal restructuring up to and possibly including governmental intervention or, more positively, providing financing and executive skills lacking in current management. In light of these issues, public bodies may therefore need to consider the effective calibration of incentives to participate in public or private markets when considering the appropriateness of incumbent regulatory, taxation and competitive regimes.

Diverse ownership of economic exposure: The duration and potential impact of any credit event or downturn may be exacerbated by structural issues which make it difficult to identify who ultimately owns the economic risk associated with, typically, a leveraged buyout and how these owners will react in a crisis. These concerns may arise out of the extensive use of opaque and complex risk transfer practices such as assignment and sub-participation, together with the increased use of credit derivatives (which may not be confirmed in a timely manner). The entrance of new types of market participants utilizing different business models adds further complexities. Differences in international insolvency practice and legislation may also add to uncertainty as issuance increasingly takes place cross-border. Some argue that these factors may create opacity which could damage the timeliness and effectiveness of workouts following credit events and could, in an extreme scenario, undermine otherwise viable restructurings. While bodies such as the International Association of Restructuring, Insolvency & Bankruptcy Professionals (INSOL International) have issued principles for workout processes[9] as well as updates on the issues presented by credit derivatives[10], an area in which ISDA have done notable work on cash settlement protocols, it is unclear how firmly these are embedded in industry practice. Some believe these issues are pertinent to public and private markets alike.

Market Access: Private equity firms typically raise funds from institutional investors and financially sophisticated individuals; there is currently little direct retail investment.[11] However, some investment entities have sought public listings which, alongside venture capital trusts and private equity investment trusts, will provide some retail exposure to the market risks these firms undertake. In certain jurisdictions, this can also bring the private equity firm itself under a separate regulatory regime from non-listed firms. Other examples include the offering of hybrid securities to retail investors as part of a private equity transaction. Depending on the structure of the offering and the disclosure regulations of the jurisdiction in which the offering is made, this can create opacity in terms of the true risk associated with such securities and the how they are positioned in the case of corporate failure.

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[9] http://www.insol.org/statement.htm

[10] http://www.insol.org/derivatives.htm

[11] There is increasing indirect retail involvement through public and private pension fund investments.

Section 2 - Specific relevance of issues to IOSCO's objectives and principles

It is recognised that not all of the issues outlined above are directly relevant to IOSCO's remit with respect to the securities regulation. IOSCO has set three objectives of securities regulation, which are:

The protection of investors;

Ensuring that markets are fair, efficient and transparent; and

The reduction of systemic risk.

These objectives are supported by the 30 principles[12] which provide guidance as to IOSCO's recommendations for the desirable attributes of the regulatory framework for public securities markets within a jurisdiction.

In order to determine which of the outlined issues are relevant to IOSCO's mandate, and are therefore an area for potential mitigation work within the organisation's regulatory framework, this report presents the results of analysis of the outlined issues against these objectives and principles. This is presented in Table 1 below.

It is recognised that differing regulatory regimes, structures and objectives amongst its members may mean that certain areas may not be specifically applicable, as described, within individual regulatory jurisdictions, or potentially fall within the remit of a number of regulatory and self-regulatory organisations.

[12] IOSCO Objectives and Principles of Securities Regulation (May 2003)

Table 1

Issue	**IOSCO Objective**	**Summary**
Increasing Leverage	Investor Protection Systemic risk reduction	Increasing leverage levels and more complex capital structures, typically within buyout transactions, have been identified in recent years within the EU. Limited quantitative data is currently publicly available in other jurisdictions. As with all leverage activity, such growth may enhance the possibility of financial distress and default associated with large and significant deals, creating potential detriment to the secondary markets if the debt is traded. Public securities markets may also be impacted as, following a public to private transaction, some companies retain the listing of previously issued debt securities. If this is the case, an increase in leverage activity by private equity firms may be pertinent to IOSCO objectives with respect to: the protection of investors in public debt and derivative markets; and the reduction of systemic risk to securities markets created either by a large and complex default or a number of simultaneous defaults in private equity transactions. Relevant IOSCO principles exist with respect to market intermediaries, secondary markets, and bond market transparency.
Market Abuse	Investor Protection Fair and efficient markets	Potential for market abuse in the public markets as a result of large private equity transactions is relevant to IOSCO's objectives of both investor protection and the operation of fair, efficient and transparent markets. Relevant IOSCO principles exist with respect to enforcement, issuers (of public debt) and secondary markets.
Conflicts of Interest	Investor Protection Fair and efficient markets	Where conflicts exist between the differing roles and responsibilities that private equity firms and market intermediaries take on in the course of private equity business, detriment can exist to both investors in private equity funds, associated public securities and the fair and efficient operation of those markets. The impact of such conflicts on public securities markets is likely to be heightened in the context of public-to-private transactions and the listing or (re-listing) of private equity portfolio companies. Relevant IOSCO principles exist with respect to collective investment schemes and

		market intermediaries.
Transparency	Investor Protection Fair and efficient markets	From an IOSCO perspective, this issue is of relevance solely to the issuance of publicly traded debt securities as part of the financing of a private equity transaction. Any lack of transparency by the issuer, or in secondary markets, could present detriment to objectives of both investor protection and transparent markets. Relevant IOSCO principles exist with respect to issuers of public debt and secondary markets.
Overall market efficiency	Fair and efficient markets	Whilst the outline issue relates to IOSCO's objective with respect to the efficient market operation, this is not relevant to any of the 30 principles of securities regulation. The Technical Committee therefore considers this issue to be outside of IOSCO's mandate in terms of consideration for potential mitigation action.
Diverse ownership of economic exposure	Investor Protection Fair and efficient markets Systemic risk reduction	The increased complexity of capital structures and market exposure to private equity owned companies creates potential detriment with respect to all three of IOSCO's objectives. In the case of financial distress, including default, of a private equity backed transaction delay and confusion in either the restructuring or settlement process could result in financial loss to investors in the issuer's publicly traded debt securities, as well as lowering overall liquidity within the market with an ensuing impact on market efficiency and, in extreme circumstances, financial stability. Relevant IOSCO principles exist with respect to issuers of public debt and secondary markets.
Market Access	Investor Protection	The variety of ownership and legal structures through which private equity firms operate, and the complex nature of securities issued in private equity transactions, can create challenges for listing authorities in ensuring the appropriate degree of investor protection if those private equity firms have retail investor clients or issue securities to the public and are not required to provide the same level of disclosure as other issuers. Relevant IOSCO principles exist with respect to issuers and collective investment schemes.

Section 3 - Consideration of potential further work within the IOSCO framework

1. The previous sections of this document have been concerned with identifying issues posed by private equity markets which are relevant to IOSCO's stated objectives and principles. Consideration is given within the following section as to further work that could be undertaken, within the IOSCO framework, as mitigation on these issues.

2. It is acknowledged that most of the issues outlined, for example market abuse and conflicts of interest, are not exclusive to private equity. Consideration has therefore been given to other work undertaken within IOSCO on these areas, and whether they provide for an effective response to the specific nature of the issues as posed by private equity.

3. Acknowledgement is given that some of the issues outlined could fall within the remit of other international organisations including the Financial Stability Forum (FSF), the Basel Committee on Banking Supervision (BCBS), the Joint Forum (JF), and the Organization for Economic Cooperation and Development (OECD). In considering appropriate recommendations, this report remains mindful of work already conducted within these fora.

4. The remainder of this section, contained in Table 2 below, will therefore analyse the six issues in turn, considering if relevant work has already been conducted/scheduled and therefore what action has been considered suitable for future IOSCO work programmes.

Table 2

Issue	**IOSCO work** **(post 2005)**	**Work in other regulatory organisations**	**Work recommended by the Technical Committee as a result of this report**
Increasing Leverage	N/A	• Large banks and private equity-sponsored leveraged buyouts within the EU – a report on financial stability, ECB (April 2007). • The FSF in a press release in March 2007 outlined that it would monitor developments in corporate leverage and implications for financial stability. • Studies on credit risk concentration: an overview of the issues and a synopsis of the results from the Research Task Force project, BCBS (Nov 06). • Credit Risk Transfer, Joint Forum (Mar 05) – the JF are in the process of updating this report following developments in credit markets since 2004.	The Technical Committee will ask the Joint Forum to consider the feasibility of a survey of leveraged buyout activity across member jurisdictions. An appropriate focus for this survey would be to understand current practice with respect to leverage levels and the complexity of capital structures in leveraged buyout transactions. The survey could also be used to determine the amount of publicly traded debt securities which private equity owned companies retain. This would highlight any regional differences and allow for a greater understanding of the potential impact of leverage on securities markets and any potential systemic implications. Such a survey would require input from the banking and market intermediary community, including investment banks. The Technical Committee therefore considers that such work would be most appropriately taken forward by the Joint Forum.
Market Abuse	• Multi-jurisdictional Information Sharing for	• Market abuse is an area of key focus across other international fora as well as within	Market abuse and financial fraud remains a key priority of IOSCO, and within

	Market Oversight (Feb 07) • Strengthening Capital Markets against Financial Fraud (Feb 05).	individual regulatory jurisdictions.	individual jurisdictions. Much of this work will encompass private equity activity. The Technical Committee does not therefore consider it relevant to mandate further specific work in this area from a private equity perspective.
Conflicts of Interest	• Board Independence of Listed Companies - Final Report, Report of the Technical Committee of IOSCO (March 2007) • Report on protection of minority shareholders from dominant shareholders or changes in control (Early 2008) • Market Intermediary Management of Conflicts that Arise in Securities Offerings (Feb 07) – (Final Report expected Q1 2008). • IOSCO Statement Of Principles For Addressing Sell-Side Securities Analyst Conflicts Of Interest, Statement of the Technical Committee of	N/A	It is recognised that conflicts arising within securities issuance have been comprehensively covered within recent work by SC3 and therefore further work is not proposed in this area. However, this report does recommend further work to analyse the mitigation of potential conflicts of interest which arise during the process of public-to-private, and private-to-public transactions. In these cases, there may be a risk to public investors if conflicts of interest are not managed appropriately. The Technical Committee has therefore proposed a review of conflicts management practice in private equity transactions that directly involve public securities markets, with a view to identifying what conflicts exist and best practice in their management. It is recommended that this work should focus on market intermediaries and acknowledges that, in jurisdictions where private equity firms are within the mandate of the regulators involved in this work, consideration should be given to

	IOSCO (Sep 03).		including such firms within this analysis. Specific focus should be given to identifying conflicts which present heightened concern, or are unique, within the context of private equity transactions. Given that IOSCO has already concluded considerable work that touch on public-to-private and private-to-public transactions, as well as intermediary conflicts of interest, when defining this work, due regard will be given to this existing body of work. This new work will focus on areas where private equity transactions present unique issues, not previously addressed by other IOSCO principles or work.
Transparency	• Transparency of Corporate Bond Markets (May 04) • International Disclosure Principles for Cross-Border Offerings and Listings of Debt Securities by Foreign Issuers - Final Report, (Mar 07) • Work on principles for disclosure by listed issuers in periodic reports (ongoing).	• European Commission Directive 2007/14/EC of 8 March 2007 laying down detailed rules for the implementation of certain provisions of Directive 2004/109/EC on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (Transparency Directive). • CESR transparency expert group work on implementation of the Transparency Directive (Feb 07). • European Commission Regulation (CE) 809/2004 of 29 April 2004 implementing Directive 2003/71/EC of the European Parliament and of the Council as	Comprehensive work has been conducted within IOSCO on transparency within both the primary and secondary markets that relates to private equity activity. These are the key areas of focus for IOSCO as outlined in the second section of this document. Further work, as a result of this report, is not considered necessary in this area.

		regards information contained in prospectuses as well as the format, incorporation by reference and publication of such prospectuses and dissemination of advertisements (Prospectus Directive).	
Diverse ownership of economic exposure	N/A	• Credit Risk Transfer, Joint Forum (Mar 05) – the Joint Forum are in the process of updating this report following developments in credit markets since 2004. • Studies on credit risk concentration: an overview of the issues and a synopsis of the results from the Research Task Force project, BCBS (Nov 06).	Relatively little work has been completed in international fora on whether there may be an impact of increasing complexity in capital structure and economic exposure of corporate securities. It is also, however, acknowledged that workout procedures and restructuring negotiations have traditionally been considered outside of the mandate of securities regulators. This report considers that, given the difference in insolvency legislation and regulatory remits across jurisdictions, any work in this area would not be practical within the IOSCO framework.
Market Access	N/A	N/A	Relatively little focus has been given to the activities of private equity firms and leveraged buyout transactions in this area. It has been generally assumed that retail investment in both private equity funds, and the complex securities issued as a result of their activities is small. This report therefore does not consider any further work appropriate at this time.

Appendix 1 - Contributors to the work of the IOSCO Task Force on Private Equity

Chair: Hector Sants (FSA)

AFM
Teunis Brosens
Bas ter Weel

AMF
Catherine Dias
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ASIC
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Appendix 2 Non-Confidential Comments Received to the Consultation Report on Private Equity

International Investment Funds Association

International Investment Funds Association

Association internationale des fonds d'investissement

February 4, 2008

Re: INTERNATIONAL INVESTMENT FUNDS ASSOCIATION (IIFA)'s comments on the IOSCO Technical Committee Consultation Report on Private Equity

The INTERNATIONAL INVESTMENT FUNDS ASSOCIATION (IIFA)[13] would like to thank IOSCO and the members of its Technical Committee ("TC") for the work that they have carried out in producing the *Consultation Report on Private Equity* and welcomes the opportunity to comment on this Report.

IIFA wishes to express its support to the current IOSCO's initiative, which consists of identifying any suitable issues which could be addressed through future IOSCO work. In particular, we support the intent by IOSCO to pursue the two pieces of work mentioned in the Report in future work programmes, namely on the one hand a survey of the complexity and leverage of capital structures employed in leveraged buyout transactions across relevant IOSCO jurisdictions, and on the other hand an analysis of conflicts of interest which arise during the course of private equity business and the controls used across relevant IOSCO jurisdictions which aim at providing appropriate levels of investor protection.

On this basis, we want to express two general remarks at this stage.

First, when IOSCO develops its assessments in the two directions mentioned above, it will have to take note of the very wide variety of private equity funds involved. Even though we admit that it might complicate the work of IOSCO at worldwide level, due consideration must be given to the local specificities of private equity funds at each national level. Both product designs and degrees of regulation vary greatly from one country to another one, and

[13] The INTERNATIONAL INVESTMENT FUNDS ASSOCIATION (IIFA) represents at worldwide level the investment management industry for collective portfolio management. Members and participants to the IIFA include 41 domestic associations from all regions (Americas, Europe, Asia, Pacific, Africa). Together, they manage more than 24 trillion US dollars or 16 trillion euros in the field of investment management. In terms of funds range, our industry includes mutual funds, UCITS and also a part of employee savings schemes funds, regulated hedge funds/funds of hedge funds and private equity funds.

therefore IOSCO should be very careful before drawing any general conclusions on private equity funds.

Second, we noticed that the Technical Committee expressly mandated that consideration must be given to participation by industry throughout its working process. Considering the various national experiences of our members in the field of private equity funds, we would be very happy to develop further contacts with IOSCO Task Force of Private Equity.

We thank you in advance for your attention to the views expressed above. Please feel free to contact the undersigned should you wish to discuss further.

Sincerely,

Stéphane Janin

Chair of the IIFA-IOSCO working committee

and

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Association of Investment Companies

Comments on the IOSCO Technical Committee Consultation report on Private Equity

Submission by the Association of Investment Companies

The Association of Investment Companies (AIC) welcomes the opportunity to inform IOSCO's deliberations on private equity. The AIC represents investment companies, which play an important role in the UK private equity market.

Investment companies are closed-ended funds, whose shares are traded on a stock exchange, and which invest in a portfolio of assets to provide their shareholders with an investment return. The vast majority of our members are UK listed, although some also trade on other markets, such as AIM.

Investment companies compete with other collective investment vehicles (such as UCITS funds) and allow retail investors to diversify their risk and secure both capital growth and income. They are widely held by retail investors – we anticipate far more than any other sector of the stock market, and certainly more than conventional 'private equity funds'.

A number of investment companies are dedicated private equity vehicles: they compete directly with funds based upon limited partnership structures. The AIC therefore has a strong interest in the issues being considered by IOSCO.

As the IOSCO invitation for comment does not specifically discuss investment companies as participants in the private equity market, this response explores in more detail their unique perspective before commenting directly on the issues raised in the consultation report.

Overview of private equity investment companies

Size of the UK market: The UK investment company sector[14] as a whole has some £95 billion of assets under management. A significant proportion of this is invested in private equity. We estimate that around £12 billion of the total UK sector is held in dedicated private equity funds.

The sector is not homogeneous but covers a broad range of private equity and venture capital structures. Venture Capital Trusts (VCTs), for example, are a specific type of investment company differentiated by their tax treatment (which includes incentives for retail investors to buy newly issued shares). They invest in small companies (depending on when they were launched, either businesses with

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[14] Broadly speaking, investment companies listed or traded on UK stock markets. If overseas listings/trading are taken into consideration, the size of the sector would be significantly larger. For example, while we do not have figures, a significant volume of private equity investment company shares are traded on Euronext.

under £15m or £7m of gross assets). These vehicles make up some £2.5 billion of private equity assets under management (in addition to the £12 billion in more conventional private equity companies). However, we recognise that this tier of investment is not the key area of interest for IOSCO, and this response does not focus on VCT specific issues.

We would also note that investment companies with more wide-ranging remits may seek to diversify their asset allocation by holding private equity investments within their portfolios alongside other assets, such as listed equities.

Investment companies with a private equity remit also include ‘funds of funds’ which gain exposure to the sector by investing in unlisted private equity funds (limited partnerships). The AIC therefore has a perspective on this debate both as a representative of specialist private equity vehicles and as a representative of investors in what the IOSC has defined as ‘private equity firms’.

Suitability of investment companies for private equity investment: Listed investment companies are particularly well suited to investing in illiquid asset classes (such as private equity) because their shares are traded on a stock market. The market matches investors who want to buy and sell their shares. This trading occurs without any direct influence on the composition of the underlying portfolio.

This contrasts with investment products such as UCITS funds. In these funds the manager may be obliged to sell underlying assets to redeem an investor with the cash value of their investment when they choose to exit the fund. This is not a problem where the fund is invested in listed assets, such as quoted equities. It would be impractical if the fund were to be substantially invested in private equity, where stakes in unquoted companies cannot be realised quickly for cash. The relationship between redemptions and the underlying portfolio means that UCITS and other ‘open-ended’ investment products (where the portfolio expands or contracts according to whether investors are joining or leaving the fund) are less suitable for significant investment in private equity. Indeed, most open-ended funds are severely restricted by regulation from investing in unquoted securities.

Of course, unlisted closed-ended funds are also used to access private equity and they do not suffer from the same problems which affect retail orientated open-ended funds. However, they involve significant barriers to entry for many investors.

Retail access to private equity: The listed investment company structure is well suited to providing retail investors with exposure to a diversified pool of assets. It allows them to spread their risk and gain the benefits of specialist fund managers in a cost-efficient manner.

Investment companies also allow retail investors to gain access to private equity. Investors do not have to invest a lump sum, perhaps involving thousands of pounds (which is a significant barrier to entry for the average retail investor to most private equity funds).

Even with only a moderate sum to invest, a potential investor can either directly approach a stockbroker or dealing service to purchase shares on their behalf. This can be done either with or without advice. Alternatively, retail investors can purchase private equity based investment companies by using ‘wrapper products’. These include the Individual Savings Account (a UK ‘wrapper’ which allows the shareholder to make capital gains and receive dividends without incurring a tax liability). Shares can also be purchased and held in ‘self-select’ pension funds. The amount required for investment can be very small – many private equity investment company shares can be purchased through savings schemes for as little as £50 (or €74) a month.

It is also worth noting that investment companies can give these investors exposure to a pool of private equity funds. This arises where they purchase a ‘fund of funds’ (whether these investments are listed or unlisted) which provides them with an additional layer of asset diversification.

Easy exit: As well as having low barriers to entry, the ability to sell shares at any point is important for retail investors. Investors will normally be well served by holding investment company shares for a number of years (whatever asset class the portfolio is exposed to) as holding for a longer time will help mitigate short term risks and volatility. However, it may be that circumstances dictate that shareholders may seek to redeem their investment before they had planned. As investment company shares are fully tradable they can be realised quickly with no penalties. This may not always be the case with unlisted private equity funds where there is often no secondary market.

Regulatory position: Investors in private equity investment companies enjoy a robust regulatory regime to protect their interests. Investor protection arises from various sources. Their status as companies means that they will be governed by company law. UK domiciled funds are required to have an independent board of directors with a legal obligation to safeguard the interests of the shareholders (a structure not necessarily paralleled in other private equity structures). When they are domiciled within the European Union the requirements of their domestic company law will also be informed by European-wide company law requirements which include measures regarding shareholder protection, for example. The company law landscape within Europe is evolving as the Company Law Action Plan is being taken forward.

Where shares in an investment company are listed on a regulated stock exchange (such as the main market of the London Stock Exchange) they are also subject to listing rules. The European Union has established baseline listing standards to provide safeguards for investors. The UK has imposed so-called ‘super-equivalent’ listing rules to provide additional safeguards. In addition to the requirements for listed shares, there are a range of European measures which inform the way in which investment company shares are traded, particularly where they are traded on regulated markets. These include the Market Abuse Directive, the Prospectus Directive and the Transparency Directive.

Where investment companies based in Europe use external managers, these functions are regulated under MiFID.

The operation of private equity investment companies are, in many critical respects, overseen by 'securities regulators'.

This paper does not go into detail on the regulatory arrangements governing investment companies but we are confident that these arrangements provide investors with appropriate consumer protection and ensures that the market for their shares is orderly. The highest standards are provided where investment company shares are listed and traded on regulated exchanges. As a result these markets tend to have the broadest range of investors (from retail purchasers to institutions) who are provided with high quality information which enables them to make investment decisions regarding their exposure to private equity investment companies. Also, as shareholders, they have important rights in relation to the governance of the company itself – including, for example, having a say in electing board members.

The regulatory regime for investment companies is comprehensive and robust.

Developing the role of private equity investment companies: In considering issues related to the development of the private equity market, the AIC **recommends** that IOSCO should recognise the role that private equity companies can play in that market. They compete with other structures, such as limited partnerships, to provide competition in relation to investment performance, regulatory standards and corporate governance. This competition has positive implications for investors in private equity and in relation to the market for 'portfolio businesses'. The AIC also **recommends** that IOSCO should be careful that any work it undertakes in this area does not prejudice the ability of private equity investment companies to compete effectively.

Private equity issues

The AIC's observations on the issues identified by IOSCO are set out below.

Increasing leverage: The health of the credit markets has been of significant public policy interest over recent months. It is also the case that (certainly until recent restrictions in the credit market emerged) private equity owned businesses may have employed greater leverage than PLCs. However, the AIC's consistent policy position has been that the level of leverage adopted in private equity transactions, and whether or not the risk it creates is appropriate, is primarily a matter for the private equity vehicle concerned and its shareholders. Although a highly-geared transaction could experience problems, and this could damage the private equity fund, it is difficult to see that this of itself would create any systemic risks in the credit market.

Lenders should understand and take account of the risk they are exposed to when they make loans to private equity vehicles. However, the private equity sector cannot be held accountable for any poor risk assessments made by credit providers. (Any suggestion that such assessments are not possible because the potential creditors will not provide sufficient information is not tenable. In these circumstances the lender should simply not make the loan.)

Despite changing economic circumstances and conditions in the credit market, the experience of the private equity market to date has actually demonstrated the robustness of the private equity model. So far the sector has not suffered any substantial failures nor contributed to the creation of systemic risks.

Of more public policy concern are the risk and liquidity management systems of the lenders, who should be the primary focus of further work in this area. Apart from strengthening systems to ensure the robustness of originators of credit, it will also be important to ensure that risk transfer mechanisms are appropriate. Again, how lenders choose to distribute risk, and the practices of institutions involved in the secondary market, is not a matter with direct relevance to private equity vehicles which are taking out leverage. It is a matter for debt market regulators to consider.

Private equity should not be singled out for special attention at the expense of other vehicles, such as hedge or sovereign wealth funds, which may also inject leverage into their transactions.

The AIC notes IOSCO's proposal for a survey of leveraged buyout activity by the Joint Forum. This may have some value – from the perspective of assessing the exposure of credit providers – but we would be concerned that activities of this nature should not create too onerous a burden on private equity practitioners. We also note that in the UK the FSA is already proposing to conduct a survey of bank's exposure to leveraged buyouts. To the extent that this information is already being gathered, any Joint Forum activity should not duplicate, or be allowed to increase, the workload in this area.

Market abuse: Market abuse is an important issue, and the AIC recognises that IOSCO will have a legitimate interest in this area. However, we are keen to emphasise that private equity vehicles are not special cases where abusive practices are involved. Any transaction involving a public company offers potential issues in this area. Indeed, given the focus on the private equity sector and the competitive pressures which exist to secure deals, it is likely that private equity practitioners are particularly good at managing this risk. Private equity operators impose strong internal controls which seek to ensure that problems of this nature do not emerge.

Investment companies are likely to be particularly strong in this area as they are themselves traded on a stock exchange, and are subject to strict rules on when and how information can be released to shareholders and the market generally. The disciplines of having their shares traded publicly means that they are continually alive to the importance of maintaining properly informed and orderly equity markets.

With this in mind, the AIC agrees with IOSCO's conclusion that the work of individual securities regulators is already addressing issues related to market abuse, and that therefore no special additional work needs to be undertaken in this area.

Conflicts of interest management: As the consultation document acknowledges, private equity transactions are not uniquely at risk to conflicts of interests. Again, the attention paid to private equity transactions, and the internal systems adopted by the industry means that possible risks are likely to be reduced. This is even more likely to be the case where private equity investment companies are concerned.

UK domiciled companies, for example, are subject to UK company law which imposes legal obligations on boards to manage conflicts of interests appropriately. In addition, all investment companies on the official list are subject to rules on 'related party' transactions – which address situations where 'co-investment' is undertaken between the investment company and its external fund manager.

The AIC notes IOSCO's intention to undertake further work in relation to the management of conflicts of interest and its likely focus on market intermediaries. The AIC welcome the intention to limit this work to areas not previously addressed and where a specific risk has been identified. This should ensure this work has a proportionate impact on the sector – particularly as we believe there are few unique factors which relate to private equity transactions.

Transparency: The UK's private equity investment company sector offers high levels of public transparency in comparison with other private equity operators. Listed companies have to comply with the listing rules, which include a number of reporting requirements in respect of their annual financial reports and governance. (The investment entity listing rules, for example, require companies to either state that they meet the requirements of the UK's 'Combined Code of Corporate Governance' or explain where and why they deviate.) Regulated stock exchanges impose further transparency obligations on investment companies via the Transparency Directive, Prospectus Directive and the Market Abuse Directive. The public disclosures required of the industry are substantial. If transparency is a concern of IOSCO, private equity investment companies should be a preferred option.

Of course, while the investment companies themselves offer transparency, the underlying businesses are not traded on public markets and so do not have to meet the same requirements. The AIC has a number of observations on this area:

- it is not clear that (in the absence of a need to maintain a fair and orderly market for quoted shares) that there is any regulatory need to provide any more information than is currently provided at the discretion of the private equity owners.

- to the extent that there is a lack of transparency, the private equity sector is not unique. 'Conventional' privately owned business and those owned by sovereign wealth funds provide similar amounts of information.

- the sector has recently signed up to a voluntary code of practice (the Walker Guidelines) which sets out a framework for portfolio businesses, and the investment vehicles themselves, to publish more information where the operations of that business have a significant impact on the public stakeholders.

The AIC also notes that access to retail investment is mentioned with reference to transparency. As discussed in the first part of this paper, investment companies do have retail investors – which is one of the reasons it already delivers high levels of information to the public.

The AIC does not believe that there are fundamental problems with transparency in the private equity sector – particularly where investment companies are concerned. Where issues do exist, the sector is seeking to ameliorate them. This should be recognised in IOSCO's assessment of the need for further work in this area. The AIC therefore agrees with IOSCO's decision not to conduct further work in relation to transparency.

Overall market efficiency: The AIC does not believe that private equity creates any adverse consequences for market efficiency. Private equity activities are in fact beneficial as the threat of intervention by private equity incentivises managers of public companies. The AIC also believes that private equity has no impact over the long-term on the depth and size of public markets as portfolio businesses are often floated to provide an exit. Finally, where private equity investment companies are concerned, they do not exclude 'public investors' from private equity owned sectors as they have low barriers to investment.

The AIC agrees that there are no significant issues regarding market efficiency which warrant IOSCO's attention.

Diverse ownership of economic exposure: As discussed above (see, Increasing Leverage) the transfer of economic risk arising from leverage is not an issue for the private equity sector itself to address. If investors are uncertain about levels of risk in debt instruments available on the secondary market, then they should not buy them. The AIC has no view on the impact of risk transfer practice on insolvency procedures, but accepts IOSCO's view that this is not an issue which should be addressed within the IOSCO framework.

Market Access: As discussed above, private equity investment companies (which include investment trusts and venture capital trusts) are available to retail investors. The AIC is confident that the UK sector is regulated appropriately for these shareholders. There is no reason in principle why private equity investment companies would raise issues which are different to other investment companies invested in other asset classes – they may offer different levels of risk, but this is relevant only to the nature of the investment opportunity not the basis for their regulation.

While investment companies can (and do) have retail investors, this should not be of concern to IOSCO. If, for any reason, IOSCO believes in the future that there may be issues of emerging regulatory concern regarding retail access to private equity through investment companies, the AIC would be keen to work with IOSCO to inform its views and, if required, develop an appropriate regulatory response.

Conclusions

In many ways, private equity is not the source of many of the key risks identified by IOSCO nor is it the only sector affected. In some ways, therefore, it is difficult to see why it has been the focus of so much specific regulatory concern. However, the AIC acknowledges that there has been significant political attention paid to the sector – driven by concerns ranging from the impact of private equity on employment levels to the amount of tax paid by private equity practitioners. With this in mind, it is understandable that IOSCO has felt the need to examine the need for action over private equity. However, the AIC has been encouraged by IOSCO's conclusions that the need for additional regulatory activity in relation to the sector is limited.

IOSCO's proportionate response to the debate is also welcome as it reduces the risk that focussing on the asset class/sector rather than related systemic issues (poor risk management practices by lenders; market abuse; market efficiency etc) could distort the perspective of the regulatory authorities and distract them from more important measures which are generic across the investment arena.

The AIC would be keen to engage further with IOSCO as appropriate on issues related to private equity investment companies, or the investment company sector more generally, if that would be helpful at any point in the future.

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Comments on the IOSCO Technical Committee Consultation Report on Private Equity

Thank you for the opportunity to comment on your report on private equity.

Private equity is playing an increasingly important role in the international financial markets. This development should not be regarded as negative from the outset: rather, any discussion of possible regulatory approaches should consider all relevant economic aspects. In our view, private equity funds help significantly to increase market liquidity and eliminate market inefficiencies while at the same time offering investors new opportunities to diversify their portfolio.

We would like to begin by stressing that hedge funds and private equity funds - though both known as alternative investments - need to be clearly distinguished from one another since they differ both in their investment strategies and in the way they operate in the capital market.

It is all the more important, in our view, to bear this distinction in mind when it comes to considering future regulatory mechanisms.

We nevertheless recognise that the growth of private equity funds prompts questions regarding their transparency, conduct in the market and sometimes high level of debt financing. In our opinion, however, many of these questions have already been adequately addressed by IOSCO and other organisations.

As the Technical Committee concludes, a closer look needs to be taken at most to the issues of leveraged buyouts and conflicts of interest which are specific to private equity business.

The committee correctly points out that much work has already been done with respect to conflicts of interest at market intermediaries. Proposals concerning the conflicts of interest between private equity firms and target companies should focus primarily on possible means of self-regulation, which offers an alternative to unilateral regulatory measures and could function in a manner consistent with market realities.

As far as the issue of market efficiency is concerned, we should like to emphasise that private equity is a particularly important source of capital in a company's start-up phase, thus making entrepreneurial activity possible in the first place. In our view, this also applies to the growth phase of established companies since private equity is often the only means of funding and implementing strategic or structural options (e.g. realising a growth strategy by establishing a new business segment or through internationalisation, acquiring a competitor, undergoing a change in ownership, succession planning).

Another important aspect is the speed of response made possible by private equity. The additional capital enables rapid implementation of measures that could not otherwise be financed or realised within an often narrow window of opportunity (buying out a competitor, entering a new market after a rival has successfully established itself).

Regarding the leveraged buyout model discussed in the paper, it is important to bear in mind that this is only one of many market strategies pursued by private equity firms: the majority operate in other areas.

In Section 3 the Technical Committee considers the potential for further work within the IOSCO framework. As the committee itself points out, extensive regulation is already in place at European level. The Transparency Directive, Prospectus Directive, Takeover Directive and Market Abuse Directive, in particular, must be complied with by private equity firms just as much as by other market players. It is therefore essential, when considering possible regulatory action, to remember that the European market is already heavily regulated and that any further regulation runs the risk of destroying the positive effects of private equity, especially in the field of venture capital.

We would be pleased to support IOSCO in its future work on this major issue for the capital markets. Please feel free to contact us at any time in this regard.

Yours sincerely
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20 February 2008

IBFed Comments on the IOSCO Technical Committee Consultation Report on Private Equity

The International Banking Federation (IBFed) welcomes the opportunity to comment on the IOSCO's Consultation Report on Private Equity. The IBFed fully supports the IOSCO's objectives of protecting investors, reducing systemic risk and ensuring market integrity.

We also find the IOSCO's work on private equity investments timely in view of the recent debates around hedge funds and private equity. Generally, there seems to be a good deal of confusion around the activities and potential issues around both types of instruments, as well as a lack of understanding as regards their different objectives and tools. It is helpful for the IOSCO to address these issues analytically.

A priori, we wish to underline our strong support for private equity investment, not only from an investment point of view *per se*, but also from a broader macroeconomic perspective. We would find it appropriate for IOSCO to acknowledge more explicitly the generally positive effects of private equity, for example in terms of economic growth and employment. From an investor point of view, private equity can generate high returns and is one of the best available tools for effective portfolio diversification.

On the other hand, we agree that several of the issues identified by the Technical Committee as regards private equity are of equal potential concern for other types of investment, including e.g. high leverage, market abuse and transparency concerns. The Technical Committee concludes rightly that these issues have already been addressed, *inter alia* through the IOSCO's own principles. We would in addition suggest that these issues be clearer set into their general context, including also the existing legislation at national level.

We support in principle the Technical Committee's conclusions with regard to the two areas that it has identified for further work, i.e. a survey of the complexity and leverage of capital structures employed in leveraged buyout transactions, and an analysis of the conflicts of interest which arise during the course of private equity business and the controls utilised across relevant IOSCO member states to ensure appropriate levels of investor protection.

As regards potential conflicts of interest, the Technical Committee is right to point out that sufficient work around potential conflicts of interests has already been carried out as far as collective investment schemes and market intermediaries are concerned. For private equity firms and target companies, the analysis should in our view not only have regard to the legislative controls, but also to best market practices and the safeguards employed by the concerned parties themselves. In particular the private equity firms have a clear vested interest of building up and maintaining investor confidence in the long term.

With regard to the often complex capital structures in private equity investment, the analysis recommended by the Technical Committee to the Joint Forum should in the first place be for information purposes. These structures are determined through market practices and in line with the principle of allocating tasks and capital in the most efficient macro-economic way. It would not be appropriate in our view to consider legislative interference with these structures. However, we would support a survey to consider how the transparency of these structures might be enhanced.

Yours faithfully,

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- European Association of Public Banks and Funding Agencies AISBL -

20 February 2008

EAPB comments on the IOSCO Technical Committee

Consultation Report on Private Equity

The European Association of Public Banks (EAPB) represents the interests of 28 public banks, funding agencies and associations of public banks throughout Europe, which together represent some 100 public financial institutions. The latter have a combined balance sheet total of about EUR 3,500 billion and represent about 190,000 employees, i.e. covering a European market share of approximately 15%.

We thank IOSCO for the possibility to comment on its consultation report on private equity.

As you are aware and as mentioned in the consultation report, private equity and hedge funds are increasingly important market players within the global capital markets. In general, we consider this as a positive development as market liquidity is increased. Furthermore, also market inefficiencies are eliminated to a certain degree. At the same time investors are offered more possibilities to diversify their portfolios.

The current paper rightly only focuses on private equity, encompassing the activities of venture capital and private equity businesses including leveraged buyout transactions. In the current public discussion, however, private equity and hedge funds are very often mixed up. We would therefore like to underline that private equity funds have to be clearly distinguished from hedge funds as they follow completely different investment strategies and operate differently on the capital markets. Any potential future regulatory projects should take these differences into account.

In the past, many questions regarding private equity funds have already been tackled by IOSCO and other organisations. As the IOSCO technical committee points out in Table 2, relevant IOSCO principles exist in particular with respect to conflicts of interest and transparency. Therefore, we feel that – if at all – issues such as leveraged buyout and specific conflicts of interest arising in the private equity business could be an issue in IOSCO's review of the private equity sector.

However, as to IOSCO's considerations of potential further work we would like to make the following important remarks:

Apart from global measures regarding private equity, extensive regulation also exists at European level. The IOSCO technical committee itself lists a couple of EU Directives in the column "work in other regulatory organisations" in Table 2 of its paper. Private equity firms have to comply, in particular, with the Transparency Directive, the Prospectus Directive, the Takeover Directive and the

Market Abuse Directive. It is therefore essential, when considering possible regulatory action, to take account of the fact that the **European market is already heavily regulated** and that **any further regulation runs the risk of destroying the positive effects of private equity**, especially in the field of venture capital.

Any regulatory measures should therefore be avoided. If at all necessary, any regulative projects should be undertaken by means of self-regulation.

Please do not hesitate to contact us if you have any questions. We would be happy to contribute to any further work of ISOCO in the future.

Kind regards,

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20th February 2008

COMMENTS ON THE IOSCO TECHNICAL COMMITTEE CONSULTATION REPORT ON PRIVATE EQUITY

Thank you for the opportunity to respond to the IOSCO Technical Committee's Consultation Report on Private Equity. Overall, I fully support the Committee's findings and the key issues that it has chosen to pursue in future work. At the same time, I would like to add the following three points as potential further issues for the Committee's consideration.

Transparency

I agree that in view of the relatively low level of direct retail investment in the private equity sector there is insufficient need for imposing public disclosure requirements on either private equity firms or their portfolio companies with respect to historical or current performance. The main argument in favour of market-wide transparency requirements for private equity firms is that they will enhance investors' capacity to assess the relative merits of investing in different firms' buyout funds. This is an especially important consideration given the typical size and illiquidity of a limited partner's investment in this regard.

It should be acknowledged, however, that a significant proportion of potential future investors in private equity at any one time will be large institutional investors, many of whom will already be 'repeat players' in the sector. Moreover, in respect of those retail investors who purchase direct or indirect exposure to buyout funds through floated vehicles or private equity investment trusts, it is unclear to what extent a higher degree of mandated performance-transparency by private equity firms would actually satisfy a definite informational need.

The main attraction of private equity as an investment choice is its capacity to promise 'super-normal' returns relative to most other asset classes including publicly listed corporate equity. Among the major factors driving private equity's competitive advantage in this regard is the considerably lower regulatory-bureaucratic burden faced by private equity portfolio companies relative to their listed counterparts, notably the absence of any ongoing requirement to disclose information 'to the market' over and above the basic legal transparency obligations applicable to all registered companies. The lower degree of mandated public disclosure enables:

(i) significant savings in legal compliance costs and other administrative expenses;

(ii) a more intimate exchange of proprietary information between portfolio company managers and private equity partners (including in some cases the direct appointment of general partner representatives on portfolio company boards); and

(iii) lower managerial time commitments in respect of investor relations and regulatory compliance matters, and hence a sharpened focus on strategic innovation and medium-term shareholder value creation.

In this light, the danger of imposing obligations on private equity firms to disclose 'to the market' is that many of the key distinguishing features of private equity as a corporate governance model will be diminished. This may in turn have a negative impact on future levels of return to limited partners, thus ultimately reducing the attractiveness of private equity as an alternative investment choice for those retail investors with a relatively high appetite for risk. Any resultant benefit for retail investors in the form of increased public accountability of private equity would therefore be outweighed by the cost of reduced choice in respect of potential risk/return distributions on corporate equity in general.

Leverage

While I support the Report's emphasis on the task of identifying the dangers associated with complex LBO capital structures and 'risk-spreading' techniques, I wish to highlight one further issue that I believe should be covered in any study of this nature. In recent years, one of the most notable trends in the global private equity sector is the increasing popularity of large-scale utilities and infrastructure businesses as potential LBO targets. Recent examples of large-scale infrastructure LBOs include the US$ 45 bn buyout of the Texan power generator TXU by KKR and Texas Pacific Group in 2007, the Australian airline Qantas' US$ 8.7 bn takeover by a consortium led by Macquarie Bank in 2006, and the Spanish construction group Ferrovial's US$ 20.4 bn leveraged acquisition of the UK airports operator BAA in 2006.

One of the main factors behind this trend is the propensity of major infrastructure businesses to exhibit stable demand profiles. This in turn enables these companies to generate relatively high and stable cash flows, which can be exploited as security in respect of buyout debts. The danger with these transactions is that, insofar as they entail the extensive use of leverage in enterprises that are national utilities or otherwise providers of a 'core' service of public interest, they correspondingly trigger the possibility of governmental intervention in the event of a major credit event. In respect of such transactions, therefore, the relevant national government effectively acts as the ultimate bearer of economic risk.

Although not related in any way to private equity activity, the events surrounding the Northern Rock banking crisis in the UK highlight the potentially detrimental effect on investor confidence and market stability when the government is compelled to act as a guarantor of last resort in respect of 'high social impact' companies. On one view, a governmental 'bail out' can be beneficial for investor confidence by averting a potential default, such as where the relevant national or regional government agrees to guarantee the portfolio company's liabilities towards creditors. However, if a national government was to react to a major credit event involving an LBO portfolio company in a politically motivated or otherwise sporadic manner, the resultant unpredictability could trigger a negative 'knock on' effect on the general confidence and stability of public debt and equity markets.

I would therefore submit that any future IOSCO study into the systemic risk implications of complex LBO capital structures considers not only the potential consequences for financial markets of the default of a major LBO portfolio company, but also the likely impact on market confidence and stability of ad hoc governmental intervention in the affairs of ‘high social impact’ companies following a major credit event.

Overall market efficiency

I appreciate the Committee’s concern about the danger of public investors losing access to firms during high-growth periods of their development, and the consequent negative impact on the efficiency of public equity markets. It is my respectful view, however, that the solution to this problem lies in reforming the practices of *public* rather than private equity investors. If private equity investors are able to reap large capital gains through exploitation of portfolio companies’ growth potential, then this is primarily indicative of the failure of share prices to reflect fully the long-term implications of public companies’ strategic investment projects.

There is the possibility, however, that market competition between public and private investors may itself mitigate the perceived informational deficit encountered by public equity investors relative to their private equity counterparts, by creating incentives for institutional investors (e.g. investment fund managers and pension funds) to invest greater resources in researching and analysing the long-term growth potential of current or potential portfolio companies. This will in turn mitigate potential levels of control premia payable to shareholders on a private equity takeover by bringing the market price of a target company’s shares closer into line with the acquisition price of its shares as determined on the basis of proprietary information gleaned from pre-bid due diligence.

I hope that my comments are useful. Please do not hesitate to contact me if you wish to discuss any of the above matters in greater detail.

Yours sincerely,

Dr Marc T. Moore

City Solicitors’ Educational Trust Lecturer
School of Law, University of Bristol, UK

European Private Equity and Venture Capital Association

POSITION PAPER

20 February 2008

EVCA's Response to the IOSCO Technical Committee Consultation Report on Private Equity

20 February 2008

Introduction

The European private equity and venture capital association, EVCA (www.evca.com), welcomes the opportunity to respond to the IOSCO Technical Committee consultation report on private equity (November 2007)[15].

EVCA was established in 1983 and is based in Brussels. It represents the European private equity and venture capital industry (PE/VC) and promotes the asset class within Europe and throughout the world. Its 1,225 members in 53 countries represent over 80% of PE/VC under management in Europe[16].

In recent times the private equity industry has received much attention, and EVCA welcomes the IOSCO consultation report as a well-balanced and helpful addition to the surrounding discussions. Indeed, since the IOCSO work was launched, a number of other

[15] See: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD254.pdf

[16] EVCA's members represent all main industry stakeholders, from PE/VC management companies to institutional investors (banks, pension funds, insurance companies…) to professional advisors (lawyers, placement agents, investment bankers…) and national (European) trade associations. EVCA's role includes representing the interests of the industry to regulators and standards setters; developing professional standards; providing industry research, professional development and forums, and facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics.

important reports concerning private equity have been completed by among others, the European Central Bank[17], the OECD,[18] the World Economic Forum[19] and the European Parliament, which commissioned its own detailed report into the large buyout segment of the Industry[20].

Given these reports and recent developments in the global financial markets, EVCA would like to respond to the issues contained within the IOSCO report, as well as make reference to its own long-standing efforts to establish self-regulatory professional standards for the industry[21].

As stated in the IOSCO report (page 6), from the outset it should be noted that when assessing or analysing private equity as an industry, private equity itself consists of many segments, and its activities can be characterised in terms of not only large leveraged buyout activity, but also expansion, growth capital and venture capital, which itself includes seed and start up financing. EVCA would suggest that the final document further highlight that the report and its conclusions lean more towards the large buyout segment, given recent focus and attention on this part of the private equity industry.

As the IOSCO paper is structured in 3 sections, firstly identifying issues which private equity may pose to capital markets, secondly analysing which of these issues may be pertinent to IOSCO's stated objectives and principles, and thirdly forming recommendations for the Technical Committee as to what further work might be considered within the IOSCO and international regulatory frameworks, EVCA will respond to each of these sections accordingly.

Section One- Overview of issues posed by private equity to capital markets

Overview

Private equity has grown from a niche industry to an accepted actor within the financial system. Its recent strong development has been facilitated by benign economic conditions, increasing the funds available, with more institutional, sophisticated professional investors attracted by the industry's long-term investment profile and the strong returns made by private equity funds and their managers. The recent financial crisis has had an impact on the investment activity of the private equity industry but its long term growth perspective remains robust.

EVCA notes that the IOSCO report analyses and raises a number of issues that have been subject to discussion in recent months. In this respect, it is worth however recalling that as a global industry, in relative terms, private equity still represents only a small part of the financial services market. By way of illustrative example, in 2006, buyout investments represented less than 1.5% of GDP (including leverage)[22]. The majority of

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[17] European Central Bank- Large banks and private equity-sponsored leveraged buyouts in the EU, April 2007: http://www.ecb.int/pub/pdf/other/largebanksandprivateequity200704en.pdf

[18] OECD- The role of private pools of capital in corporate governance, May 2007: http://www.oecd.org/dataoecd/47/27/38672168.pdf

[19] "The Global Economic Impact of Private Equity", World Economic Forum, January 2008: http://www.weforum.org/en/media/Latest%20Press%20Releases/PrivateEquity_PressRelease

[20] European Parliament - Study on Private Equity and Leverage Buyouts November 2007: http://www.peracs.de/report/doc.pdf

[21] EVCA Professional Standards: http://www.evca.com/html/PE_industry/IS.asp

[22] Source: Based on EVCA/Thomson Financial/PriceWaterhouseCoopers

those selling companies to private equity funds are families, private individuals and local parent companies: secondary sales from one buyout fund to another fund represent 11% of all transactions[23].

Furthermore, the risks covered by this section of the IOSCO paper are in fact common to any economic entity. Although private equity does indeed have an increasing role in the economy, it is not the driver of the current financial market turmoil – rather a market participant, which manages third party money in the vast majority of cases for institutional, sophisticated or professional investors. Furthermore, neither has private ownership of companies been the driver for current market turmoil, and attempts to create different categories of treatment for private ownership could in fact exacerbate the current, uncertain market conditions still further.

Increasing Leverage

It should be recalled that leverage levels depend on general economic perspectives and defaults occur not only in the private equity sphere. This is a regular fact of life among companies, be they private or listed, as all companies use both debt and equity.

Investors can be exposed to private equity assets either as Limited Partners in private equity funds or as holders of leveraged loans. Despite being a relatively small asset class, the due diligence undertaken in both cases is usually very thorough and covers the strategy of fund's managers and the ability of the underlying company to service its debt:

- European investors with exposure to private equity funds have less than 7% of their total assets invested in such funds[24]. The historical annual return of buyout funds is 14.4%, with the median return 7.4%[25];

- Banks with exposure to leverage buyout loans have less than 1% of their total assets invested in these instruments[26]. Unsold leverage buyout loans in the secondary market as of February 2008 have experienced a decrease in their fair value but are not defaulting loans per se.

Furthermore, it should also be noted that leverage at the level of the private equity fund or at fund of funds level is very rare: indeed regulation in several jurisdictions and contractual agreements between Limited Partners (LPs) and General Partners (GPs) in private equity funds either prevent this from occurring or authorise it only at very low levels.

Recent market developments also confirm that although in the recent past leverage levels in terms of EBIT multiples have peaked, they are no longer rising rapidly, and the market is in fact self-correcting. This can be also seen through the rise of and then removal of 'covenant light' loans, working on the basis of, and then responding, to market forces. Putting the covenant clauses into any regulatory field would be similar to a price control mechanisms. Indeed, the risk associated with these different models should be regarded as under the responsibility of the lenders, accepting or not the

[23] Source : CMBOR – Data 2000-2006 – various editions of the report on the European buyout market

[24] Source: 2005-2006 Russell Survey o Alternative Investing

[25] Source: EVCA/Thomson Financial – expressed returns are net IRRs since inception at 31.12.2006

[26] Source: European Central Bank, Monthly Bulletin, August 2007, p.93

requirements of the borrowers and the economic and financial analysis of the subsequent buyout deal.

Financial Stability

In respect of the related issue of financial stability, the real questions to be asked and answered lie in the field of the ultimate (debt) holders, not only in terms of regulatory aspects but also on their ability to price risks they are able/willing to take. It is clear that the securitization has a positive aspect of diversifying risk, however, for some specific financial products it seems that a moral hazard has emerged. It should be understood that the impact of the level of debt taken on board by private equity fund managers is properly assessed by them as they can lose a significant share of the funds they managed and also their own personal money. However, all expectations are not self-fulfilling and an adverse economic environment for example can stress the cash position of companies. In this respect, EVCA is also undertaking work into analysing the impact of tax deductibility of interest expenses on the underlying portfolio company. Historically, mortality rates of leveraged buyout transactions is around 6%, which slightly less than the average default rates among US corporate bond issuers[27].
The impact of complex capital structures remains to be further investigated and notably in relation to both the INSOL guidelines, as well as from a European Union Perspective, European Insolvency Regulation 1346/2000 could indeed be helpful.

It seems to EVCA that the difficulties mentioned above relate to any kind of companies with complex structures and not solely to private equity backed companies. However, EVCA would welcome further collaboration with IOSCO regarding the impact of INSOL Guidelines and the European Insolvency Regulation.

Market Abuse

EVCA fully supports the need for fair trading, be it within public or private environments. Indeed, the potential for market abuse exists in both public and private transactions, for example at level of lending banks, external advisors, auctioneers, company management or other relevant entity. Furthermore, such a potential environment exists within any trade sale or takeover bid.

To address these issues from a private equity perspective, over many decades EVCA has developed Guidelines[28], which cover code of conduct, governing principles and sound practices for the management of private equity and venture capital operations. In each case, high levels of integrity by private equity practitioners are stressed, and private equity management companies frequently have stringent in-house rules preventing personal dealings and sanction any breach of confidentiality.

Conflicts of interest

From a Private Equity perspective, in conducting their due diligence process before signing an agreement and funding the fund, private equity investors should undertake extensive discussions with the fund managers to fully assess the governing rules, including the time devoted to monitoring portfolio companies and the allocation of responsibilities between the different managers.

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[27] Source : Per Strömberg (2008), 'The new demography of private equity' in 'The Global Economic Impact of Private Equity Report 2008', World Economic Forum, January 2008.

[28] EVCA Professional Standards: http://www.evca.com/html/PE_industry/IS.asp

According to commercial law, all board members shall act in the interest of the company. However, Private Equity funds are active shareholders driving value creation in the underlying companies and it may be in the best interest of the latter that the fund manager takes a portfolio approach when proposing strategic alliances between underlying companies. The private equity industry usually deals with this aspect by implementing specific mechanisms that avoid individuals to be conflicted.

Regarding leverage finance providers, the management of conflicts of interest falls under their own responsibility. It is also true for financial analysts in lending banks who may have to assess competing positions from the buyer or the seller, who may happen to be, both, clients of the bank. Banks have to ensure their internal procedures are clear and fair and do not impair the private equity fund's position. Lastly, IPO mandates to banks are almost always competitive, whether launched by a private equity house or any other company. Listing and conduct of business rules in the context of competitive IPOs are well known to market participants and strictly scrutinized by regulators.

Transparency

Whilst welcoming the fact that IOSCO noted that existing private equity industry transparency to its investors is already very extensive, EVCA would also like to highlight that it has provided its members with comprehensive guidelines in order to improve the relevance and the consistency of reporting to investors. These reporting guidelines[29] cover the annual meeting, the timing of the reporting process, the fund performance, the portfolio reporting, the stock distribution and the capital account. The most sensitive part of the reporting process is the valuation of the portfolio companies. This has now been harmonised through the International Valuation Guidelines prepared by AFIC, BVCA and EVCA, and endorsed by over 35 national associations worldwide and other stakeholders, including the ILPA[30]. This is a clear recognition of the rigor of these standards - which are IFRS compatible - as the industry's "clients", namely institutional investors, have endorsed these guidelines and pushed for such harmonisation,

Whereas IOSCO suggests that currently these standards have not been adopted consistently across the industry, such standards should also allowed sufficient time to not only develop and spread, but also for their effects to be analysed.

For its part, EVCA would argue that given the average ten-year negotiated contractual relationships that underpin investments into private equity funds and the related legal recourse open to such parties when investing, such standards have over time proven themselves to be adequate. Moreover, in the small number of situations where private equity funds are quoted on public markets, they are then subject to public market regulation and oversight, including in respect of information and reporting requirements.

EVCA would also note that it is important to note the ongoing evolution of this work as part of EVCA's approach to professional standards as a whole, and is open to further exploring with IOSCO as to how these standards could be further used as a global model for the private equity industry.[31]

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[29] http://www.evca.com/pdf/evca_reporting_guidelines_2006.pdf

[30] http://www.privateequityvaluation.com/

[31] http://www.evca.com/html/PE_industry/IS.asp

Market access

The private equity industry has always made clear that its specific business model and the long-term commitment (added to low liquidity) should only be available to investors with a sufficient degree of knowledge, expertise, sophistication and the ability to factor the risk profile of their investments. Retail investors per se may not be aware enough to make their own investment timeframe compatible with private equity.

As noted by the IOSCO report, some listed private equity funds are on the market and enable retail investors interested in private equity to build an efficient portfolio. Such listed funds have to comply with strict rules concerning information and investment protection, which are not compatible with the current management of mainstream private equity funds, which are mainly funded by institutional and professional investors. From a European Union perspective, EVCA believes that the clear difference between classes of investors and thus the products and investment opportunities open to them will remain, notably given work on the UCITS, MiFID and Prospectus Directives.

Section Two – Specific relevance of issues to IOSCO's objectives and principles

EVCA welcomes the fact that IOSCO (page 11) recognises the role that both regulatory and self-regulatory organisations can play in addressing principle-based objectives that support and facilitate confidence within the market and among financial services participants.

From the self-regulatory perspective, EVCA has long believed that the highest professional standards are crucial to a stable, long term relationship with institutional investors and regulators. They are also vital to increasing overall transparency and trust in the asset class. As a result, for nearly three decades, EVCA has worked with the industry to create the most advanced professional standards of any alternative asset class anywhere in the world, which are compulsory for full EVCA members, who represent over 80% of the capital under management in Europe.

In addition to the IFRS and US GAAP compatible valuation guidelines[32] and reporting guidelines, management principles for private equity houses[33] as mentioned above, the European private equity industry under the auspices of EVCA has already enacted OECD-inspired guidelines for the corporate governance of portfolio companies[34].

EVCA would warmly welcome exploring with IOSCO ways in which this ongoing work, which is supported by a range of private equity industry stakeholders, could be further enhanced and extended as an international model for the private equity industry.

Section 3 - Consideration of potential further work with the IOSCO framework

EVCA firstly welcomes IOSCO's acknowledgement that most of the issues outlined are not exclusive to private equity, and where work is undertaken, the activities of other key organisations into private equity should be taken into account, so as to avoid regulatory

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[32] http://www.evca.com/pdf/international_valuation_guidelines.pdf

[33] http://www.evca.com/pdf/evca_governing_principles.pdf

[34] http://www.evca.com/pdf/evca_corporate_governance_guidelines.pdf

or supervisory overlap. In this respect and way of examples, further to the extensive and very recent work of the European Central Bank[35], EVCA also notes the recent work of the OECD in analysing and addressing the role of private pools of capital in corporate governance[36].

Where IOSCO does consider further work necessary, EVCA welcomes IOSCO's underlying approach of working to better understand and determine the issues around private equity. EVCA stands ready to continue to its dialogue with IOSCO and to provide further information and additional data as helpful.

As noted above, EVCA also intends to continue its own work in the use of self-regulatory voluntary professional standards for the private equity industry and is open to further explore with IOSCO as to how these standards could be further used as a global model for the private equity industry.

EVCA therefore concurs with IOSCO's assessment of future actions as per the list of issues as presented and discussed in section 3, namely that work needs proportionate, measured and focused only on specific issues and in specific circumstances. Such an approach will help to avoid unintended consequences of excessive or inappropriate

Concluding Remarks

EVCA would welcome any comments on its response to the consultation.

EVCA looks forward to continuing its dialogue with IOSCO, notably in respect of its professional standards as noted above and can be contacted via the address below:

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Bastion Tower
Place du Champ de Mars 5
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Tel: + 32 2 715 00 20
Fax: + 32 2 725 07 04
Email: public.affairs@evca.com

[35] European Central Bank- Large banks and private equity-sponsored leveraged buyouts in the EU, April 2007: http://www.ecb.int/pub/pdf/other/largebanksandprivateequity200704en.pdf

[36] May 2007: http://www.oecd.org/dataoecd/47/27/38672168.pdf

Association Française de la Gestion financière

SJ – n° Div.2347/Div.

February 12, 2008

Re: ASSOCIATION FRANCAISE DE LA GESTION (AFG)'s comments on the IOSCO Technical Committee Consultation Report on Private Equity

The ASSOCIATION FRANCAISE DE LA GESTION FINANCIÈRE (AFG)[37] would like to thank IOSCO and the members of its Technical Committee ("TC") for the work that they have carried out in producing the Consultation Report on Private Equity and welcomes the opportunity to comment on this Report.

AFG wishes to express its support to the current IOSCO's initiative, which consists of identifying any suitable issues which could be addressed through future IOSCO work. In particular, we support the intent by IOSCO to pursue the two pieces of work mentioned in the Report in future work programmes, namely on the one hand a survey of the complexity and leverage of capital structures employed in leveraged buyout transactions across relevant IOSCO jurisdictions, and on the other hand an analysis of conflicts of interest which arise

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[37] The Association Française de la Gestion financière (AFG) represents the France-based investment management industry, both for collective and discretionary individual portfolio managements. Our members include 405 management companies and 673 investment companies. They are entrepreneurial or belong to French or foreign banking or insurance groups.

AFG members are managing more than 2500 billion euros in the field of investment management. In terms of financial management location, it makes the French industry the leader in Europe for collective investments (with more than 1500 billion euros managed by French companies, i.e. 22% of all EU investment funds assets under management, wherever the funds are domiciled in the EU) and the second at worldwide level. In terms of fund domiciliation, French funds are second in Europe and third at worldwide level. Regarding product interests, our association represents – besides UCITS – the employee saving scheme funds, hedge funds/funds of hedge funds as well as a significant part of private equity funds and real estate funds. AFG is of course an active member of the European Fund and Asset Management Association (EFAMA) and of the European Federation for Retirement Provision (EFRP). AFG is also an active member of the International Investment Funds Association (IIFA).

during the course of private equity business and the controls used across relevant IOSCO jurisdictions which aim at providing appropriate levels of investor protection.

On this basis, we want to express two general remarks at this stage.

First, when IOSCO develops its assessments in the two directions mentioned above, it will have to take note of the very wide variety of private equity funds involved. Even though we admit that it might complicate the work of IOSCO at worldwide level, due consideration must be given to the local specificities of private equity funds at each national level. Both product designs and degrees of regulation vary greatly from one country to another one, and therefore IOSCO should be very careful before drawing any general conclusions on private equity funds.

For instance, French Private Equity funds have reached today an excellent mix between product innovation on the one hand and savers' protection on the other hand – perfectly illustrated by the current ranking of the French private equity fund industry, which for instance ranks number two at European level. Various degrees of flexibility are offered to investors among a wide range of types of French private equity funds (including for instance the so-called FCPR), correlated to several degrees of protection. Moreover, the French general regulatory framework requires that funds are run by management companies subject to specific authorisation and supervision by the regulator (i.e. a private equity fund "activity programme" is necessary in addition to getting the approval by the regulator on the regular asset management authorisation). Furthermore, the French regulatory framework ensures that in any case market integrity is not harmed by the French Private Equity funds acting on financial markets – e.g. regarding market abuse. Therefore, we think that the French pattern could be scrutinised by IOSCO as an interesting one, having been able both to develop up-to-date innovation and to keep a high level of safety for investors.

Second, we welcome the fact that the Technical Committee expressly mandated that consideration must be given to participation by industry throughout its working process. Considering the various national experiences of our members in the field of private equity funds, we would be very happy to develop further contacts with IOSCO Task Force of Private Equity.

We thank you in advance for your attention to the views expressed above.

If you wish to discuss the contents of this letter with us, please contact myself
Pierre Bollon, at +33 1 44 94 94 14 (e-mail: p.bollon@afg.asso.fr),
Stéphane Janin, Head of International Affairs Division at:
+33 1 44 94 94 04 (e-mail: s.janin@afg.asso.fr) or his deputy:
Catherine Jasserand at +33 1 44 94 96 58 (e-mail: c.jasserand@afg.asso.fr).

Sincerely,

Pierre BOLLON

AFG (Association Française de la Gestion financière)
31 rue de Miromesnil •75008 Paris • France

The British Private Equity and Venture Capital Association

February 2008

IOSCO TECHNICAL COMMITTEE CONSULTATION REPORT ON PRIVATE EQUITY

This response is made by the Regulatory Committee of the British Private Equity and Venture Capital Association. The BVCA represents the overwhelming majority of UK-based private equity and venture capital firms. The UK private equity and venture capital industry is by far the largest in Europe and second only in size in the world to that of the United States.

The BVCA's experience

We welcome IOSCO's consultation report and the work of the Task Force on private equity. The issues identified in the report have recently been the subject of debate at a domestic level in the UK and Europe. The BVCA has been working closely with the European Commission, the UK Parliament Treasury Select Committee, the UK Treasury and Financial Services Authority (the **"FSA"**) on these issues and other topics of public concern of less relevance to IOSCO's objectives.

The UK private equity and venture capital industry is fully regulated. The vast majority of BVCA member firms are authorised and regulated by the FSA The BVCA Regulatory Committee works closely with the FSA in connection with the design and implementation of new rules and the supervision of the private equity market.

The BVCA has also been pursuing its own initiatives in response to political, public and press interest in the industry. The BVCA recently invited Sir David Walker to conduct a review into transparency and disclosure in the private equity industry. Following consultation, Sir David published a set of guidelines for the larger firms operating in the UK, which is now being implemented by all affected firms. The Technical Committee has concluded that the issue of transparency does not merit further work at this stage, we nevertheless invite IOSCO to consider Sir David's review and recommendations, details of which are available at www.walkerworkinggroup.com .

We have not commented on every issue identified in IOSCO's report, particularly where the Technical Committee has concluded that further work is unnecessary in a particular area.

General observations

Breadth of the private equity and venture capital market

We welcome the Technical Committee's recognition (in paragraph 7 of the report) that the issues identified are relevant principally to the bigger firms and transactions. It is proportionate and appropriate to consider each issue in this light. The vast majority of BVCA member firms have no involvement in leveraged buyout activity.

Relevant to other market participants

The BVCA represents the interests of private equity firms (as defined in paragraph 6 of the report). We welcome Technical Committee's recognition that many of the issues identified in the report are of considerable relevance to market intermediaries as well as to firms.

Key issues

Increasing leverage

We welcome the proposed IOSCO-Joint Forum survey about the complexity and leverage of capital structures employed in leveraged buyout transactions in IOSCO jurisdictions. We also welcome the Technical Committee's balanced overview of the issue, which recognises that increasing leverage is a function of the relative costs of debt versus equity finance. We note that, most recently, leveraged finance activity appears to have fallen back globally, apparently as a result of the credit crunch.

We would be delighted to meet with IOSCO to discuss how the BVCA can help with the UK element of IOSCO's survey, whilst recognising that the principal focus in this area is likely to be on the prudential regulation of banks.

Our initial reactions to the Technical Committee's overview and summary in the report are as follows.

The consultation report drew attention to the possibility of default and failure by a private equity backed company. There has been considerable press comment on this, particularly in the UK. It is important to note that corporate failure is ultimately a consequence of market forces: when a business fails it is likely to be because the market for the products and services of that company has declined or because management at the business have not been able to grow the business. This is not a particular or unique feature of businesses backed by private equity. A decline in a market would have occurred anyway and a company failing because of a weak management team is arguably in a better position to recover if it has professional and experienced investors backing it, as is the case where private equity is involved. There is no evidence that private equity backed businesses are statistically more vulnerable. Indeed, the recently released report from the World Economic Forum on the Global Economic Impact of Private Equity, found that private equity-backed companies have a default rate of 1.2% per year, compared to an average default rate of 1.6% for US corporate bond issuers.

In the worst case of failure by a large and highly leveraged private equity backed company, returns to investors would be likely to be impaired (notwithstanding the diversification which is typical of a private equity fund). As a consequence, one or more private equity firms may be forced to exit the market (being unable to raise new funds through poor performance). There may also be temporary turbulence in debt markets. However, we consider a more systemic failure or long term impairment in the private equity market to be very unlikely.

Conflicts of interest

We welcome the proposed IOSCO analysis of the conflicts of interest which arise in private equity business and the controls used in IOSCO member states to provide appropriate investor protection.

We are keen to participate in the process in accordance with the Technical Committee's mandate and would welcome an initial meeting to discuss the issues.

Our initial reactions to the proposed focus of the IOSCO analysis are as follows.

Conflicts of interest are not unique to private equity structures. For example, conflicts of interest which arise where an executive of a private equity firm is appointed to the board of an investee company are no different to the personal conflicts which arise for any representative-director in a standard corporate structure. IOSCO's existing work on corporate governance and conflicts of interest is therefore relevant.

Conflicts of interest which do arise can readily be addressed because of the nature of the investor-base: typically financial institutions, pension funds, foundations and endowments, funds of funds or very high net worth individuals. Investors generally have substantial in-house expertise and/or are well advised. Investors and fund managers generally negotiate the terms of investment at arms' length with the negotiating position often balanced in favour of the investor.

The result is often a very detailed and comprehensive agreement that provides detailed mechanisms for fully disclosing and resolving conflicts. In these circumstances, the starting point should be to leave conflicts management to contractual agreement, with limited regulatory intervention. Appropriate regulatory intervention should be principles-based, imposing senior management responsibility for the assessment, articulation and management of conflicts including, in many cases, through appropriate disclosure and consent.

Market access

The Technical Committee is correct to conclude that retail investment activity in private equity funds is limited. The BVCA has been engaging with the FSA and others about facilitating retail access through appropriate vehicles. Our focus at present is on encouraging the wider spread of private equity investment by UK and European pension funds, which presently lags behind the commitments of US pension funds. This provides indirect retail access in a manner consistent with the long term and illiquid nature of private equity investment. We agree that further IOSCO work in this area is inappropriate at the moment.

Market abuse

There is no difficulty in applying market abuse laws to private equity business connected with public markets. We agree that further work by IOSCO at this stage is not warranted.

Please contact us to discuss these issues, in particular the proposed IOSCO survey of leverage and analysis of conflicts of interest. In the first instance, please contact Margaret Chamberlain, chairman of the Regulatory Committee, on +44 (0)20 7925 3000 or margaret.chamberlain@traverssmith.com .

Yours faithfully

SIMON WALKER

CHIEF EXECUTIVE