NVP

Nederlandse Vereniging
van Participatiemaatschappijen

NVP-GEDRAGSCODE EN -LIDMAATSCHAPSCODE 2016

& INVEST EUROPE HANDBOOK OF PROFESSIONAL STANDARDS 2018

WAT IS HET DOEL?

De leden van de Nederlandse Vereniging van Participatiemaatschappijen (NVP) hechten aan een goed functionerende participatiemarkt in Nederland en verschaffen duidelijkheid over hun drijfveren en handelen. In deze geactualiseerde gedragscode is vastgelegd vanuit welke principes de leden van de NVP werken en waar zij voor staan.

Participatiemaatschappijen zijn belangrijke investeerders in het bedrijfsleven en leveren op die manier een bijdrage aan de Nederlandse economie en werkgelegenheid. Zij zijn betrokken aandeelhouders in niet-beursgenoteerde ondernemingen en investeren voor de lange termijn. Op die manier creëren zij waarde voor bedrijven, hun beleggers en de samenleving als geheel.

Sinds 1986 heeft de NVP een gedragscode en sinds 2007 een lidmaatschapscode. De steeds verder professionaliserende en groeiende participatiesector had behoefte aan zelfregulering. In de codes zijn duidelijke afspraken gemaakt over hoe er door leden van de NVP wordt gehandeld. De NVP heeft het initiatief genomen om beide codes aan te passen zodat zij actueel blijven.

De essentie van participeren

Waardecreatie voor beleggers en de samenleving

Participatiemaatschappijen verschaffen risicodragend kapitaal aan niet-beursgenoteerde bedrijven. Bij volwassen bedrijven heet dit private equity, bij jonge en startende bedrijven venture capital. Participatiemaatschappijen werven dit kapitaal bij beleggers zoals pensioenfondsen, verzekeraars en family offices.

Participatiemaatschappijen investeren bij de start van bedrijven, om bestaande bedrijven te laten groeien, wanneer bedrijfsonderdelen verzelfstandigd worden en bij bedrijfsopvolging. Zij leveren naast kapitaal ook kennis, ervaring en een netwerk. Na doorgaans vier tot zeven jaar wordt het bedrijf verkocht aan een andere financiële investeerder (participatiemaatschappij, informal investor of family office), een ander bedrijf of naar de beurs gebracht. De bedoeling is dat bij verkoop het bedrijf een beter toekomstperspectief heeft dan op het investeringsmoment. Het behaalde financiële rendement gaat met name naar de beleggers in het participatiefonds, waaronder pensioenfondsen.

DE OPZET
VAN DE GEDRAGSCODE

De gedragscode is gebaseerd op vijf algemene principes die door de leden van de NVP onderschreven worden en leidend zijn in het dagelijks handelen:

1 Een participatiemaatschappij handelt maatschappelijk bewust

2 Een participatiemaatschappij heeft een lange investeringshorizon

3 Een participatiemaatschappij communiceert open

4 Een participatiemaatschappij respecteert vertrouwelijkheid

5 Een participatiemaatschappij houdt zich aan de regels

De vijf principes, o.a. ontleend aan de 'Code of Conduct' van Invest Europe[1], worden hierna toegelicht. Voor de toepassing ervan in de praktijk maken leden gebruik van de best practices van het *'Invest Europe Handbook of Professional Standards'*. Deze zijn bij dit document gevoegd. Deze best practices zijn op veel situaties en bijbehorende stakeholders[2] van toepassing: start- en groeikapitaal, buyout- en buyin-transacties, nationaal en internationaal, institutionele of andere beleggers. Leden kunnen van de best practices afwijken als zij voor hun specifieke situatie een andere manier hebben om zich aan de vijf principes te houden.

1 Invest Europe is de Europese zusterorganisatie van de NVP.

2 Wanneer in deze gedragscode gesproken wordt over stakeholders wordt gedoeld op een ruime groep betrokkenen bij de vennootschap. Stakeholders betreffen zowel de belanghebbenden binnen de vennootschap (werknemers, managers, aandeelhouders) als die daarbuiten (klanten, kredietverschaffers, medeaandeelhouders en overheid en maatschappij, toeleveranciers, etc.). Niet iedere situatie waarin de gedragscode van toepassing is, is voor iedere stakeholder relevant. Daarom wordt gesproken van 'relevante stakeholders'.

Waar gaan de best practices over?

De bijgevoegde best practices bezien op alle activiteiten van een participatiemaatschappij. Van het opzetten van een fonds, het fondsen werven bij beleggers, het investeren in een bedrijf, het beheren van een portefeuilleonderneming, tot het verkopen van een portefeuilleonderneming en het uitkeren van rendement aan beleggers. In het oog springende voorbeelden zijn:

- Wat en in welke vorm wordt er gerapporteerd aan beleggers?
- Wat zijn typische fondsvoorwaarden? Hoe worden de kosten van het opzetten van een fonds verdeeld?
- Hoe is een participatiemaatschappij intern optimaal georganiseerd zodat belangenconflicten geminimaliseerd worden?
- Hoe gaat een participatiemaatschappij om met portefeuilleondernemingen die beneden verwachting presteren?
- Hoe wordt een onafhankelijke raad van commissarissen voor een portefeuillebedrijf samengesteld?
- Wat zijn gebruikelijke regelingen bij verkoop van een portefeuilleonderneming?

DE PRINCIPES
UITGEWERKT

1 Een participatiemaatschappij handelt maatschappelijk bewust

Een participatiemaatschappij is zich bewust van haar maatschappelijke verantwoordelijkheid en de rol die haar portefeuilleondernemingen spelen in de samenleving. Participatiemaatschappijen zorgen ervoor dat zij op verantwoorde wijze zaken doen. Zij geven hieraan invulling door factoren als impact op milieu, gezondheid en veiligheid van werknemers en goed ondernemingsbestuur te laten meewegen bij de selectie en het beheer van portefeuillebedrijven (ook wel aangeduid als ESG: Environmental, Social & Governance). Door hun actieve betrokkenheid zijn participatiemaatschappijen bij uitstek geschikt om aan ESG aandacht te besteden en een positieve maatschappelijke bijdrage te leveren. Participatiemaatschappijen realiseren zich dat zij een belangrijke invloed hebben op de economie en maatschappij en houden daarom in de communicatie naar buiten toe daar actief rekening mee.

2 Een participatiemaatschappij heeft een lange investeringshorizon

Een participatiemaatschappij gaat een langdurige samenwerking aan met haar portefeuilleondernemingen. Dit leidt tot een langetermijnrelatie met de relevante stakeholders van die bedrijven. Met het management worden bij aanvang van de relatie duidelijke en gedragen doelen afgesproken. Het gemeenschappelijke doel is duurzame waardecreatie die zich vertaalt in een gezond bedrijf en rendement voor de beleggers in het participatiefonds. Ook de samenwerking met beleggers is langdurig van aard en gebaseerd op goede afspraken over transparantie en afstemming van belangen.

De essentie van participeren

Langdurige relaties

Het actieve en betrokken aandeelhouderschap van participatiemaatschappijen in portefeuillebedrijven

Participatiemaatschappijen investeren in bedrijven en maken samen met het management van de onderneming een plan om het bedrijf te verbeteren. Gemiddeld duurt hun betrokkenheid vijf jaar. Gedurende die periode zijn zij actieve aandeelhouders met invloed op strategische en financiële onderwerpen en over de benoeming van het bestuur van de onderneming. Daarnaast hebben zij vaak ook een vertegenwoordiging in de raad van commissarissen.

Het langetermijnpartnerschap tussen participatiemaatschappijen en beleggers

Het vermogen waarmee participatiemaatschappijen investeren wordt geworven bij beleggers zoals pensioenfondsen, verzekeraars en family offices, en samengebracht in een participatiefonds. De participatiefondsen hebben meestal een looptijd van 10 jaar of langer.

3 Een participatiemaatschappij communiceert open en transparant

Een succesvolle samenwerking kan alleen worden gerealiseerd wanneer de participatiemaatschappij open en duidelijk communiceert. Een participatiemaatschappij maakt voorafgaand aan de samenwerking haar bedoelingen tegenover de direct betrokken partijen duidelijk en zal, voor zover dat van haar verwacht mag worden, tijdig duidelijkheid verschaffen over eventuele veranderingen in haar plannen.

Participatiemaatschappijen moeten daarnaast procedures hebben voor het beheersen van belangenconflicten. Belangenconflicten moeten zorgvuldig worden geïdentificeerd en bekendgemaakt aan de relevante stakeholders. Met deze belangenconflicten gaan participatiemaatschappijen adequaat en zorgvuldig om.

4 Een participatiemaatschappij respecteert vertrouwelijkheid

Een participatiemaatschappij ontvangt in het kader van haar werkzaamheden veel informatie die concurrentiegevoelig kan zijn of vertrouwelijk is, zoals gegevens van beleggers en (potentiële) portefeuilleondernemingen. Zij gaat op vertrouwelijke wijze met deze informatie om. Alleen wanneer dat voor breed gedragen maatschappelijke verantwoording nodig is en de participatiemaatschappij uitdrukkelijk toestemming heeft gekregen, kan deze informatie met derden worden gedeeld.

5 Een participatiemaatschappij houdt zich aan de regels

Een participatiemaatschappij houdt zich aan wet- en regelgeving[3] en respecteert de rechten en bevoegdheden van de diverse organen van de portefeuilleonderneming. Dit zijn: de raad van commissarissen[4], de algemene vergadering van aandeelhouders, het management, en ook de ondernemingsraad van de portefeuilleonderneming. Dit geldt zowel naar het doel als de strekking van de wet. Een participatiemaatschappij bevordert dat haar portefeuillebedrijven op dezelfde manier omgaan met wet- en regelgeving. Regels en gebruiken in het zakelijk verkeer kunnen verschillen per land, sector en type transactie. Het is belangrijk dat participatiemaatschappijen weten welke verschillende regels en gebruiken van toepassing zijn in hun portefeuillebedrijven, situaties en sectoren. Zij moeten er rekening mee houden dat de redelijkheid en billijkheid van hun handelen veelal zal worden beoordeeld aan de hand van deze regels en gebruiken.

Dit langetermijnpartnerschap wordt gevormd na uitvoerige informatie-uitwisseling en na onderhandeling tussen de participatiemaatschappij en (potentiële) beleggers.

Tijdens de levensduur van een fonds zetten de participatiemaatschappij en de beleggers zich actief in om bij alle aspecten van de investering en het beheer van het fonds te voldoen aan hoge professionele standaarden. Beleggers vereisen van de participatiemaatschappij afstemming van de belangen van de participatiemaatschappij op die van de beleggers ('alignment of interests'), transparantie en verantwoording, onder andere door middel van rapportages.

3 In het bijzonder de sinds 2011 in werking zijnde 'Alternative Investment Fund Managers' (AIFM)-richtlijn die onder andere participatiemaatschappijen onder toezicht van de Autoriteit Financiële Markten (AFM) en De Nederlandsche Bank (DNB) stelt.

4 Indien van toepassing. Zie: 'Handboek voor de Participatiecommissaris' van de NVP voor een uitgebreide handreiking voor het invullen van de rol van participatiecommissaris.

WERKING EN HANDHAVING

NVP-GEDRAGSCODE

De NVP zorgt voor een brede bekendheid van haar gedragscode bij leden en andere relevante groepen. Daarom zal er tweejaarlijks een evaluatie naar de bekendheid, implementatie en naleving van de gedragscode plaatsvinden onder de leden van de NVP. Deze evaluatie zal worden uitgevoerd door een afvaardiging van NVP-leden en onafhankelijke partijen, ondersteund door het NVP-bureau. Deze onafhankelijke partijen kunnen bijvoorbeeld wetenschappers, corporate governance-specialisten en juristen zijn.

Een goede toetssteen voor de vraag of de principes van de gedragscode bij een bepaalde gebeurtenis zijn nageleefd is het oordeel dat de handelwijze van het NVP-lid strookt met de gewenste positie en transparantie van de participatiesector in de maatschappij en dat een NVP-lid het acceptabel zou vinden als andere partijen onder vergelijkbare omstandigheden op een vergelijkbare manier zouden handelen.

Belanghebbenden kunnen zich richten tot het bestuur van de NVP bij (een vermoeden van) niet-naleving van de NVP-gedragscode door een NVP-lid. Als het bestuur vaststelt dat er sprake is van niet-naleving dan kan zij besluiten tot een interventie of in ernstige gevallen overgaan tot schorsing of royement van het desbetreffende lid. Het bestuur van de NVP bepaalt wie belanghebbende is bij naleving van de NVP-gedragscode.

Indien het bestuur om haar moverende redenen niet kan of wenst te oordelen over de beweerdelijke niet-naleving van de NVP-gedragscode, bestaat voor het bestuur de mogelijkheid een onafhankelijke commissie, samengesteld uit deskundigen van binnen en buiten de participatiesector, te vragen over de kwestie een bindende uitspraak te doen. Daartoe aangezocht door het bestuur van de NVP, zullen personen met de volgende kwalificaties door haar worden benoemd:

- twee personen met ruime ervaring in het beheren van investeringen in de participatiesector. Omdat enige afstand van de dagelijkse praktijk geboden is, wordt gedacht aan voormalige investeringsmanagers van een participatiemaatschappij,
- één persoon met ervaring in het beleggen in participatiefondsen,
- één persoon met een juridische achtergrond en ervaring in de participatiesector,
- één persoon met ervaring in de toezichtspraktijk. Hierbij wordt gedacht aan iemand met ruime ervaring als onafhankelijk lid van een Raad van Commissarissen in de participatiesector.

Door de NVP en haar bureau worden binnen redelijke grenzen middelen ter beschikking gesteld aan de commissie om, binnen een redelijke termijn, tot een uitspraak te kunnen komen. Het bestuur van de NVP neemt een passende maatregel, rekening houdend met de uitspraak van de commissie.

De essentie van participeren

Streven naar goed ondernemingsbestuur

Participatiemaatschappijen spelen een belangrijke rol in het professionaliseren van het ondernemingsbestuur in niet-beursgenoteerde bedrijven

Om een investering in een bedrijf succesvol te laten zijn is goed ondernemingsbestuur een voorwaarde. Goed ondernemingsbestuur houdt in dat er duidelijke afspraken zijn over verdeling van zeggenschap, taken en verantwoordelijkheden en over verantwoording en rapportage. Goede governance zorgt voor goed geïnformeerde besluitvorming. Goede governance draagt ook bij aan realisatie van de wettelijke verplichting van het bestuur van de onderneming om bij besluiten rekening te houden met de belangen van alle belanghebbenden.

LIDMAAT-SCHAPSCODE

ALGEMENE RICHTLIJNEN SPECIFIEK VOOR LEDEN VAN DE NVP

1 Het lidmaatschap van de NVP houdt in de ondersteuning van de doelstellingen van de NVP, te weten de belangen van de Nederlandse participatiesector te behartigen, de bekendheid van participatiemaatschappijen te vergroten en een gunstig klimaat te onderhouden voor ondernemingen die private equity of venture capital nodig hebben.

2 De leden besteden aandacht aan verdere professionalisering van de participatiesector.

3 De leden nemen deel aan de marktonderzoeken van de NVP en haar Europese zusterorganisaties met betrekking tot investeren, desinvesteren, fondsenwerving, sociaaleconomische impact en rendement voor zover van toepassing.

4 De leden bevorderen verantwoord gedrag ten opzichte van elkaar en ten opzichte van de ondernemingen die private equity en venture capital nodig hebben.

5 De NVP vereist van haar leden onderschrijving van haar gedragscode en haar lidmaatschapscode. Daarmee zijn de leden aan deze codes gebonden. Het wordt aangemoedigd dat leden een verwijzing naar de gedragscode op hun website plaatsen.

De sociaaleconomische bijdrage van participatiemaatschappijen in Nederland

In 2016 hadden ruim 1.400 Nederlandse bedrijven, waarvan ca. 90% in het MKB, een participatiemaatschappij als aandeelhouder. Samen hadden deze bedrijven een geschatte omzet van €85 miljard en bieden zij meer dan 380.000 mensen werk.

Tussen 2007 en 2015 trokken 2.880 Nederlandse bedrijven samen €24 miljard private equity en venture capital aan. Deze bedrijven worden door de combinatie van kapitaal, kennis en het netwerk van de participatiemaatschappij innovatiever en productiever, waardoor zij concurrerender worden, kunnen groeien en kunnen internationaliseren.

Na gemiddeld vijf jaar worden de bedrijven verkocht. Uit de opbrengsten krijgen de beleggers hun inleg terug en hun aandeel in het rendement.

De NVP dankt iedereen die het afgelopen jaar betrokken is geweest bij het proces tot herziening, in het bijzonder de gedragscodecommissie bestaande uit:

Brechta Kuijpers, Synergia Capital Partners
Taco Rietveld, HB Capital
Leo Verhoeff, Simmons & Simmons
Michael Lucassen, TIIN Capital
Miriam Dragstra en Bert de Haas, BOM Capital
Joost Bakhuizen, Van Lanschot Participaties

Wilt u meer weten?

Neem voor meer informatie contact op met de
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INVEST EUROPE

PROFESSIONAL STANDARDS

HANDBOOK

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About Invest Europe

Invest Europe, formerly the European Private Equity and Venture Capital Association (EVCA), is the association representing Europe's private equity, venture capital and infrastructure sectors, as well as their investors.

Our members take a long-term approach to investing in privately-held companies, from start-ups to established firms. They inject not only capital but dynamism, innovation and expertise. This commitment helps deliver strong and sustainable growth, resulting in healthy returns for Europe's leading pension funds and insurers, to the benefit of the millions of European citizens who depend on them.

Invest Europe aims to make a constructive contribution to policy affecting private capital investment in Europe. We provide information to the public on our members' role in the economy. Our research provides the most authoritative source of data on trends and developments in our industry.

Invest Europe is the guardian of the industry's professional standards, demanding accountability, good governance and transparency from our members.

Invest Europe is a non-profit organisation with 25 employees in Brussels, Belgium.

Contact

For more information about Invest Europe, please visit **www.investeurope.eu**.

For more information on our Professional Standards, please contact us at **professionalstandards@investeurope.eu** and we will respond to your enquiry promptly.

Contents

INTRODUCTION TO THE HANDBOOK

The Promotion of Professional Standards

Invest Europe promotes the highest ethical and professional standards within the private equity, venture capital and infrastructure industry[1].

Ethical behaviour is fundamental to the success of our industry. Industry participants operate in an environment of trust. Invest Europe members are entitled to expect their peers to act in accordance with the highest ethical and professional standards and are expected to behave in a similar manner towards portfolio companies, service providers and other stakeholders. Further, in order to ensure sustainable, equitable and positive conditions for the industry across Europe, it is in members' best interests to promote confidence in the industry for the public at large. Being a member of Invest Europe creates a responsibility to act in a manner that is both ethical and beneficial to the interests of the industry and its stakeholders.

Observance of the standards set out in this Handbook enables Invest Europe to better represent and promote the interests of its members.

1 For the purposes of this Handbook, "private equity" and "industry" are used as generic terms to refer to and to encompass venture capital, infrastructure and private equity.

This Handbook brings together the key elements of governance, transparency and accountability that are expected of industry participants. It provides accessible, practical and clear guidance on the principles that should govern professional conduct and the relationships between all those engaged in the industry, with a particular focus on the relationship between those operating the funds (referred to as General Partners or GPs) and their investors (referred to as Limited Partners or LPs), and between GPs and portfolio companies, whilst taking into account the importance of the role the industry plays in society at large. The GP/LP terminology used in this Handbook is explained under the heading "The long-term partnership between GPs and LPs."

In addition, the Handbook includes the core financial recognition and reporting requirements for private equity funds, in the form of the IPEV Valuation Guidelines (which are endorsed by Invest Europe) and the Invest Europe Investor Reporting Guidelines, as well as the Invest Europe Guidance for Placement Advisers, so as to provide an efficient "one stop" reference for all aspects of professional standards.

Our industry is based on an active investment and ownership model involving two key relationships:

1. The long-term partnership between GPs and LPs

Private equity is foremost an ownership model for investments in privately held companies of all sizes and at all stages of development. Typically the funds raised for such investments are structured as closed-ended Limited Partnerships. The investors are the limited partners, and are referred to as the LPs, and the investment manager is the general partner, and is referred to as the GP. While other legal forms are also commonly used, for the sake of simplicity, the terms GP and LP are used generically throughout this Handbook whatever the legal structure of a particular fund.

The nature of the long-term partnership formed through negotiations and ongoing interactions between GPs and LPs is fundamental to how the industry operates and is what sets it apart from other asset classes. Private equity funds typically have a lifespan of at least 10 years. During the life of a fund the GPs and LPs actively engage to ensure high professional and ethical standards are followed in all aspects of the investment and management of the fund. LPs demand accountability, transparency and alignment of interest from the GPs and the GPs demand accountability, transparency and timely engagement from the LPs.

2. The active and responsible ownership of portfolio companies by GPs

Private equity is generally characterised by a high level of engagement between the GPs and the portfolio companies. GPs are able to bring not only investment capital, but also experience and knowledge as well as networks to the portfolio companies. Good corporate governance is key to creating lasting value. In order to create such lasting value for stakeholders, GPs play an active role in the strategy and direction of the portfolio company, through their board representation and/or their dealings with portfolio companies outside the boardroom. GPs demand rigorous accountability, transparency (through monitoring and reporting), and adoption of best practices by their portfolio companies.

An industry committed to good corporate governance and responsible investment

The industry has been and continues to be instrumental in developing good corporate governance standards in unlisted companies. Successful investment requires well-informed decision-making at all levels and by all parties. At its core, good governance creates alignment of interests and the environment for the attitudes, mechanisms and behaviours that allow this well-informed decision-making to take place. Poor governance can lead to misalignment of interests, bad decisions and business failures.

The private equity industry contributes to bringing out the value creating potential of each portfolio company, with both the time and the resources necessary for sustainable growth. The consideration and management of Environmental, Social and Governance (ESG) opportunities and risks in the investment process and the management of the firm itself are becoming more important to GPs and LPs alike to safeguard the long-term performance of investments. While combining economic development, the reduction of environmental impacts, social progress and professional governance, investing responsibly also helps to ensure that a GP is doing no harm to the industry and its stakeholders. It is also in the industry's best interest that industry participants communicate how ESG factors are considered and managed throughout the investment process.

Purpose of the Handbook

This Handbook aims to help members of Invest Europe to exercise business judgment in a manner consistent with the Code of Conduct and high ethical standards. For example, private equity investment may give rise to situations in which there is a conflict of interest between various parties involved in a fund, business, transaction or negotiation. It is the intention of this Handbook that those participants in the industry who follow the guidance within it will be able to manage such conflicts openly, honestly and with integrity.

This Handbook is drafted so as to be applicable to as wide a range of situations and circumstances as possible, as well as a broad range of investment situations, from seed and development capital to large leveraged buyouts or buy-in transactions.

AIFMD and other regulations

The Alternative Investment Fund Managers Directive (AIFMD) is the most significant piece of European legislation affecting the private equity industry. It entered into force in July 2011 and has been transposed into the national law of every EU Member State. It applies to some (but not all) Invest Europe GPs. In addition, many other national and pan-European regulations will apply to private equity firms and investors, and the regulatory rules of other countries will have significance for private equity fund managers, portfolio companies and LPs.

While recognizing the importance of and referring to these laws where relevant, this Handbook is not intended to be a guide to, or act as a detailed operational manual for, compliance with the AIFMD, or other laws and regulations (e.g. FATCA, etc.).

However, the Handbook does seek to clarify how existing standards are best articulated within the prevailing regulatory framework (including AIFMD) and highlights where its impact is viewed as particularly important. For example, Invest Europe's Code of Conduct has long recognised the importance of treating investors fairly, and therefore complements one of the core objectives of the AIFMD.

No particular operational jurisdiction is envisaged and therefore references to shareholders, the board and management should be taken as functional titles rather than particular legal structures.

History of the Handbook

The industry's original Code of Conduct, published in 1983, has been developed over the years, having regard to the "Model Code of Ethics: A Report of the SRO Committee for the International Organisation of Securities Commissions (IOSCO)" published in June 2006. This recommends that firms engaged in the financial services industry adopt as ethical principles Integrity and Truthfulness; Promise Keeping; Loyalty-Managing and Fully Disclosing Conflicts of Interest; Fairness to the Customer; Doing no Harm to the Customer nor the Profession and Maintaining Confidentiality.

The Handbook was first published in January 2013 to integrate all the then existing EVCA professional standards documents, namely the EVCA Code of Conduct, the EVCA Governing Principles (adopted May 2003) and the EVCA Corporate Governance Guidelines (adopted in June 2005).

Current version

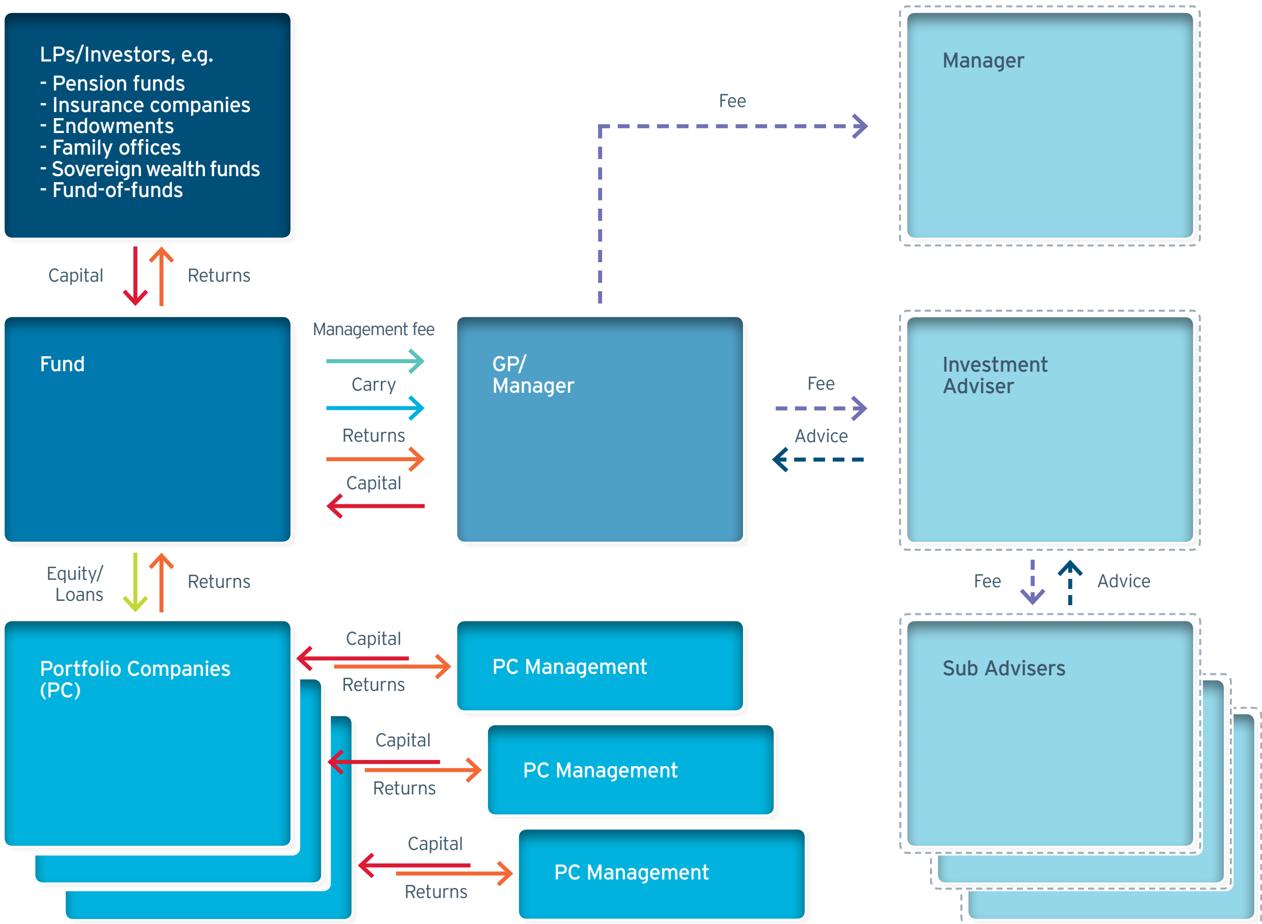
The Handbook is a dynamic document. The Invest Europe Professional Standards Committee has responsibility for maintaining the Handbook. The Professional Standards Committee welcomes your feedback and suggestions for editing. Please direct any comments to professionalstandards@investeurope.eu.

The Handbook will be formally reviewed on a regular basis, to take stock of and to reflect industry developments. It has most recently been reviewed in 2017 by the Invest Europe Professional Standards Committee, including member consultation.

This version was published in April 2018.

Typical fund structure

The diagram below sets out a typical fund structure showing the relationship between LPs and GP and fund and portfolio companies. This is illustrative only. There are many variations to this model.



Note *Dotted lines signify some optional variations*

1

SECTION 1

CODE OF CONDUCT

CODE OF CONDUCT

1.

Act with integrity

2.

Keep your promises

3.

Disclose conflicts of interest

4.

Act in fairness

5.

Maintain confidentiality

6.

Do no harm to the industry

CODE OF CONDUCT
OBJECTIVES

The objectives of the Code are:

- to state the principles of ethical behaviour that members of Invest Europe abide by;
- to assert on behalf of the membership the collective observance of high standards of commercial honour and just and equitable principles of trade and investment; and
- to provide the basis for consideration of, and dealing with lapses in, professional conduct within the Invest Europe membership.

Compliance with the Code is MANDATORY for all Invest Europe members and it is expected that the member procures that its affiliates working with it will also adhere to the Code. Issues of non-compliance are dealt with through the Professional Standards Committee on behalf of the Board of Directors of Invest Europe. In the event of a proven serious case of misconduct by a member, Invest Europe can impose sanctions on the specific member that ultimately can result in expulsion of that member from Invest Europe.

Complaints about Invest Europe member firms should be addressed to:
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SECTION 2

COMMENTARY ON THE CODE OF CONDUCT

COMMENTARY ON THE CODE OF CONDUCT

The following section includes commentary which is helpful in the interpretation and application of the Code. Further explanation on how the Code itself can be used in practice is set out in Section 3.

The six principles that comprise the Code stand together as a whole rather than being independent from one another.

A litmus test for application of these six principles is a personal conviction that your actions would stand up to public scrutiny. An alternative test is to judge your actions by reference to whether you would find it acceptable for other parties to pursue a similar course of action under similar circumstances.

2.1 Act with integrity

Integrity is the fundamental building block of trust in business relationships.

Trust is built upon repeated interactions between individuals that involve clarity, reliability, honesty and a high standard of both personal and professional behaviour. Integrity implies that competitive advantage and commercial success are derived through the application of superior individual and collective skill and not through the use of inappropriate pressure, or manipulative, coercive or deceptive devices or practices. The GP will act with integrity towards its LPs, portfolio companies and other stakeholders and will seek to ensure that the portfolio company conducts its business with integrity. In order to maintain these high standards of behaviour firms are expected to implement and maintain processes and controls to both detect and address conduct that is either unethical or breaks the law. The GP expects the same from its LPs in all areas where they interact. Acting with integrity implies not seeking to evade or avoid the consequences of error.

2.2 Keep your promises

Ethical business behaviour implies keeping promises regardless of whether or not there is a legal obligation to do so.

Promises are made in the light of circumstances which are known at the time that the promise is made. Within the industry[2], commitments are often made subject to conditions such as the provision of further information, carrying out due diligence, the results of uncertain external events and other matters. This means that clarity about what is actually committed to and what is still subject to further investigation is very important.

2 For the purposes of this Handbook, "industry" is used as a generic term to refer to and to encompass venture capital, infrastructure and private equity.

The ethical individual or business only makes promises which they reasonably believe are capable of being fulfilled.

Promises are of equal importance regardless of to whom they are made.

2.3 Disclose conflicts of interest

Conflicts of interest can occur when a person who has a duty to another also has a personal or professional interest that might interfere with the exercise of independent judgment. They inevitably arise within business. In private equity[3], conflicts can arise between the GP and the fund and its LPs; between different funds; between different LPs in the fund; between LPs of different funds managed by the GP; and between the fund and other investors in the respective portfolio companies. **Procedures to ensure the management and disclosure of conflicts should be in place at all firms, and conflicts of interest should be diligently identified and disclosed to all parties concerned.**

A GP should seek to manage conflicts of interest fairly. Where these conflicts of interest affect LPs, the GP should always consult with the LP Advisory Committee ("LPAC") as part of this process. To facilitate the management of conflicts, LPs should ensure they declare their own conflicts of interest in any situation.

2.4 Act in fairness

Fairness means "playing by the rules," whether legislative or not, based on facts and circumstances. Fairness must also take account of the impact of decisions and actions on others, both as individuals and groups, and how these actions would be perceived.

3 For the purposes of this Handbook, "private equity" is used as a generic term to refer to and to encompass venture capital, infrastructure and private equity.

Rules for conducting business may vary between countries, regions, societies, legal systems and transactions. It is important that members understand the different rules that apply to their particular jurisdiction, business or situation as the fairness of their actions will often be judged by these rules, formal or informal.

"Fairness" can have a regulatory as well as a commercial dimension when considered in the context of relationships with investors. Whilst management of the fund by the GP must be in accordance with the fund's strategy and objectives as agreed in the documentation, there are other occasions when a GP should consider the treatment of investors on an individual basis to be satisfied that it is treating them fairly. In particular, a GP should consider carefully whether any particular investor is being given preferential treatment and if so whether this has been disclosed to the other investors. Fairness may not always mean treating everyone the same way, but transparency in this context can be a key element of "fairness". Legal and regulatory requirements may also make specific provisions relating to disclosures.

Consultation with the LPAC or all LPs, where relevant, helps to ensure fair treatment and an awareness of the issues of concern to these groups. An LP should pay due regard to the interests of the fund as a whole and how their individual behaviour may implicate or impact on the fund, the other LPs or the GP. LPs should engage with the GP and other LPs in a timely manner when situations arise which require consideration, particularly when they might lead to an LP vote under the fund documents.

Ensuring adequate information is available ensures actions are judged objectively for their fairness. A GP should pay due regard to the information needs of LPs in the fund, and communicate, within the confines of confidentiality, adequate information to them in a way which is timely, clear, fair and not misleading. Good investor relations for a GP depend upon clear disclosure and timely communication of relevant and material information. The GP will seek to establish transparent communication with portfolio company management. LPs should also communicate clearly and promptly with the GP.

2.5 Maintain confidentiality

In the ordinary course of business, individuals and firms will obtain a range of financial and non-financial information from other market participants and through their role in the managing of investments. Some of this information will be publically available; however, some will be commercially sensitive and the dissemination of which could cause damage or a financial loss to the information's owner.

The GP will treat portfolio company or LP information as confidential in so much as they are made aware that, or should expect that, it is confidential or commercially sensitive. Any usage of such information should be restricted to what has been agreed with the owner of such information or may be mandated by law or regulation.

LPs should also comply with the contractual and regulatory requirements to maintain confidentiality, for example on receiving confidential information when carrying out due diligence on a fund (to which it may or may not decide to commit), or when receiving information that would be considered confidential as an LP in the fund.

In an effort to safeguard the commercial interests of disclosing parties, reasonable steps should be taken to protect information from inappropriate disclosure and due care should be taken to follow any agreed procedures.

2.6 Do no harm to the industry

Success in commercial enterprise requires the pursuit of competitive advantage.

The pursuit of competitive advantage is not in itself harmful to the industry. Industry members should, however, conduct their business in a responsible manner and not engage in practices that are foreseeably damaging to the public image and general interests of the industry and its stakeholders. All participants in the industry should promote best practices and a high standard of both personal and professional behaviour to support the wider benefits of long-term, sustainable investment, economic growth and value creation.

Private equity plays an important part in today's economy. As such Invest Europe expects its members and the funds and portfolio companies they manage to comply with the applicable laws and regulations in the jurisdictions in which they operate.

Private equity aims at creating lasting value in the companies they own. Therefore, causing reputational damage to the industry through the violation of applicable laws and regulation for gain or gratification is considered harmful to the industry as a whole.

Commentary on the Code of Conduct
Guidance on the application of the Code
Guidance for Placement Advisers
Investor Reporting Guidelines
IPEV Valuation Guidelines

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SECTION 3

GUIDANCE
ON THE APPLICATION OF THE
CODE
OF CONDUCT

Questions and Answers

OUTLINE

This section of the Handbook is intended to provide illustrations and guidance on conduct during the entire life cycle of a fund, from conception and fundraising through investing to its winding up, which is consistent with the principles of the Code. In doing so, it takes account of common and good market practice and corporate governance in the industry[4] wherever possible.

The illustrations are not intended to be exhaustive or prescriptive. While the questions aim to provide a useful resource, it should not be assumed that "one size fits all". Some of the scenarios may be inappropriate due to the size, nature, local environment and complexity of some GPs' operations. Local legal and regulatory requirements, and the extent to which there are fiduciary relationships and obligations, vary across jurisdictions. Additionally, the differing investment objectives of different funds may also mean that some examples may not be appropriate to all funds.

Over the last six years, we have seen the first harmonised pan-European legislation in the form of the Alternative Investment Fund Managers Directive (AIFMD) and its implementing regulations come into effect. However, the actual implementation of the AIFMD into national laws is the responsibility of the EU member states, so differences in the application and interpretation of the AIFMD rules across member states remain. In addition, many firms are below the threshold for compliance and, though impacted by the AIFMD to some extent, may be subject to alternative regulations.

Further, Invest Europe members may also market their funds to investors outside the EU (e.g. in the United States) and will then also have to comply with legal and regulatory requirements in the targeted markets. Many jurisdictions have additional laws and regulations impacting the conduct of business generally and fund management specifically which will also need to be considered. The principle is that the specific legal requirements have to be met by the affected GPs and their funds in all relevant jurisdictions. **This document therefore does not and cannot describe all requirements or provide a complete or mandatory statement of the duties of those involved in the establishment and operation of funds. It is not a substitute for suitable professional advice, which should be obtained as appropriate.**

The following section, while endeavouring to capture broad aspects of pan-European legislation and regulation, does not reflect the impact of differing legal structures used for private equity[5] vehicles. Furthermore, it is assumed that funds are being marketed to sophisticated LPs and hence this document does not address the large range of legal protections surrounding investments that are marketed to retail investors.

4 For the purposes of this Handbook, "industry" is used as a generic term to refer to and to encompass venture capital, infrastructure and private equity.

5 For the purposes of this Handbook, "private equity" is used as a generic term to refer to and to encompass venture capital, infrastructure and private equity.

Q&A

The Q&A in Section 3 is set out under a number of headings, which are summarised in the following schedule.

3.1 FUND FORMATION: INITIAL PLANNING

In the Handbook, the fundraising team is referred to as the group of professionals employed directly by the GP or its affiliates specifically involved in the fundraising process for the GP. The fundraising team may be assisted by outside professionals, including legal advisers, placement advisers and other specialists. The effective integration and co-ordination of these advisers is an important part of a successful fundraising process.

There are a number of factors that the fundraising team should consider and address during its initial planning. Doing so will help to ensure that the GP will be able to keep its promises to investors and operate the fund with due skill, care and diligence. A well-structured fund, with an adequate level of financial and operational resources, will be better placed to satisfy the needs of LPs and create a strong foundation for the operation and management of the fund after closing.

One of the impacts of the AIFMD is more specific registration and marketing requirements for affected funds and managers. It is important to note that, in some jurisdictions, the GP and/or fund need to be legally established as a prerequisite for starting the registration and authorisation process by the regulatory authorities and hence the marketing of the fund. It is the responsibility of the GP to make sure that the fundraising team comply with the applicable regulations for marketing the fund, and should seek appropriate assurances from third parties (particularly placement advisers) that they will comply with all applicable fund marketing regulations.

3.1.1. Early-stage planning

Question

What issues should the fundraising team consider and address during its early-stage planning?

Explanation

Appropriate early-stage design and planning of a fund is vital to its success. The structural elements of the fund must match the intended investment strategy. Advance planning also helps to focus the fundraising team so that effort and cost are not expended inappropriately. Planning during this stage will normally outline all of the fundraising team's activities up to the first closing of the fund and the key business milestones and regulatory approvals required.

Recommendation

The fundraising team's early-stage planning should address the following issues:

- **Fundraising timing** including reviewing any restrictions from existing funds or contracts on raising new money, and the availability of the GP's human and financial resources to market and raise the fund;
- **Fundraising budget and costs** including consideration of the costs of the fundraising such as legal and regulatory charges, travel and placement adviser costs, and the apportionment of these costs between the fund and the GP;
- **Investment strategy** including what is the fund's investment policy and objectives as well as any specific requirements coming from that strategy such as fund size or geographic scope;
- **Resources for implementing the strategy** including identifying the human resources that will be needed to implement the fund's objectives and responsibly manage and administer the fund and the GP's activities while ensuring such individuals are likely to remain committed to the fund for its duration;
- **Fund structure** including form and jurisdiction as well as key structural terms such as the length of the investment period and term of the fund, minimum and maximum fund sizes and deal flow allocation between other funds managed by the GP;
- **Fund economics** including the level of management fees, the provisions regarding transaction, advisory or other costs to be incurred by the fund or the GP and the appropriate profit share and carried interest structure, in particular focusing on the apportionment of carried interest, timing of payments and GP clawback mechanisms;
- **Marketing strategy** including what type of LPs will be targeted for the fund and the resulting regulatory requirements for marketing, the structural impact on the fund, and other specific requirements of the targeted group (such as environmental, social and governance ("ESG") or other reporting needs); and
- **Responsible investment considerations** including their incorporation into the GP's organisation and its investment and portfolio monitoring processes and policies.

3.1.2. Fundraising and regulation

Question

How will regulation impact the fundraising?

Explanation

An efficient and well-planned marketing campaign is vital in ensuring that fundraising is successful. Many European, as well as non-European, jurisdictions regulate the marketing of funds and restrict solicitation to certain types of LP (such as sophisticated and professional investors). In some jurisdictions licences are required to carry out marketing activity and

3.2 FUNDRAISING

restrictions may apply to early informal discussions with potential LPs. Planning should identify the relevant jurisdictions where regulations need to be analysed and gives the fundraising team the opportunity to obtain appropriate advice to remain in compliance with the relevant regulation.

Under the AIFMD, the rules governing marketing of funds within the EEA may depend on the jurisdiction of the fund vehicle, as well as the location and regulatory status of the GP. Subject to varying notification and filing obligations, an EEA "marketing passport" should be available in respect of EEA funds to managers duly authorised by an EEA member state under legislation implementing the AIFMD. However, this is not the case for non-EEA funds and/or non-EEA managers. Furthermore, EEA fund managers which are not required to be authorised under the AIFMD will not benefit from this passport, unless they "opt-in" to full AIFMD compliance or have registered under other applicable legislation. They will need to take advice in every country in which they wish to market their fund.

In many jurisdictions there are restrictions on the types of investor to whom it is permissible to market funds. The tests for determining eligibility vary from jurisdiction to jurisdiction. In some areas, the potential investor's net worth or the minimum size of investment may be criteria for permitting marketing.

Failure to comply with the relevant regulatory requirements may have civil, regulatory and even criminal consequences. The civil consequences can be liability for damages or even the commitment of the LP to invest becoming unenforceable. The regulatory consequences can be public censure, impairment or loss of authorisation and even criminal prosecution.

Recommendation

The GP must ensure it is aware of and compliant with all applicable legal requirements and restrictions on marketing funds in each jurisdiction in which it wants to approach prospective investors.

Investors should be obliged to confirm that they meet the GP's requirements in terms of eligibility, are suitably experienced and understand and accept the risks of the investment.

The fundraising team should maintain a record of all persons to whom it markets the fund and a record of all information provided to them, in order to be able to provide evidence that it has complied with applicable laws.

3.1.3. Structuring

Question

What matters in relation to the structure of the fund should the fundraising team consider during early-stage planning?

Explanation

Although the final structure of a fund will largely be determined by the negotiations and discussions with potential LPs, a proposed structure is necessary from both a regulatory and commercial perspective to allow the fundraising team to market the fund and be able to keep promises made during the fundraising process. Certain categories of target investor may have an impact on the structure and the processes of the fund (such as US-based ERISA investors). The solutions to these issues tend to be similar in all funds and they may be addressed at the planning stage if it is intended to market the fund to such LPs.

Recommendation

The fundraising team should identify a proposed structure for the fund, including suitable vehicle(s) for the fund. Wherever possible, the GP should take account of the likely requirements of targeted investors when considering these structures (including their tax requirements and the regulatory requirements of different vehicles in different jurisdictions). Consideration should also be given to the allocation of any ongoing costs of the maintenance of the fund as a consequence of any structuring.

The fundraising stage is the stage at which the GP's relationship with the LPs is established. This relationship with the LPs should rest on the six principles of the Code, together with the requirements of transparency, compliance with fiduciary duties and the exercise of due skill, care and diligence.

3.2.1. The fundraising process: planning, responsibilities and costs

Question

Who takes part in the fundraising process and what are their responsibilities?

Explanation

A private equity fundraising is a complex, time and resource-intensive process with many parties, internal and external to the GP, involved. The fundraising team generally takes the lead role in planning, co-ordinating and executing the fundraising but invariably the process involves many other parts of the firm, including the investment professionals.

The fundraising team will usually have certain responsibilities for the effective execution of the fundraising such as complying with applicable marketing laws, developing the information and documents provided to potential LPs and carrying out anti-money laundering checks.

Private equity remains a people business. In terms of credibility and continuity, LPs often expect the key people, both individuals in the investor relations team and senior investment professionals identified during the fundraising process, to remain involved with the fund after the closing.

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Recommendation

Careful consideration is required of the resources needed for the fundraising process including how much can be managed in-house by the GP and what roles can be played by advisers and other third parties.

The GP must secure adequate resources to meet the demands of the fundraising process while continuing to be able to fulfil the existing portfolio management, investment and other duties arising from its current funds and portfolio.

Tasks and responsibilities during the fundraising stage should be clearly identified and appropriately apportioned. If specific knowledge is not available in-house, consideration should be given to hiring external advisers who can support the fundraising team in these areas.

It should also be made clear to potential LPs which responsibilities will be undertaken by the GP (including as appropriate the specific roles of the fundraising team) and which by external advisers once the fund has been raised.

Question

Is it right to expect either the fund or GP to reimburse LP due diligence costs incurred in deciding to invest in the fund?

Explanation

On occasion, LPs may request the GP to partially or fully reimburse certain agreed costs of the fund review process (e.g. travel expenses, consultants, advisers, legal fees, etc.).

Recommendation

It is not a generally acceptable practice for LPs to expect that their due diligence costs should be reimbursed either by the fund or the GP when considering an investment in a fund. This practice is likely to be unacceptable to the other committed LPs, who would ultimately bear the burden of these costs, or could leave the GP and the LP in question open to accusations of bribery or improper conduct. If a GP does enter into such an arrangement, it must be properly disclosed to other LPs.

Question

Should costs incurred by the GP during the fundraising process be borne by the fund or the GP?

Explanation

The fundraising process can be a costly exercise, with several parties involved including a placement adviser, lawyers, accountants and fund administrators.

Recommendation

The GP should ensure that thought goes into budgeting for the fundraising process and be clear and transparent with potential LPs about how the advisers will be paid and how the GP treats its own fundraising costs.

It is generally accepted that lawyers, accountants and fund administrators can be paid out of the fund formation costs up to an agreed cap, but placement adviser fees should not be paid as part of the fund expenses, formation or otherwise.

3.2.2. Target LPs

Question

What factors should the fundraising team take into consideration when targeting LPs for a fundraise?

Explanation

The fundraising team will normally start by approaching existing LPs if the GP has raised a prior fund, as new investors will typically take comfort from the continuing commitment of existing investors.

The quality and reliability of each LP affects all those investing in a fund, as drawdowns will be made throughout the life of the fund. If one LP defaults, even when suitable penalties are applied, other LPs are likely to be disadvantaged especially if as a result the fund cannot honour an agreement to invest. Managing a default situation will require GP time and will inevitably incur a cost to the fund; in addition, this may reflect negatively on the GP and its reputation.

Moreover, whilst all LPs should be afforded fair treatment, some LPs may require specific opt-out or excuse clauses that will prevent them from participating in certain investments. If these issues are not addressed during the fundraising, the fund may find it more difficult to make investments, or be forced to find additional financing at short notice.

A further consideration is the long-term nature of the relationship with a prospective LP and whether they are likely to invest over multiple fund cycles.

Recommendation

The GP should target potential LPs with the aim of attracting a balanced and, if possible, diversified group of LPs, having regard to the nature of the fund, its objectives, structure and any regulatory requirements. Such diversification, by type and geography of LP, will help to ensure that the fund has a reliable source of capital to fund its strategy and mitigate the impact of a default by an individual LP.

LP default is a relatively rare occurrence, but carries serious implications. Therefore, robust contractual default provisions are required to protect both fellow LP and the GP’s interests.

Similarly, any withdrawal of an LP should be subject to strictly defined and exceptional situations.

Fund documents should still contain an express right to require the withdrawal of an LP who is causing serious legal, regulatory or taxation problems or reputational issues for the fund and its investors.

In accordance with the principle of disclosing conflicts of interest and acting in fairness, the GP should consider whether any opt-out rights granted to individual LPs should be disclosed as part of the due diligence process.

3.2.3. Know Your Investor

Question

Should the GP be responsible for scrutiny of investors with a view to preventing money laundering or other illicit practices?

Explanation

The definition of what money laundering is and the application of anti-money laundering (AML) legislation can vary from jurisdiction to jurisdiction. However, there are general requirements and common principles with respect to AML legislation stipulated in the guidelines issued by the Financial Action Task Force (FATF) and these include checks not only on the investing entity but also for establishing who is the "beneficial owner" of the investing entity, to prevent the laundering of money through fund investments.

Recommendation

The GP is responsible for ensuring compliance with applicable anti-money laundering requirements.

Irrespective of considerations concerning compliance with law, a GP should take care only to introduce reputable, long-term partners into the fund.

GPs should ensure that the fund documents require LPs to provide any necessary identification information that the GP requires to meet its policies and relevant regulatory and legal requirements, including providing documentation to the authorities during the life of the fund. Failure or refusal to meet this requirement should provide the GP with the right to require the LP to withdraw from the fund.

Legal advice should be obtained on this matter as early as possible to ensure that all relevant money laundering checks are undertaken and properly documented. These checks must in all cases comply with the relevant local rules in the jurisdiction where the fund is domiciled as well as that from which it is administered. In addition, during fundraising, steps should be taken to ensure that capital commitments are not made to facilitate money laundering. Investment should not be accepted where the source of the investment causes concern (e.g. where the investment originates in an FATF black-listed country) or the LP's (or its beneficial owners') identity either cannot be verified or is reasonably deemed an internationally sanctioned person or institution, or until further, enhanced due diligence is completed and confirms these factors are not an issue.

Subscription documents should include specific information and confirmation from LPs in the fund regarding the origin of money invested, corroborated by appropriate documentation and supported by suitable warranties where applicable. The fund documents should enable the GP to require LPs to update or expand such information, documentation and warranties as applicable and provide the GP with the right to manage the situation if their failure to provide such information, documentation and/or warranties impairs the ability of the GP and the other LPs to carry on the business of the fund.

3.2.4. Structure of the offer: Terms of investment

Question

Should different investors be offered different terms?

Explanation

The terms for investment in a fund will normally be subject to and the result of negotiation. Given the diverse nature of potential LPs in private equity, some LPs may require specific terms to deal with, for instance, their own regulatory obligations.

LPs may also be keen to get certain preferential rights or economic advantages (such as positions on the LPAC, preferential access to co-investment opportunities, reduced management fees or a participation in carried interest). It should also be noted that trade and strategic investors may have different priorities for their investment compared to those of financial investors.

However, in a fund, it is generally presumed that all LPs will be treated fairly (and applicable law may require fair treatment). The AIFMD, for example, provides for mandatory disclosure concerning the differentiated treatment of investors including a description of the preferential treatment and the type of investor who obtained such treatment. Including such disclosure would also be in accordance with the Code of Conduct's principle of disclosing conflicts of interest.

The extent to which specific LPs are granted influence over the management of the fund should be considered carefully. If such influence alters the management structure of the fund it can compromise LPs' limited liability. Substantial influence on the management of a fund (in particular the decisions to invest or divest) can subject the fund to merger regulations and notification requirements with undesirable consequences for both the fund and its LPs. Some LPs may also have an issue if another LP, rather than the fund manager, has a role in the investment decision-making process.

Recommendation

Whenever possible, the GP should try to ensure that all LPs in the fund benefit from fair treatment. Different terms can be offered to different LPs but, wherever possible, preferential treatment or specific economic benefits to individual LPs or groups of LPs should be justifiable (e.g. with reference to the amount invested by a particular LP or the specific experience of an LP which adds additional value to the fund).

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Also, any preferential treatment should be clearly disclosed to all other LPs from the outset in a way that such LPs at least know that certain other LPs may benefit from preferential treatment. If certain LPs are on different terms, this can have an impact on the alignment of LPs' interests.

LPs should not generally participate in the day-to-day management (including the investment decision process) of the fund. Where they do so, they and their fellow LPs should be aware of the legal risks that arise from doing so in certain jurisdictions and which may mean that an LP loses its limited liability. They may also expose themselves to claims from other LPs.

In determining initial terms and during subsequent negotiations with potential LPs, a GP should consider the overall alignment of interest of the LPs. Most favoured nation (MFN) clauses are often used to entitle some LPs to claim the same beneficial terms granted to other LPs so the fundraising team needs to consider the impact on the existing LPs as well as legislation such as the AIFMD which requires fair treatment of investors and disclosure of differential treatment when making concessions to potential LPs in subsequent negotiations.

Where a fund is structured as multiple parallel partnerships or entities, the fundraising team should seek to avoid one such entity or a single minority LP (in the context of the whole fund) being able to unduly influence the fund or block special resolutions without adequate justification.

3.2.5. Fundraising documents

Question

What documents should the fundraising team produce with respect to the fund and what matters should these documents address?

Explanation

Due to the fact that negotiations with potential LPs will usually continue until the final closing of a fund, documents tend to be continually revised to reflect these negotiations. However, certain core elements that describe the offer and its essential characteristics should remain constant.

These core elements will usually be addressed in a combination of documents which will normally include a private placement memorandum (often the main "marketing" document) and the constitutional documents of the fund. Local laws in the jurisdictions where the fund is marketed may set out requirements on the structure and content of the private placement memorandum and fund documents.

The fundraising team will also normally assemble a comprehensive data pack or virtual data room of documents about the fund, its investment strategy and the GP's prior track record, collectively comprising the due diligence materials. This material will often contain confidential and proprietary information from the GP as well as, potentially, on current portfolio companies that will need to be appropriately handled. In addition, the fundraising team may receive investor questionnaires covering a variety of topics, including for example ESG disclosure.

As a general rule, any changes to the fund documents would require the approval of LPs. However, some fund documents provide a carve-out for changes agreed after the first close with prospective investors in the fund which are not adverse to the interests of existing LPs. These changes can in some jurisdictions be made by the GP without LP consent in order to facilitate its fundraising efforts, provided however that where any LP is adversely affected by the change in question then the affected LP would have to consent to the change.

Continuous amendment of documents as negotiations with investors advance and the structure is formalised can create a risk, if not addressed appropriately, that not all LPs will receive the same information about the fund before they make a commitment to the fund. In accordance with the principle of fairness, it is essential to ensure that all LPs receive and acknowledge they have received complete final documentation prior to closing.

The time schedule for the negotiation should allow for any required regulatory approval of amended fund terms (for example, this will often be the case for funds managed by AIFMD-authorised managers).

Recommendation

The fundraising team should ensure that it has sufficient resources to manage the information and documentation demands of the fundraising process, including the preparation of data rooms and responses to investor questionnaires and other inquiries.

A draft private placement memorandum or similar fund documents should be made available to LPs with a finalised version issued prior to first closing, with, where necessary, updates issued prior to each subsequent closing. Draft constitutional documents establishing the fund (e.g. Limited Partnership Agreement, Management Agreement, subscription documents) will also need to be produced and made available to prospective LPs.

Appropriate records should be kept to ensure that all LPs are able to review the same information. The use of due diligence data rooms (physical or virtual) can be an effective way to provide information to prospective LPs, provided that security and confidentiality are maintained. Between the first and final closings this information should be updated if changes are required and such updates should be disclosed to both existing and potential LPs, so that all have had access to the same information.

Appropriate advice should be sought on the requirements of the laws in all jurisdictions where the fund is marketed.

The private placement memorandum should contain full and true information presented in compliance with applicable local laws and in a manner that is clear, fair and not misleading. Appropriate steps should be taken to ensure and record the accuracy and completeness of the memorandum, employing third-party advisers where appropriate (e.g. to independently review a GP's track record information).

The fundraising team should ensure that it can justify and support expressions of belief and statements made in the fund's private placement memorandum and marketing materials using reliable documents and research, updating these where necessary until the fund has reached final closing.

Consideration should also be given to the content of the due diligence information to be provided to prospective LPs. The information should clearly disclose any potential conflicts of interest arising out of the GP's corporate structure. The medium through which it will be delivered should be considered too.

Appropriate measures to ensure confidentiality in disclosure, including possibly entering into non-disclosure agreements should be considered. Thought should also be given as to how meetings with prospective LPs will be held and the level and timing of access to information.

3.2.6. Terms in the fund documents

Question

What are the typical terms to be set out in the fund documents?

Explanation

The fund documents should set out the key terms and provide the framework within which the GP will operate the fund.

The minimum requirements for the fund documents heavily depend on the jurisdiction and applicable regulatory requirement and as such should be checked by legal counsel.

Recommendation

It is recommended that the fund documents should address, at a minimum, the following matters:

Investment strategy

- the investment scope of the fund;
- the investment policy, investment criteria and investment period of the fund, including the applicable investment, lending and borrowing guidelines and investment restrictions. (NB: These must be set out particularly clearly as, often, these important matters will not be set out in any detail in other key documents, and they are usually incorporated by cross-reference to the private placement memorandum);
- the responsible investment approach of the GP and/or the fund and the procedures for ensuring compliance with any associated policies.

Team

- a description of the management structure and the management team, and identification of the key executives of this team;
- a description of the team's skills and experience;
- details of team continuity, dynamics, decision-making processes and team succession.

Structure and powers

- a description of the legal structure of the fund;
- a summary of the powers of the GP;
- conflict of interest resolution procedures;
- remit and composition of the LPAC;
- Key Person provisions regulating the departure of key executives (for example, requiring the GP to cease new investments if key personnel are no longer available to make the key investment decisions);
- GP removal provisions (e.g. in the event of fraud, negligence, etc.);
- transfer of GP and LP interest provisions;
- indemnification provisions.

Reporting

- a summary of the key reports on the fund produced by the GP for LPs;
- their frequency (e.g. quarterly financial statements, half-yearly reports and annual audited accounts);
- the timetable within which they will be circulated to LPs;
- the valuation policies to be used in such reports;
- disclosure and detailed breakdown of the nature and source of all fees paid directly or indirectly by portfolio companies to the GP and/or any related entities/individuals (such as employees, operating partners, advisers or similar);
- other reports, such as those covering ESG matters or those required to satisfy tax and other regulatory obligations.

Financial terms

- the establishment costs of the fund, those to be borne by the fund (and any cap thereon) and those to be borne by the GP;
- the terms of the management fee (including the point at which it commences) and the differentiation of costs borne by the fund and the GP;
- the provisions dealing with fees received from portfolio companies by the GP or its related parties, and to what extent such fees received will be offset against the management fee or otherwise credited to the fund and any other fee and expense allocation provisions required so that LPs have a proper understanding of the fees and expenses charged (keeping in mind any regulatory requirements such as under the AIFMD);

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- the GP capital commitment;
- the carried interest arrangements, including the rate, basis of calculation, catch-up, escrow, clawback and true-up provisions;
- the mechanics for drawdown of commitments and in the event of an LP's default on such a drawdown (which should normally impose significant sanctions on a default to reduce the risk of such default);
- if applicable, the pricing of interests, units, shares, etc. in the fund;
- how distributions to LPs will be made.

Co-investments

- the allocation policy for co-investment opportunities, including disclosure of any priority co-investment rights;
- the policy on co-investment with other funds managed by the GP or any of its associates.

Term and new funds

- the term of the fund, the process for extending the fund and termination and liquidation procedures for the fund;
- the circumstances in which investments may be purchased from or sold to other funds managed by the GP or its associates;
- any restrictions on the circumstances in which the fundraising team or the GP will be permitted to establish any other fund with a similar investment strategy or objective.

Risk factors

- a summary of the risk factors that are relevant to investment in the fund, including a general warning to LPs of the risks that are inherent in investing in such funds, and also any particular risk factors that may adversely affect the fund's ability to carry out the investment policy or to meet its return objectives.

Tax considerations

- an outline of the tax structure of the fund and the key considerations for investors in the fund.

Regulatory disclosure

- in certain jurisdictions, regulation may require detailed disclosure on certain aspects of the investment mandate and ongoing operations of the fund.

Marketing restrictions

- a summary of the key restrictions on who can invest in the fund in major jurisdictions where the fund is being marketed.

The fund documents (private placement memorandum or similar and constitutional documents) should be prepared and made available to LPs in sufficient time for them to consider these documents prior to closing and to allow time for negotiation with the GP. Appropriate subscription documents and confirmation of participation should also be circulated.

The fundraising team should take advice on whether the law in any jurisdiction where the documents will be sent requires any other legal or regulatory matters to be addressed.

Question

What responsibilities exist with regard to the availability and use of additional credit finance within the fund structure?

Explanation

It is now typical for funds to be raised with additional bridging financing in the form of facilities secured on the LPs' undrawn commitments. Such facilities, which are made available at the level of the fund (as opposed to facilities at the level of the fund's individual assets) are typically established as a redrawable facility from a bank or other specialist lender and are used by the GP for a range of cash efficiency reasons including reducing the volume of drawdowns made to and from LPs and avoiding the need to draw funds from LPs for temporary investments. This kind of financing does not increase the investment capacity of the fund.

LPs need to understand the rationale for using the facility and the key terms associated with it, and may wish to put restrictions on how such a facility is used. As with the general requirements of the fund formation documents, the criteria for disclosure regarding such credit facilities may depend on the jurisdiction and applicable regulatory requirements and therefore should be checked by legal counsel.

Typically, the specific terms of the facility may not be in place until after the fund has been formed and therefore it may not be possible to disclose full details in the fund formation documents – in which case a statement indicating an outline of any proposed facilities will be all that is available. Once the facility is in place, LPs will need to be informed of the final terms.

Where material, LPs may wish to see the impact of the facility on the net IRR and net money multiple of the fund in order to be able to compare and benchmark the underlying net performance with other funds.

Occasionally, though only rarely in the context of direct private equity funds, a facility is put in place to increase the investment capacity of the fund (i.e. the facility is expected to be long term and allow the fund to make investments in excess of 100% of LP commitments). In such circumstances LPs need to be informed of the size and scope of such borrowings and understand the implications. Such facilities give rise to fund leverage (which may have regulatory implications).

Recommendation

The fund formation documents should address the following items:

- Intention to use a bridge facility during the fund life - if no facility is proposed or can be put in place then this should be disclosed.

- Reasons for using (and/or restrictions on the use of) the facility – for example:
  - to reduce the frequency of drawdowns (e.g. to enable a specified number of investments to be acquired at the same time)
  - to fund temporary investments
  - to avoid the need for rebalancing among LPs during fund-raising by providing funding for all investments between first and final closing of the fund
  - to optimise cash efficiency
  - to provide letters of credit / bank guarantees in support of the fund's portfolio
  - to accelerate distributions

The fund formation documents should also make it clear that the use of such a bridge facility will have an impact on the net IRR, net money multiple and, where relevant, the achievement of the hurdle for payment of carried interest.

If available at the time the fund formation documents are written, the following should be included:

- Anticipated size of the facility
- Proposed limits on the duration of the facility
- Details of the permitted usage of the facility (e.g. for investments, for management fees and expenses, for temporary investments)

Where the specific terms of the facility have not been finalised until after the fund has been established, the GP should provide the details referred to above either in the next quarterly report or in a separate communication to LPs. Disclosure on the terms associated with facilities designed to increase the investment capacity of the fund should be disclosed separately from those applicable to bridging facilities.

Where, exceptionally, a credit facility is to be used to increase the investment capacity of the fund (i.e. fund leverage), there should be a clear statement to this effect, and all disclosure relating to this facility should be made separately from that relating to bridging facilities.

Once the fund is up and running, ongoing reporting should ensure transparency for LPs on the usage and impact on returns of the facility, and should include the key terms of the facility as part of the fund overview. For details of the ongoing quarterly reporting requirements, see the Invest Europe Investor Reporting Guidelines.

3.2.7. Presentations to LPs

Question

What responsibilities arise with respect to marketing presentations?

Explanation

Presentations and information provided by the fundraising team that influence LPs' decisions are often subject to the law of all the jurisdictions where a fund is promoted. These laws will often apply to information provided to LPs, irrespective of the media by which it is communicated.

In some circumstances, presentations may be made to potential LPs at an early stage and the information provided to them may influence their decision to invest, even though they have not yet received any formal fund documents. It is important that potential LPs are made aware of any changes to information provided to them at any point during the fundraising process, so that they are able to make a balanced investment decision based on correct information.

Recommendation

As set out in section 3.1.2. "Fundraising and regulation", the fundraising team must comply with local laws relating to the marketing of funds in all jurisdictions where the fund is promoted and appropriate professional advice should be obtained.

The fundraising team should ensure that information provided to potential LPs and promotional statements made to them in whatever form (e.g. in telephone calls, meetings, slide presentations, letters, emails, websites, etc.), even at an early stage, is correct and fairly presented. Any subsequent material changes to such information should be communicated to potential LPs.

3.2.8. Responsible investment

Question

What information should GPs provide to LPs on the issues of responsible investment?

Explanation

The topic of responsible investment is of great significance to the industry. As society is addressing the sustainability agenda, the consideration and management of ESG opportunities and risks in the investment process are becoming more important to GPs and LPs alike to safeguard the long-term performance of investments. Furthermore, it is in the industry's best interest that industry participants communicate how ESG factors are considered and managed throughout the investment process. Besides the potential to have a positive impact on the long-term performance of a portfolio company, investing responsibly helps ensure that a GP is doing no harm to the industry, the portfolio companies and their stakeholders.

An example of the industry's increased focus on responsible investment is the initiative behind the ESG Disclosure Framework for Private Equity, which was introduced in March 2013[6].

6 See: https://www.investeurope.eu/about-us/responsible-investment/other-industry-standards/

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Recommendation

GPs should clearly define and document their responsible investment policy and the procedures for compliance with such policy and will typically be asked by LPs to provide information both during due diligence and throughout the life of the fund. The GP should disclose its industry association memberships and/or other memberships and affiliations.

During fundraising, as set out in the ESG Disclosure Framework, a GP should seek to disclose information sufficient to enable an LP that has expressed an interest in ESG management to:

1. assess if the GP is aligned with the LP's ESG-related policy and investment beliefs;
2. assess the GP's policies, processes, and systems for identifying ESG-related value drivers and managing material ESG-related risks; and to identify possible areas for future development;
3. understand if and how the GP influences and supports its portfolio companies' management of ESG-related risks and pursuit of ESG-related opportunities;
4. assess how the GP will help the LP to monitor and, where necessary, ensure that the GP is acting consistently with the agreed-upon ESG-related policies and practices as set forth at fund formation;
5. assess the GP's approach to managing and disclosing material incidents at the GP and portfolio companies.

For more information, please also see the Invest Europe Responsible Investment Bibliography.

3.2.9. Track records

Question

What information should be provided about the track record of the GP?

Explanation

Potential LPs will expect detailed track record information for the GP to be made available as part of the due diligence process. It is an important part of acting with integrity that the track record properly represents the GP's prior performance and is both complete and accurate. It is possible for such material to be misread or to mislead potential LPs, particularly in view of changing circumstances for the GP or if there is a selective presentation of material.

Recommendation

Information with respect to the track record should not be presented on the basis of selective or incomplete data that is unrepresentative or misleading. The basis of all such statements should be fully disclosed in the fund documents. In particular, the period to which any track record information relates and any unusual factors that might influence the returns presented should be disclosed. Gross and net track record information should be calculated and compiled in accordance with the valuation and accounting standards appropriate for the fund's jurisdiction. Any use of benchmarks must be appropriate, consistent and clearly defined.

The fundraising team should ensure that when there is any material change that affects such information prior to final closing, it is disclosed to all LPs.

Track record information may be confidential (for example, to previous employers or portfolio companies) and the fundraising team should ensure that appropriate consent is obtained before it is used.

3.2.10. Forecasts

Question

Should the fundraising team make forecasts?

Explanation

The fundraising team may wish to make forecasts regarding likely performance in the fund's chosen sectors, target IRR and money multiple. However, it is very easy for such material to be misread or to mislead potential LPs, particularly in view of changing circumstances or if there is a selective presentation of material.

Recommendation

Forecasts are not required by law or regulation in institutional products/private placements and are therefore not a typical feature of the fund documents. The making of forecasts within the fund documents is ultimately a business and economic decision of the GP and its fundraising team when marketing the specific product.

If the GP and its fundraising team decide to include forecasts in an offering document, such forecasts must not be made on the basis of data that is unrepresentative, misleading or incomplete. Further, the relevant data, the assumptions and the approach taken to produce the forecasts should be fully disclosed in the fund documents.

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3.2.11. Time period for fundraising

Question

Is there any specific period during which fundraising must be completed?

Explanation

It is important that fundraising does not continue indefinitely, as this can prevent the GP from implementing the fund's investment strategy, while resources continue to be committed to marketing. There may also be time limits imposed by certain laws and regulations.

Between first and final closing a GP may make investments for the fund. Should this period become extended any portfolio created has a greater potential to change in value, raising the question of fairness in the division of gains and losses between first and the following close investors. There may also be tax implications from such value changes.

Recommendation

The fundraising team and the GP should ensure that fundraising is completed within a reasonable time after first closing of the fund. Market terms typically dictate that a final close should take place within a prescribed period of the first close, unless changed by LPs' consent.

Consideration should be given to levying an equalising interest payment from LPs who commit to the fund after the first closing to reflect the cost of money for LPs committing at an earlier stage of the fundraising process. The purpose of this is so that all LPs can be treated as if they had committed at the first closing. The equalising payments are generally credited pro rata among the existing LPs and not treated as an asset of the fund.

If the fund makes investments between the first and final closing, consideration should be given to how to allocate any gain or loss during that period and any resulting tax implications that might arise.

When making investments on behalf of the fund, the GP should implement the fund's investment policy with due skill, care and diligence and in accordance with the agreements the GP has made with the LPs in the fund.

A GP should be mindful of the impact of the conduct of its business and should give due consideration to material risks and opportunities associated with ESG and potential other responsible investment factors throughout the period of its investment and more generally throughout the life of the fund.

3.3.1. Due diligence

Question

What due diligence should be done by the GP when evaluating an investment for the fund and to what level of detail?

Explanation

The due diligence process undertaken by the GP prior to making an investment in a portfolio company is vital. The information acquired during the process, together with the GP's own knowledge and expertise, will form the basis of any investment decision.

The due diligence process will investigate a wide range of aspects of the target company's business including commercial, market, financial, tax, legal, regulatory, pensions, insurance, information technology, intellectual property, environmental, social and governance aspects and management capability. The objective will be to gain a detailed understanding of the prospects for the target company, evaluating the risks and issues it is facing or may have to face in the future that may play a part in the GP's investment decision and the ultimate success of the portfolio company over the projected investment period. From this, an assessment will be made of the potential for value creation and ultimately exit opportunities from the investment for the fund.

In certain circumstances, a GP may face time constraints on the execution of an investment. These can arise from the specific bidding environment of the transaction or the condition of the portfolio company in the case of a turnaround or distressed investment. Planning and prioritisation will be needed in these circumstances to ensure the GP has an adequate understanding of the opportunity to make its decision.

Recommendation

A GP should seek sufficient information to allow it to properly evaluate the investment opportunity being proposed and to establish the value of the target company. The information sought should (within the confines of what is practicable in the circumstances) address all appropriate issues (which may include the financial position of the target company, the experience and ability of its management team, the sector(s) and geography(ies) in which the target company operates, the potential to exploit any technology or research being developed by the target company, possible scientific proof of any important concept, protection of important intellectual property rights, pension liabilities, relevant ESG factors, litigation risks and insurance coverage).

The due diligence process should also include testing the assumptions upon which business plans are based and objectively evaluating the risks that may arise from investing and the potential return on investment.

Other appropriate checks, as required by LPs, regulators and other stakeholders should be carried out. This should include taking steps to be satisfied that the transaction does not facilitate money laundering, and to ensure that the investment complies with anti-corruption or anti-bribery regulations and relevant sanctions regimes.

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3.3.2. Approach to responsible investment

Question

How should a GP approach responsible investment risks and opportunities?

Explanation

A GP should be mindful of the risks posed and opportunities presented to its portfolio companies by ESG factors. The success of an investment may be impacted not only by its financial performance but also by other performance criteria. A GP needs also to be mindful of its own LPs' approaches to responsible investment and to seek to comply with their requirements, which may include expectations in relation to reporting on responsible investment factors in the investment and ownership processes and in some cases exclusion from investing in certain sectors.

Examples of some of the practical arrangements for achieving integration of responsible investment include:

- using ESG information requests/questionnaires for the portfolio company, an example of this is the ESG DDQ for Private Equity Investors and their Portfolio Companies as published by Invest Europe in 2016;
- using a standardised ESG investment checklist and formally addressing ESG factors in the investment process;
- including ESG site visits during the due diligence and ownership phase;
- including a dedicated ESG section in investment proposals.

Recommendation

GPs should integrate consideration of responsible investment risks and opportunities into their due diligence and investment approval processes and keep their investment documents and processes under periodic review.

Any staff training needs on responsible investment matters should be identified, addressed and kept under regular review. Evaluation of responsible investment matters should not be limited to legal compliance, but could also include any additional standards and practices that could materially impact an investment from an ESG perspective; potential future regulation and marketplace factors such as existing or emerging voluntary standards; consumer expectations and client requirements; and broader issues that could have a reputational impact. It is also important that ESG risks and opportunities are considered across portfolio companies' value chains.

Where the GP has identified ESG risks and opportunities that are deemed potentially material to the success of the investment or are particular focus areas of LPs, the GP should ensure that practices are developed to mitigate associated risks and pursue opportunities. These practices should also be included in post-investment action plans. The implementation and effectiveness of these practices should be monitored as appropriate, and therefore the GP should consider how it will obtain relevant ESG data from the portfolio companies. Noting that the ESG context could evolve, the GP should undertake to regularly update its responsible investment risk/ opportunity analysis and revise, remove or add governance and monitoring frameworks as appropriate.

A GP that has created governance structures and due diligence processes for responsible investment factors should report to LPs on its findings on a suitably regular basis. The GP may also choose to send unsolicited reports on responsible investment factors and performance to all LPs, or report following a significant ESG incident.

3.3.3. Investment decision

Question

How should a decision to invest in a portfolio company be reached by a GP?

Explanation

Any decision by a GP to make an investment involves an appraisal of the opportunity and an evaluation of the risks versus the rewards of the opportunity. The information on which this decision will be based will usually have been gathered and critically appraised within the team of executives working on the transaction during the due diligence phase. The quantity of such information, however, will normally be so great that it will need to be summarised before it is presented to the Investment Committee or other decision-making body of the GP that ultimately decides whether or not to make an investment.

Undertaking a successful due diligence exercise that confirms the validity of the underlying assumptions of a business plan will not generally be sufficient in itself. What is also required is the experience of the senior executives of a GP to add value to the due diligence exercise by critically evaluating the information collected by applying their depth of business and investment experience.

The investment proposal is an important document; not only does it provide a written record of the information considered in making an investment decision, but it will typically contain the core investment thesis that will continue to provide the yardstick by which the success of an investment will be judged during its regular review by the GP.

Recommendation

The results of the due diligence exercise and the GP's senior executives' recommendations should be distilled into a comprehensive written investment proposal, which accurately reflects the potential of the target company, addressing a range of both financial and non-financial factors. Amongst these factors is the ability of the GP to execute and manage the investment. As part of this process, consideration should be given as to whether the proposed investment fits the investment criteria and complies with the investment restrictions in the fund documents.

Investment decisions should be made by suitably senior and experienced personnel of the GP; normally these individuals will form an Investment Committee. If there are any significant changes to an investment proposal, further review, evaluation and additional approvals may be required.

It is good practice to use the underlying reports from which the investment proposal is drawn to form an important set of source documents for strategic review and assessment of the performance of the portfolio company.

3.3.4. Structuring investments

Question

What factors should the GP consider when structuring and negotiating an investment?

Explanation

Investments by funds can be structured in many ways. In some cases the fund may be a passive minority investor in a portfolio company, while in others the fund may obtain substantial or indeed full control over the portfolio company. In determining how the investments should be structured, consideration should be given to the jurisdiction in which the investment is to be made, the investment strategy of the fund and whether the investment is to be the acquisition of a minority or majority interest.

The GP may also need to carefully consider its position and strategy when investing alongside other parties (e.g. as part of a syndicate) and whether it owes any duties or obligations to others as a result.

It is possible for the structure of an investment to impose liabilities and responsibilities on the fund and any such liabilities will typically be thoroughly investigated with the help of the fund's lawyers.

Recommendation

The GP should structure and negotiate each investment made by the fund in such a way so as to ensure that it meets both the obligations to and the interests of the fund. This will often involve the engagement of specialised, local professional services firms to help with and to advise on legal, tax and regulatory matters.

When structuring any investment the GP should take steps to consider the tax, regulatory (such as US ERISA) and other consequences for the fund and its LPs of making the investment.

3.3.5. Responsibilities to other shareholders in the same or other classes of shares and to bondholders

Question

How should the fund conduct itself in relation to other investors in the portfolio company?

Explanation

In some jurisdictions, it is common practice in the industry for different classes of investors to acquire different types of security according to their relative position in the transaction, the nature and level of the risk they are taking on and the relative value they are bringing to the investment.

The returns for each type of security, whether equity or debt, will typically vary depending on certain outcomes. It is therefore possible that conflicts may arise between holders of different classes of securities.

Recommendation

Whether as a shareholder in the portfolio company, or through provisions agreed in the Investment Agreement, the fund has ownership responsibilities and should exercise those responsibilities proactively and in a way that continually supports the value of the fund's investment.

The negotiation of shareholder rights should be conducted openly and with clarity among all investors in the portfolio company.

Due consideration should be given in advance to potential areas of conflict and where conflict does arise, the resolution of that conflict should be conducted fairly and, to the extent possible, in such a way that the outcome does not impact the value of the portfolio company.

3.3.6. Investment Agreement

Question

What documents should constitute the Investment Agreement and what commercial terms will they address?

Explanation

There will be a large number of documents produced during the process of making an investment, for example shareholders' and investor rights' agreements, articles of association and loan agreements. These are collectively referred to in this Handbook as the Investment Agreement. The content of these documents will be influenced by many factors, for example local legal and regulatory requirements and tax and structural considerations, such as whether a minority or majority interest is to be acquired.

The documents will need to fully reflect all aspects of the agreed transaction and take account of the commercial terms that the GP has agreed with other shareholders (if any) and the portfolio company. It is common practice to set out in the Investment

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Agreement the roles of the GP, other parties and the management team of the portfolio company in relation to the governance and running of the portfolio company.

These commercial terms may address the following matters, although this varies depending on whether a minority or majority interest in the portfolio company is acquired:

- ownership and control of the portfolio company post-investment;
- share transfers (mandatory, permitted and prohibited) and pre-emption rights;
- incentives for the management team of the portfolio company and obligations imposed on them;
- division of managerial responsibilities following the investment;
- warranties, representations and indemnities;
- investment performance milestones and any future obligations to provide further funding;
- board and shareholder consents needed before specified actions are taken;
- agreements with lenders to the portfolio company and inter-creditor arrangements;
- quality, quantity and frequency of information that is to be provided;
- exit provisions such as tag-along or drag-along rights and/or compulsory sale provisions to resolve any deadlock regarding a sale, and also order of priorities on a liquidation[7];
- the consideration of ESG risks and opportunities[8].

There is a strong likelihood that local legal advice will be required in the drafting of the various documents constituting the Investment Agreement.

Recommendation

As explained above, a variety of matters should be considered when negotiating an investment to ensure that the legal documents reflect the commercial terms negotiated by the GP. The GP should consider using local legal advice on the appropriate manner for recording what has been agreed.

3.3.7. GP's consent to portfolio company actions and board appointments

Question

Through what mechanisms should the GP seek to ensure that it is able, on behalf of the fund, to influence a portfolio company?

7 (i) a tag-along is a right for a shareholder to insist that his/her shares are bought on the same terms by the same purchaser as another shareholder who is selling his/her shares; and (ii) a drag-along right entitles a selling shareholder, such as a private equity investor, to require the remaining shareholders to sell their shares to a third-party purchaser on the same terms.

8 Typically management agrees to uphold ESG practices in accordance with local legislative requirements and industry good practice (including adherence to any voluntary ESG standards) and report on performance regularly. Where no local ESG framework has been implemented, management often agrees to work with the GP to identify and address any ESG risks and opportunities through implementation of a practical ESG framework.

Explanation

There are a number of different ways in which the GP can ensure that the fund can influence a portfolio company. Which of these will be appropriate will depend on a number of factors (including the size of the fund's investment and the level of influence that the GP considers to be appropriate). If the fund holds a majority shareholding in the portfolio company, it will have the ability, as a matter of company law, to determine the outcome of matters that are reserved to shareholders. The GP may also seek to specify certain additional rights in the portfolio company's constitutional documents and agree contractual rights in the Investment Agreement it enters into with the shareholders of the portfolio company, such as (i) requiring certain strategic and significant operational matters to be subject to prior investor/shareholder consent; and (ii) the ability to make board appointments.

(i) Investor consents

In some jurisdictions, it is common in the Investment Agreement between the fund and the portfolio company for certain actions of the portfolio company to be subject to the prior consent of the GP on behalf of the fund in its capacity as shareholder. These are commonly called "investor consents".

Where the GP has appointed individuals to the portfolio company's decision-making body, their consent may also be required before certain action can be undertaken by the portfolio company, although they will often be under a duty to act in the best interests of the portfolio company, rather than the fund.

The availability and level of investor consents that are deemed appropriate will vary depending on the size and nature of the fund's investment.

(ii) Board appointments

The GP will typically also consider making:

- appointments to the board or other decision-making bodies of the portfolio company (see further section 3.4.5. "Board structure");
- appointments of persons to internal committees of the portfolio company (e.g. advisory committees or the remuneration or audit committees, where relevant).

It is important to note that individuals appointed to sit on the board of the portfolio company by the GP may have responsibilities both towards the GP who has arranged their appointment, as well as to the portfolio company and all its shareholders as a director (as well as to the company's creditors in certain circumstances). Typically, such individuals, as directors of the portfolio company, will be required to act in the best interests of the portfolio company. The portfolio company's interests may conflict with those of the fund and in such circumstances the director must act in accordance with the relevant legal rules applying to directors with conflicts of interest (which may be determined in part by the company's bye-laws or articles of association) and in accordance with the duties owed to the portfolio company.

Recommendation

In relation to investor consents, the GP should consider requiring the portfolio company to obtain investor consents for governance, corporate, financial and accounting, business and other key matters. The list of matters will vary depending on the relevant jurisdiction, the size of investment, the type of organisation and the shareholding held, but the following should be considered:

- significant developments in the business (e.g. capital expenditure, new issues of capital, acquisitions or disposals of significant divisions, businesses or assets including real estate, changes to the portfolio company's constitution);
- major outsourcing contracts;
- changes in the capital structure and borrowing arrangements;
- changes in leases or other material contracts;
- material litigation claims;
- changes of control, acquisition or disposal of shares by other shareholders;
- adoption of the portfolio company's audited accounts;
- making any dividends or distributions;
- adoption of a new business plan;
- changes to the portfolio company's key management or their remuneration;
- adoption of or changes to the communication policy;
- developments in the financial or other performance criteria of the portfolio company which will materially change the nature of the business in which the fund has invested;
- winding up or dissolving the portfolio company;
- any transactions between portfolio company and shareholder, portfolio company management or other related parties;
- any ESG issue that could materially impact the investment or the risk profile of the investment.

Investor consents, while needing to be comprehensive in scope, must not be so wide-ranging as to restrict the management team's ability to run the portfolio company or take up excessive amounts of the GP's time. The list is not exhaustive; rather it gives an indication of some typical matters which are subject to investor consent.

When considering the advantages to the fund of taking any control rights, the GP should also consider possible liabilities or restrictions imposed by law on those exercising certain types of control.

3.3.8. The portfolio company's corporate strategy

Question

To what extent is the GP on behalf of the fund responsible for the definition and execution of the portfolio company's corporate strategy?

Explanation

At the time of investment by a fund, the investment decision is normally taken in support of a specific strategy, business plan and management team. Frequently, through the negotiation process leading up to investment by the fund, the GP will have had significant input in determining the target's future corporate strategy. Over a period of time, this business strategy may need to be refined and amended.

Recommendation

The degree of activism of the GP will vary according to the nature and structure of the investment made, the size of its ownership stake and the jurisdiction in which the portfolio company is located. The GP should therefore ensure its level of involvement is suitable relative to the circumstances of a particular portfolio company and the fund's ownership strategy/policy.

Guidance on the application of the Code
Guidance for Placement Advisers
Investor Reporting Guidelines
IPEV Valuation Guidelines

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Consistent with these considerations, the GP should be an active participant through its board representation or, where permitted by the relevant company law in a particular jurisdiction, through the exercise of shareholder voting or contractual rights in the setting of the portfolio company's strategy. The responsibility for execution of strategy sits with the board and management team of the portfolio company. The GP should ensure that it remains informed of the progress being made towards achievement of the strategy. Where appropriate, the GP, once again through its board representation or through the exercise of shareholder voting or contractual rights, where so permitted, should be available to advise and assist where the strategy needs to be refined and amended.

Further, the GP should ensure that the portfolio company understands the importance of having the right mechanisms and processes in place for responsible, efficient and appropriate decision-making and effective corporate governance.

3.3.9. Co-operation with co-investors and syndicate partners

Question

What relationship should the GP have with co-investors and other members of a syndicate in which the fund participates?

Explanation

Where an investment has been syndicated or there are co-investors, a GP may not be able to control an investment and may have to co-operate with other shareholders in order to achieve defined goals and build a consensus as to appropriate actions to be taken.

Recommendation

The GP should act in the interests of the fund and any other clients investing in the relevant portfolio company and identify and manage any conflicts of interest that may arise between them. Wherever possible, the GP should only accept an obligation in favour of another investor if it would be in the fund's interests to have some agreement or understanding with the investor.

3.3.10. Co-investment and parallel investment by the GP and its executives

Question

What issues should the GP consider regarding co-investment and parallel investment by itself, its associates or its executives?

Explanation

Where the fund documents permit the GP, its associates or its executives to co-invest or make parallel investments alongside the fund, there is potential to create a conflict of interest for the GP.

Recommendation

Subject to what is provided in the fund documents, details of co-investment arrangements should be disclosed to the fund's LPs. To avoid the potential of prejudice to the fund's interest, it is recommended that such documents only permit co-investment or parallel investment by the GP, its associates or its executives where investment and divestment is exercised on a pro-rata basis with the fund, in the same securities, at the same time and on the same investment terms. If this recommendation is not followed, it is particularly important that the operation of the co-investment arrangements is subject to the GP and fund's conflict of interest procedures and should be disclosed to LPs and documented.

3.3.11. Co-investment and parallel investments by LPs and other third parties

Question

What issues should the GP consider regarding co-investment and parallel investments by LP co-investors and other third parties?

Explanation

In some circumstances, LP co-investors in the fund or other third parties with whom the GP has some relationship may wish to invest directly into a company that the GP is considering investing in on behalf of the fund. When a co-investment is more successful than the fund as a whole, the fund's LPs may argue that a greater proportion of the investment should have been allocated to the fund. On the other hand, such syndications may allow funds to invest in a target company otherwise beyond their reach, while still complying with any diversification restrictions in the fund documents.

Recommendation

The GP should determine the fund's appetite for each investment and only after should co-investment and/or parallel investments be considered (apart from in the case of pre-arranged and disclosed co-investment arrangements or where the LP co-investor lends special expertise or other value to the transaction).

Where co-investment opportunities are anticipated during the life of the fund, detailed and clear contractual terms with regard to co-investments and direct investments are essential in the fund's documents and details of co-investment arrangements, both for the fund and individual deals, should be disclosed to the fund's LPs.

3.4 MANAGEMENT OF AN INVESTMENT

When a conflict of interest arises, it should be resolved in accordance with the GP's conflict of interest resolution procedures. LPs may place themselves in conflict of interest situations where they engage in co-investments. The conflict may be more problematic where the LP also sits on the LPAC. The criteria for invitations for LPs to co-invest present another potential source of conflicts of interest. The parameters of any co-investment process should be clearly set out to all LPs in advance.

3.3.12. Divestment planning

Question

How should the GP plan for the disposal of an investment?

Explanation

It is important to ensure that before an investment is made the key shareholders agree a common strategy for realising the investment.

It will not always be possible to achieve this strategy, for example if the investment fails to perform and/or purchasers decline to come forward, but it is desirable to agree an exit strategy in advance.

Recommendation

In initially considering the investment, exit considerations should form part of the discussions and provisions negotiated to cover both likely and less likely situations. These considerations should be reflected in the overall investment recommendations.

The divestment or exit process should be discussed with co-investors, other syndicate members and the management team of the portfolio company before the initial investment. The GP should seek to ensure that, on investment, it negotiates suitable mechanisms to ensure that any deadlock regarding divestment of an investment can be resolved in a manner appropriate for the fund.

Good management of an investment is essential if a fund is to maximise its returns. Value in an investment can be wasted and opportunities missed if this part of the investment process is not undertaken properly. The private equity model of active investment management and long-term value creation requires that the conventional rights and entitlements associated with share ownership are accompanied by responsibilities towards portfolio companies and towards LPs in the funds invested in those portfolio companies.

Much of the regulatory activity directed at the industry in recent years has been driven by a public perception of the industry as one pursuing short-term rather than long-term gain. Regulatory initiatives seek to correct this perceived imbalance both indirectly (through tax and remuneration regulation) and directly through so-called "asset stripping" regulation. Careful planning and local insight will be needed in order to comply with regulatory developments varying considerably from one jurisdiction to another.

The following sections on investment monitoring and exercise of GP consents reflect the duties of the GP towards the LPs invested in its funds to both effectively monitor and manage the investments. The section on board participation reflects the duties of directors appointed by the GP to serve the interests of the portfolio companies.

3.4.1. Investment monitoring

Question

How should the GP monitor an investment made by the fund?

Explanation

Most jurisdictions have legislative obligations regarding information to be provided to stakeholders of portfolio companies. However, it is common practice for funds that invest in portfolio companies to require more frequent and detailed information than required by legislation. In particular, the GP may require more frequent and detailed quantitative and qualitative information regarding the portfolio company. Reporting should reflect the GP's desire to impact strategy and value creation as well as enabling compliance with the Invest Europe Investor Reporting Guidelines and with any other specific reporting obligations to the LPs in the fund, or to regulators, as applicable. Such requirements may also depend on the GP's ownership stake.

Typically, key performance indicators (KPIs) are developed that allow portfolio company management and the GP to carefully monitor company performance.

This investment monitoring function and information flow should enable the GP to confirm that the investment is progressing in accordance with the relevant business plan and the GP's investment thesis. It should also provide sufficient information to identify any failures to meet targets or milestones and form the basis of remedial plans where necessary.

Recommendation

The GP should ensure that it dedicates sufficient time and resources, including senior and experienced resources, to monitoring the investments of the fund and apportions these resources and responsibilities appropriately both between funds and individual investments.

3.4 MANAGEMENT OF AN INVESTMENT

At the time of the investment, the GP should agree with the portfolio company's management and incorporate in the Investment Agreements, the financial and non-financial reporting requirements (including content, frequency and timing) that take into account its own reporting obligations, its ability to perform its responsibilities on behalf of the fund as shareholder and the efficient and effective use of resources within the portfolio company.

The GP should prepare regular written analyses of investments, which should be reviewed by senior and experienced executives of the GP. The written analyses could address performance of the portfolio company against the agreed investment thesis and its targets and milestones detailed in the business plan for the portfolio company. They could also note significant developments since the last review and those likely to occur in the near term, provide information on any changes to personnel and the financial and non-financial status of the portfolio company. Non-financial information should include environmental, social and governance KPIs. Recommendations should be made on any remedial action that the GP should consider taking in order to ensure the portfolio company continues to achieve the financial and non-financial targets set.

Question

What are the responsibilities of the GP in relation to performance information of portfolio companies?

Explanation

Some portfolio company information will be confidential; the GP should be aware of this, and more generally the need to treat corporate information with due consideration to commercial sensitivity and the requirements of the portfolio company's other stakeholders.

Recommendation

The GP must not disclose any information that it may receive on behalf of the fund from a portfolio company in a manner that may breach any duty of confidentiality that it may owe to the portfolio company. Therefore, the GP needs to agree the rights it needs with the portfolio company and in particular should seek to agree appropriate rights to disclose information to the fund's LPs so that they may, in turn, monitor their investments in the fund and comply with their own reporting requirements including, if applicable, to regulators. Also, the GP should ensure that its own LPs are bound by appropriate confidentiality obligations with respect to the confidential information, which they receive.

3.4.2. Environmental factors

Question

What environmental factors should the GP consider in relation to the management of the fund's portfolio companies?

Explanation

Generally, GPs should support a prudent and sustainable approach to environmental risks and opportunities that can affect their portfolio companies. Such risks could concern a range of factors including resource use/depletion, water scarcity, waste production and disposal; emissions to air, land and water; energy use, cost of carbon and climate change; biodiversity and habitat conservation. Conversely, environmental opportunities may include energy (or other resource) efficiencies, waste reduction or the development of new products with positive environmental attributes (e.g. using timber labelled as being from sustainably managed forests).

GPs are generally expected to influence the management of environmental risk and opportunity factors in portfolio companies, so as to reduce risk and/or create value, with a view to long-term sustainable change.

Recommendation

Management of investments should include an ongoing evaluation of the likely impact of portfolio companies, their products and their supply chains on the environment. Such evaluation should take into account the efficacy of environmental risk management policies and procedures. For example, leading companies institute full environmental management systems, certified to ISO14001. Consideration should also be given as to the likely impact of environmental factors on the portfolio companies and their supply chains (e.g. climate change, extreme weather events, etc.).

GPs should recommend to the boards of portfolio companies, pursuant to shareholder documents, to identify and take material environmental factors into account in the formulation of the portfolio company's business plan.

3.4.3. Social factors

Question

What social factors would be applicable to the conduct of the fund's portfolio companies?

Explanation

Generally, factors which affect the workforce, customers, suppliers and communities of a portfolio company should be evaluated at board level. Social factors can include stakeholder dialogue and human rights issues, such as the observance of core labour standards in areas including health and safety, child labour, illegal or forced labour, employment of migrant labour, trade union rights and discrimination in the labour market.

Managed badly, social factors can give rise to risks to brand and reputation (e.g. a key supplier attracting negative publicity for poor labour practices), to the attraction and retention of high quality staff, and to productivity (e.g. strikes at production facilities). There may also be legal consequences for the company and its directors.

Conversely, when managed well, social factors can add real value. Examples include establishing a reputation as an "employer of choice" through progressive employment policies and practices (thereby reducing recruitment costs and improving productivity), maintaining a "social licence to operate" (through strong community relations), and ensuring continuity of supply (through effective supplier selection, engagement and auditing).

GPs are generally expected to influence the management of social risk and opportunity factors in portfolio companies, so as to reduce risk and/or create value, with a view to long-term sustainable change.

Recommendation

Management of investments should include an ongoing evaluation of the likely impact of social factors on the businesses (e.g. availability/quality of workers, conduct of staff or business partners, trends in customer attitudes, etc.) as well as the social impact of products (e.g. responsible marketing, or health and safety concerns) or operations. Consideration should be given to the completeness and effectiveness of any existing socially-related policies and procedures, to manage risks and leverage opportunities and to the need for, and implications of change.

GPs should recommend to the boards of portfolio companies to identify and take material social factors into account in the formulation of the portfolio company's business plan.

Human rights (covering workplace and supply chain issues – see Explanation) are likely to be an integral part of the social factors and board level discussions may include development of strategies to prevent direct and indirect involvement in human rights violations. Depending on the size and nature of the business, a portfolio company should also consider integrating its management of social factors into a full corporate sustainability programme and publishing progress reports on a regular basis, as part of a defined external stakeholder engagement strategy. A GP should ensure that such items are put on the agenda for board discussion where appropriate.

3.4.4. Governance factors

Question

What governance factors are applicable at the portfolio company for the conduct of a fund's business?

Explanation

One of the key areas of due diligence that should be completed by a GP prior to investment is corporate governance at the prospective portfolio company. The corporate governance systems, processes and controls applied by the senior management team at the company will reveal much about the effective running of the business to be invested in. A business with effective corporate governance in place will provide a strong platform for the rapid implementation of value building initiatives. A business with weak, ineffective corporate governance will make a higher risk investment but is likely to reap considerable benefit from the implementation of robust governance systems and processes that are suitable for the business.

Effective corporate governance, once installed, should support the decision-making process and follow-through within the organisation and the alignment of interests across the stakeholders in the business including management, employees, the GP and investors in the fund. Such alignment of interest is also part of a responsible investment framework.

A portfolio company is likely to be provided with guidance on governance requirements by the GP at initial investment. In some cases, the implementation of specific requirements will be a condition of closing the transaction. The management of a portfolio company can be strongly influenced by the attitude of the GP to board effectiveness, controls, checks and balances.

Ensuring the GP's governance objectives are achieved, whilst preserving the autonomy of the portfolio company board to drive business growth and not hamper it with bureaucratic processes and controls, is an important balance to achieve and to be able to demonstrate at the point at which the business is sold.

Recommendation

If not already in place, the GP should typically ensure that each portfolio company has appropriate governance structures to safeguard against fraud, bribery, corruption and other breaches of legal rules applying to the company and to ensure internal financial control, quality assurance, risk and conflict management and transparent reporting and communication.

To ensure that portfolio companies are applying appropriate good governance practices and standards, the GP should ensure it remains up to date and familiar with legal rules, good practice and guidance in the respective countries and industries in which its portfolio companies are based. Typically, the GP should periodically review the adequacy of its practices and standards.

This can be done in a number of ways, for example through a suitable law firm or adviser which can ensure that relevant Codes and Standards are understood, particularly by those individuals who will be representing the GP on the board of the portfolio company. It can also be achieved by ensuring diverse and experienced executives are members of the board or respective supervisory committees of the portfolio company, who can demonstrate a good understanding of and track record in applying the required governance standards and practices.

Poorly structured incentivisation packages can adversely affect governance. Therefore, the GP should consider the incentivisation packages in light of their impact on alignment with the objectives of long-term growth and good corporate governance.

3.4 MANAGEMENT OF AN INVESTMENT

Where the GP has identified risks and opportunities (including ESG risks and opportunities) that are deemed material to the success of the investment, the GP should ensure that practices are developed to mitigate risks and pursue opportunities. The implementation and effectiveness of these practices should be monitored and reported on as appropriate. The GP should regularly review the responsible investment risk/opportunity analysis and revise, remove or add policies, procedures and tools for implementation as appropriate (see also section 3.3.2.).

Finally, it is important that the GP also demonstrates to its wider stakeholder community sound ESG practices and standards that are both appropriate and proportionate to its own business.

3.4.5. Board structure

Question

How should the GP act in relation to the board of the portfolio company?

Explanation

Dependent on the level of ownership, the GP will typically appoint one or more experienced members of its own staff or representatives to the board of the portfolio company. Appointees of the GP will normally have in-depth experience of the sector and will often have been involved in the original due diligence and review of the investment.

Depending on jurisdiction, a company may have a single or two-tier board structure. There are many variations in the overall composition of boards, but in relation to non-executive members of a board, these may include some/all of the following: one or more single directors who are members/employees/representatives of the GP of the fund; an independent non-executive chairman; and/or, an independent non-executive board member. These non-executive members of the board may be selected because they have specific and appropriate knowledge and insight.

Recommendation

The GP should ensure that the board is structured and appointments are made to ensure relevant experience and diversity, and are made in the best interests of the portfolio company. The relationship between the board and the management of the portfolio company should be clear and supported by appropriate documentation of roles and responsibilities.

Question

What is the best size for a board?

Explanation

There are a number of think tanks and organisations offering best practice guidance on the office of director and on the governance of companies.

The minimum and maximum size of the board is usually stipulated in the Investment Agreement reflecting the specific situation of the company, the governance goals of the owners and any local legal requirements.

Thinking has evolved on optimum board size. Factors to bear in mind when considering board composition include: the skills required to run the business; the interests of the shareholders and their desire for active participation in, as well as efficiency of, decision-making; the governance and logistics and cost implications of convening a large group of people frequently; and the need for balanced decision-making through diversity of opinion.

Recommendation

No number can be stipulated for optimum board size but the board should periodically review its composition and its success and adjust its size accordingly.

Question

Is a diversity policy necessary?

Explanation

Boards function as decision-making and review forums involving people with differing skills and approaches. Diversity of skills and styles leads to better balanced and informed decision-making.

Recommendation

In reviewing board composition, the board should be aware of the benefit of diversity in its selection as well as any applicable regulatory/legal requirements regarding Board diversity. A policy need not be codified to be effective, but it may be helpful to have a written diversity policy to further the selection process.

Question

What are the key components of the portfolio company's strategy that are the responsibility of the board?

Explanation

A portfolio company's strategy consists of a number of core components which are the responsibility of the board. First and foremost is the development of long-term value creation through sources of current and future revenue. Of importance here are the efficient, effective and sustainable delivery of appealing products and services, the development of competitive future products and services, attracting and retaining talent and management capacity, the effective use of available resources (including financial resources) and obtaining future financial resources to help grow the business effectively and efficiently.

Recommendation

A key component of the industry's investment and ownership model is to ensure that the interests of the members of the portfolio company board are aligned. All members of the board should seek to understand, support and further develop the business strategy of the portfolio company and should challenge that strategy in the context of their individual understanding of market, product, service, financial and societal developments as appropriate. The corporate governance structure implemented by the board should support the strategy. The GP representatives also bring additional value over and above their own personal knowledge, skills and experience, having the wealth of knowledge from across the GP firm to draw upon for the benefit of the portfolio company when required.

Question

What is the board's role in relation to the identification, assessment and management of the risks and opportunities of the portfolio company?

Explanation

A key element of a portfolio company's business strategy execution is the identification and assessment of risk and opportunity, including decisions on what levels of risk are acceptable, what risks are associated with each opportunity, how such risks can be mitigated and controlled and how to manage the business accordingly.

The components of risk management include the clear communication of the values of the portfolio company and its appetite for risk. For example, when pursuing new business opportunities, the allocation of roles and responsibilities and the design and implementation of policies and procedures relating to the identification, control and management of risk, and the measurement of and timely reporting on the impact of risk on performance.

Recommendation

All members of the board are ultimately responsible for, and should actively participate in, risk and opportunity identification, assessment and management across all business areas, including the review of financial and non-financial (e.g. ESG) factors.

This includes ensuring that the management of the portfolio company establishes effective policies and procedures that adequately address the identification and control of risk, including legal risks. Members of the board should actively and regularly seek assurance that risk management procedures are in place and are operating effectively.

Question

How should the board determine what constitutes a reasonable structure and level of remuneration for portfolio company employees and management?

Explanation

The structure and remuneration of portfolio company executives and senior management should provide an incentive for excellent long-term performance, reward for sustainable financial and non-financial results and ethical conduct. Balancing remuneration in the context of the relevant industry, the expertise and contribution of individuals and the long-term needs of the business are key roles of the board. In many cases, consideration of these factors will be led by a remuneration committee.

Recommendation

Frequently in private equity investments, the portfolio company executives will have built in incentivisation at the time that the original investment by the fund is structured and executed. The board's (or remuneration committee's) role should therefore be more appropriately focused on ensuring that existing incentives continue to be appropriate for both the business and the shareholders as the circumstances of the business change over time.

The board should determine the appropriate levels of remuneration of portfolio company executives and regularly evaluate and review remuneration levels and, where appropriate, introduce changes thereto. Conflicts of interest in establishing or reviewing remuneration levels for board members should be avoided wherever possible and managed openly and constructively in all cases.

3.4.6 Board membership

Question

What does being a board member entail?

Explanation

An overriding duty of loyalty to the company applies to each director, whether executive or non-executive and whether or not appointed by a particular shareholder, although the precise legal responsibilities vary according to the type of company and jurisdiction.

A director is expected to devote such time and resources as is reasonably necessary to carry out his/her duties as a director. Attendance at and being well prepared for board meetings should be assumed. Directors with particular skills may be asked to serve on additional board committees (e.g. directors with accountancy training serving on audit committees).

Recommendation

A director should be prepared to invest time in his/her role as a director to understand the needs of the company and to participate in review and decision-making affecting the business.

The GP should ensure that its appointee(s) to the board fully understand their responsibilities to the GP and their legal duties to the portfolio company as a member of the board. GPs and the individual directors should familiarise themselves with local law requirements in this regard.

3.4 MANAGEMENT OF AN INVESTMENT

Question

Whose interests do the GP-appointed director(s) look after on a board?

Explanation

Whatever the means of appointment, directors do not serve the interests of one particular shareholder but act in the interests of the portfolio company. The position of director is a fiduciary one. A director does not act as the representative or advocate of the body which appointed them. Fiduciary duties generally are summarised as a duty of loyalty to the company, a duty to avoid and disclose conflicts, duties of confidentiality, a duty to act in good faith, to exercise care, skill and diligence and to act with integrity.

Recommendation

A GP-appointed director should always be aware that he/she must act in the interests of the portfolio company and all its shareholders. The individual may find that they are in a personal position of conflict, owing duties both to the GP and the portfolio company. Whilst there is normally an alignment of interest, where conflicts arise, the GP may need to excuse the director from being involved in the GP's decisions relating to the portfolio company, and/or the director may need to resign from the board of the portfolio company. The GP should ensure that its board appointee(s) clearly disclose any conflicts of interest with respect to their role as members of the board promptly when they arise, and comply with relevant legal rules and the policies and procedures established by the GP and/or the portfolio company.

Question

What skills does the GP-appointed director need to be a board member?

Explanation

Many skills are applicable to membership of a board of directors. The company may particularly need directors with industry experience, with legal, corporate finance or accounting experience, or with general management experience that are relevant for the company and/or the sector and geography it operates in. All these skills, plus the ability to evaluate risk, the ability to build consensus and demonstrate leadership and other skills, are likely to be needed by every company over time and are unlikely to be offered by one sole director.

Recommendation

The GP should encourage its board appointee(s) to seek appropriate support and training to enable them to carry out their duties as board members to the best of their abilities and in accordance with their legal duties and contractual commitments. The GP should seek to ensure that all appointees to the board are individuals of appropriate authority, skill and experience who can provide value and insight to the portfolio company. Also the ability to work collaboratively and openly with senior management and other directors is of great importance.

Question

What liabilities attach to board membership?

Explanation

The office of director is a position of responsibility and trust and no one should be forced into accepting the position. Some individuals may be unwilling to accept office because of the potential liabilities attaching to the position of director.

Depending on jurisdiction, directors may incur personal (including potentially criminal) liabilities in particular for failure to maintain company books and records; non-compliance with applicable tax, anti-trust, anti-corruption, health and safety, environmental and other laws; transactions not performed at arm's length; and/or in certain insolvency situations. Directors are generally entitled to expect indemnification from the company and from their appointing GP in the case of GP-appointed directors. Directors and Officers liability insurance (often called "D&O" insurance) may typically be purchased to address such risks.

Recommendation

Directors should ensure that the boards on which they serve obtain legal or other specialist advice for complex board decisions. The GP and portfolio company also procure adequate liability insurance is in place and commensurate with the specific circumstances.

Question

How many board seats should an individual accept?

Explanation

Someone with a track record of good performance as a board director may find themselves invited to join multiple boards. This may lead to the person having limited time to perform their duties fully.

Recommendation

A director should only accept the number of board seats that they can reasonably expect to perform effectively, taking into account unforeseen developments in companies and the need to participate not only in full board meetings but also in committees and to devote sufficient time to review board information.

3.4.7. Exercise of GP consents

Question

What factors should the GP take into account when evaluating shareholder consent issues in a portfolio company?

Explanation

The level of GP (investor) consents that are deemed appropriate will generally be agreed when negotiating the Investment Agreement. This is considered in section 3.3.7 "GP's consent to portfolio company actions and board appointments".

Normally, an investment will be structured in such a way that certain proposed actions by the portfolio company will require consent from shareholders, including the GP on behalf of the fund. These shareholder consents should be differentiated from consents required from members of the portfolio company's board where the GP has appointed one or more executives to that board.

Recommendation

The GP should ensure that when giving or withholding consent it acts in the best interests of the fund and in accordance with its policies. Executives who are on the board of a portfolio company normally have to act in the best interests of the portfolio company. It may therefore be advisable to have a different member of the GP staff or representative exercising shareholder consents.

3.4.8. Exercise of influence on responsible investment factors

Question

How should a GP exercise its influence with regard to responsible investment strategies, policies and practices in place at a portfolio company?

Explanation

A GP may be in a position of considerable influence as regards the development, implementation and monitoring of ESG strategies, policies and practices in place at portfolio companies.

The GP, ideally through the information produced and provided by the portfolio company, should be in a position to identify, monitor and support the mitigation of relevant risks and the recognition and pursuit of opportunities in responsible investment matters that can affect the portfolio company[9]. Where appropriate, the GP, through its board representation or through the exercise of shareholder voting or contractual rights, where so permitted, should be available to assist and advise the portfolio company on how to investigate and address the ESG factors that are relevant for the business. The GP should ensure that it remains informed of the progress being made towards achievement of ESG objectives.

These may manifest themselves in a wide variety of ways from the specification of and capital investment into a new production facility through to the criteria applied to potential add-on investment targets for the portfolio company.

9 For more information, please see the Invest Europe Responsible Investment Bibliography.

Recommendation

The GP should ensure that at portfolio company board and management level there is appropriate awareness and adequate knowledge of responsible investment matters relevant to the country and sector the portfolio company operates in, including familiarity with appropriate external guidance issued by national, supranational and private bodies.

The GP should ensure that responsible investment matters are discussed on a regular basis in board meetings.

A GP should aim to ensure its own and its portfolio companies' awareness and due consideration of responsible investment guidance and codes of conduct as applicable to the sectors and geographic regions in which each portfolio company operates are maintained.

3.4.9. Responsibilities in relation to other stakeholders

Question

To what extent does the GP have responsibilities in relation to other stakeholders?

Explanation

The nature of private equity investments is such that, in certain jurisdictions, it is not uncommon to operate with different classes of securities with different rights and obligations attached to them.

Additionally, all private equity investments will have a number of other stakeholders including, but not limited to, employees, customers, suppliers, government authorities, regulators, trade unions and the wider community.

3.4 MANAGEMENT OF AN INVESTMENT

Recommendation

The GP should act openly, honestly and with integrity, balancing the interests of the portfolio company, and the needs of effective decision-making with an informed understanding of the needs and information requirements of its other stakeholders.

Within this context, GPs should also note that applicable legal rules (including under the AIFMD) may require periodic and ad hoc reporting and disclosure to national competent authorities, portfolio companies and other shareholders in those companies.

3.4.10. Follow-on investments

Question

What provision should the GP make for follow-on investments?

Explanation

It may be necessary or desirable to make follow-on investments into a portfolio company (e.g. to fund expansion plans or to re-finance a poorly performing portfolio company).

The opportunity to make a follow-on investment in a successful portfolio company may give rise to a conflict of interest where the GP is managing more than one fund that has invested, or where the GP or its associates have invested directly in the portfolio company.

Recommendation

The fund's constitution should make provision for follow-on investments by the fund into a portfolio company. This may include allowing the GP to retain or recycle an appropriate amount of capital, to drawdown commitments on an as-needed basis, or to make appropriate follow-on investment(s) where necessary after the end of the investment period. How such follow-ons are dealt with is something that should be clearly set out in the fund documents.

Decisions to make such follow-on investments should be subjected to the same rigour and made in the same manner as the original decision to invest. These decisions should be supported by adequate written evidence that demonstrates a clear benefit to the fund in making the follow-on investment and that the decision is supported by the fund's policies.

Any conflict of interest that arises out of an opportunity to make a follow-on investment should be resolved in accordance with the GP's conflict of interest resolution procedures. Due to the inherent conflict, it is generally not advisable for follow-on investments to be made by a different fund from the fund which made the original investment (although it may be possible in certain cases on a fully transparent and agreed basis with robust safeguards).

3.4.11. Underperforming investments

Question

What steps should be taken when an investment fails to meet the targets established in its business plan?

Explanation

Unfortunately, not all investments will succeed, and while it may not be possible to save an investment made into a portfolio company with a fundamental structural problem, it may be possible to turn around a poor performance record or preserve value in an investment through:

- meeting with the management of the portfolio company to discuss performance and to agree strategies and tactics through which turnaround can be achieved;
- increasing the frequency and depth of monitoring of the investment and meetings with management;
- agreeing the need for and type of remedial action required with management. This might include the introduction of expert advisory firms to help solve issues, develop new approaches and identify new opportunities;
- supporting the company with outside resources;
- introducing changes in the portfolio company's management team, perhaps introducing a senior level "trouble-shooter";
- agreeing to reschedule payments (e.g. loan or fixed payment commitments) or renegotiate banking covenants to allow a portfolio company "breathing room" with its bank(s).

GPs should be aware that while bankruptcy laws may vary from country to country, they may impose a personal liability (including criminal liability under certain circumstances) on a portfolio company's directors (including *de facto* and "shadow" directors) if they permit the portfolio company to carry on trading in certain circumstances.

Recommendation

As soon as information, received as part of the monitoring process, reveals that an investment is not "performing", the GP should look to take rapid action and meet with the management of the portfolio company and, as necessary where the underperformance is financial, other providers of finance such as banks and co-investors, to agree remedial action plans and any additional information requirements.

When managing an underperforming investment, the GP should ensure that adequate local legal advice has been sought and that the portfolio company remains in compliance with all applicable legal and regulatory requirements, including where they relate to ESG factors. Directors who are not familiar with the specific legal requirements in turnaround, restructuring or insolvency situations (or the specific jurisdiction where the portfolio company is located) should seek legal advice in due time.

If the GP has appointed director(s) to the board, if permitted in the particular jurisdiction, consideration should be given to having a different executive responsible for exercising the fund's rights as shareholder to reduce conflicts of interest. It is important that communication with LPs remains open and clear in order to manage expectations in relation to the investment.

GPs and portfolio companies should consider the need for timely provision of information to and communication with other stakeholders when an investment is in difficulty. The timing of communication with employees can be particularly complex and the role that employee representation groups might play should be carefully considered.

When managing underperforming investments, the GP should ensure that sufficient resources remain committed to the monitoring and management of other investments.

3.4.12. Factors particular to investing in distressed assets

Those subsets of the industry that focus on distressed assets have typically attracted heightened attention from a range of stakeholders. The conduct of all parties to distressed asset investing may have considerable impact on the public perception of private equity investing as a whole.

Question

What particular considerations should be taken into account when establishing, investing and managing a fund dedicated to investing in distressed assets?

Explanation

The obligations of the GP and LPs of a fund toward each other, portfolio companies, stakeholders and the wider public are fundamentally the same as for other types of private equity investing. What is different is the higher likelihood of the actions of the GP to affect stakeholders and attract attention from the general public and for their ongoing processes to be subject to wider scrutiny.

Recommendation

GPs of such funds should be aware of the increased legal, reputational and other risks, and carefully describe the particular risks associated with the asset class to prospective LPs. In turn, LPs should carefully consider the ability of a prospective GP to effectively manage stakeholder, public and regulatory relations in what can be a particularly challenging environment.

Parties to investments in distressed assets should be prepared for their decisions and actions to be challenged by a wide range of stakeholders, both those directly affected by such decisions and actions and by a wider group of external parties. Detailed understanding of the legal rights and duties of all parties involved is essential, including the directors and others involved in decision-making on behalf of the portfolio company. It is important to be clear in the allocation of responsibility for managing these legal issues, and to be aware of the wider issues in relation to any decisions taken.

3.5 DISPOSAL OF AN INVESTMENT

Disposal of an investment is a vital stage in the life of a fund. The outcome of the disposal process will determine the return to LPs and will establish the basis on which the GP's performance will be judged by the LPs, those to whom the GP markets future funds and by the wider community.

The disposal process will also involve interaction with other parties, such as co-investors and the portfolio company itself, and can also give rise to conflicts of interest. It is important that these are appropriately managed by the GP.

3.5.1. Implementation of divestment planning

Question

When should the sale of an investment take place?

Explanation

Establishing the appropriate point to dispose of an investment is a matter of judgment for the GP. Any decision to realise an investment involves a comparison of the present value of an investment, its potential future value and the opportunities to realise that value in the future. In making this consideration, the exit decision should take account of the broader context of the investment within the fund, including the cost of continuing to hold the investment for the fund's investors and any factors arising from agreements with other shareholders, co-investors or the portfolio company and its management. While a divestment plan is usually considered at the time of investment, setting out the path to exit, this should remain a dynamic document reflecting developments in the portfolio company and the broader market as the investment progresses.

3.5 DISPOSAL OF AN INVESTMENT

A change in ownership of a company may impact different stakeholders. The governance and shareholder provisions agreed with any other shareholders as well as financing arrangements and other agreements linked to ownership might be impacted by the change in control. Reaction with the company among its employees, customers and suppliers may vary. In general, there may be various ESG factors impacting the divestment and its timing.

Recommendation

The GP should, as far as is possible, dispose of investments at a time and in a manner that accords with any existing divestment strategy and maximises the return to the fund's LPs. GPs should be mindful of the aim to divest the fund's assets within the lifetime of the fund to the extent that exit opportunities permit.

In preparing for a portfolio company exit, the GP should also consider any ESG factors that may be relevant, either for the portfolio company itself or a future buyer of its shares.

3.5.2. Responsibility for divestment decision-making

Question

Who should make the decision to realise an investment?

Explanation

As the exit decision is a matter of judgment, it is important that the decision-making process engages the GP in the same manner as the original investment. Senior input is required to assess risks and opportunities from the decision. Where co-investors, from the fund or otherwise, are involved or control is otherwise shared, this may require agreement outside the GP and fund before launching an exit.

The exit decision also results in financial transaction, with funds moving between the parties. As a result, like an investment, an exit falls within the scope of anti-money laundering regulations.

Recommendation

The GP should establish a process for deciding whether and how to dispose of an investment. Wherever possible this process should mirror the process that is followed when considering an investment decision and any proposed divestment should be subject to equally rigorous checks. The GP must follow anti-money laundering procedures to verify the origins of the funds received in the sale process.

3.5.3. Warranties and indemnities

Question

Should warranties and indemnities be given on exit?

Explanation

A purchaser of a portfolio company may seek a range of warranties and indemnities from the fund. Negotiation over these will invariably be a key issue for the GP when disposing of an investment. During negotiations, the GP must consider the risks and detriment to the fund in giving such warranties and indemnities against any enhancement of return that they could bring.

When deciding whether to give a warranty or indemnity, the GP may also take into consideration the remaining life of the fund and the fact that it may be difficult to drawdown cash or re-draw distributions from investors to meet liabilities in the event of a claim. The establishment of an escrow account or the use of a warranty insurance product are potential solutions to address this issue. Time limitations and financial caps can also be considered and negotiated.

Recommendation

GPs should normally only give warranties and indemnities on behalf of the fund on a disposal where this is expected to produce an enhanced return for investors, or the warranties relate purely to title to shares owned by the fund and authority to enter into the transaction documents.

The liability under such clauses should be capped in quantum and time and the GP should seek to ensure that the fund is able to meet these liabilities. An escrow account is commonly used to fulfil this purpose and could be set up at the time of the exit. In order to achieve an added layer of security that the fund will be able to meet any liabilities, the original fund documentation should contain an investor clawback provision, enabling a certain percentage of distributions to be clawed back from investors should this become necessary even after the end of the life of the fund. This provision should be limited in time and amount, as investors will otherwise not agree to it. The GP may also take out insurance to cover warranties and indemnities; doing so may help to meet the expectations of a potential purchaser and allow full distribution of the proceeds.

3.5.4. Cash vs. shares/earn-outs on realisation

Question

Should a cash exit always be sought?

Explanation

A GP's obligation is to seek the best returns from an investment for the fund and the GP must consider opportunities to effect non-cash disposals in light of this. It may be that, for example, there is no cash purchaser for an investment, or that a cash price is offered but at a lower valuation than a "share for share" swap into a quoted vehicle, or that the fund can participate in the future value of an investment through an earn-out. However, there are also the risks of falls in the market.

Any decision to accept a non-cash disposal is also likely to involve additional costs. For example, there will be a cost in safeguarding and administering any quoted investments held by the fund. Fund documents often include restrictions on the holding of quoted securities, which may limit the options available.

Cash returned is also an important measure of performance; LPs may also have concerns about or may be restricted from receiving distributions in-specie and there may be restrictions upon a holder's ability to sell quoted securities, also known as "lock-up periods".

Recommendation

GPs should carefully assess any non-cash offer consideration in an exit, considering any particular restrictions from the fund documents. The decision should balance the immediate value of any other cash offer; the life cycle of the fund; the need to return cash to LPs; the potential future value and exit opportunities in any securities offered; and the ability to hedge against downside market risks.

3.5.5. Sale of a portfolio company between funds managed by the same GP

Question

Should one fund managed by the GP be permitted to purchase the investments of another fund managed by the same GP?

Explanation

Situations where funds managed by the same GP are transacting between themselves inevitably lead to conflicts of interest as each vehicle may have different investors and therefore different interests. Such conflicts are typically difficult to resolve and therefore in most circumstances are unlikely to be acceptable to LPs.

That said, there may be exceptional circumstances where such transactions can be countenanced, for example where it is the right time for one fund to exit (for example, because it is at the end of its life cycle), but where there is still future value which can be created in the investment and where there is a strong case that the manager is uniquely placed to deliver such value. In these circumstances, there will be conflicts of interest that need to be carefully managed and disclosed. Importantly, the price and warranties to be provided, if any, and the conditions attaching to them need to be defensible to both the buying and selling fund's investors.

Recommendation

The sale of investments between funds operated by the same GP is generally not recommended as it leads to significant potential conflicts of interest.

In cases where such sales and/or co-investments between funds are contemplated, GPs should ensure that they discuss this transaction at the earliest opportunity with the relevant LPACs for the funds, the transaction is handled in accordance with the fund documents and that the LPs in both funds are made fully aware of the transaction. The GP should strictly adhere to the conflict management provisions set out in the fund documentation and also its own internal conflict management policy.

Whenever considering such a transaction, a GP must be able to demonstrate that no fund has been preferred at the expense of another (for example, by arms-length negotiation or obtaining an independent valuation of the investment). Teams acting for each of the funds should either be separated, subject to appropriate information barriers, or GPs and LPs should be made aware of any potential conflicts of interest with regard to a common representation.

3.5.6. Managing quoted investments

Question

What issues should the GP consider when managing quoted investments?

Explanation

There are a number of issues that affect the GP when it holds quoted investments. Dealing in such investments will often be subject to additional regulation (such as prohibitions on insider dealing and market abuse). The GP may also need to consider the impact on the market of its dealings in the portfolio company's securities.

In many jurisdictions it is illegal to deal in securities issued by quoted companies when in possession of unpublished price-sensitive information relating to that company's business. Where a GP has maintained a close relationship with a portfolio company after a flotation there are circumstances where the GP may receive such information. This may prevent the GP from selling an investment until that information is public.

Market rules may also prescribe certain periods in which the portfolio company directors may not deal in investments. These rules may also be relevant where an employee of the GP remains a director following a flotation. The risk of the GP committing an insider dealing offence is increased where the GP maintains a presence on the portfolio company board.

In many jurisdictions insider dealing is a criminal offence, punishable by imprisonment and substantial fines. Insider dealing may also allow anyone who has suffered a loss as a result of the GP's conduct to recover any loss that they have suffered from the GP.

Recommendation

The GP should adopt appropriate policies on the management of quoted securities, including considering whether it is appropriate to retain a seat on the board.

The GP must ensure that it does not breach prohibitions on insider dealing and market abuse when managing quoted investments. Careful consideration should also be undertaken in all reporting and communication to the fund's LPs to not disclose any price sensitive information that is not available to other market participants.

Where the GP retains a relationship with a portfolio company whose securities are quoted, the GP should ensure that it does not utilise any confidential information it acquires to determine or influence its disposal policy, unless that information is available to all of the portfolio company's shareholders.

The GP should recognise and observe any applicable guidance and requirements concerning responsible investment[10] management which are relevant to the listed securities markets in which the GP operates.

10 https://www.investeurope.eu/about-us/responsible-investment/responsible-investment-bibliography/

3.6 DISTRIBUTIONS

Distributions to LPs during the life of a fund and during its liquidation are an important obligation of the GP, as the returns distributed to LPs are the most tangible measure of the GP's performance. The GP must ensure that it effects distributions as required by the fund documents at all times.

3.6.1. Distribution provisions

Question

What provisions should be made regarding distributions from a fund to LPs?

Explanation

Clarity over what is distributed, how it is accounted for in the calculation of carried interest, whether it could be subject to recall, and how a distribution may impact uncalled commitments to the fund are all important issues. Addressing these will help ensure that disputes do not arise as to the apportionment of profits and losses between the GP and the LPs and that there is clarity regarding the LPs' outstanding obligations to the fund.

Recommendation

The fund documents should include adequate provisions on distributions. These provisions should address at least the following issues:

- how profits and losses will be allocated between the GP and the LPs (the inclusion of a clear statement of intent on how the operation of the carried interest allocation will work and/or a description of the distribution of proceeds waterfall will help this);
- when carried interest allocated to the GP may be distributed;
- GP clawback provisions;
- what special provisions may relate to distributions to the GP in respect of the GP's investment in the fund;
- the extent of the GP's discretion to make distributions;
- whether distributions can be made in-specie;
- how any distributions in-specie will be valued (generally this should be on a conservative basis or where freely tradable, reflecting the average daily trading price over an appropriate number of days). Due to restrictions on certain LPs concerning distributions in-specie, the process for making such distributions should be set out clearly in the fund documents;
- the extent to which distributions will take account of taxation liabilities;
- the extent to which the GP may be permitted to re-invest capital proceeds, dividend and other income, rather than distributing it;
- the need for distribution notices to identify clearly whether any of the distribution being made increases the LPs' uncalled commitment to the fund, or is potentially subject to recall at a later date and if so under what provision of the fund documents;
- LP clawback provisions;
- how distributions will be classified (e.g. income or capital);
- the source of the distribution, e.g. sale of a company, dividend payment, interest payment, etc.;
- when distributions will be made.

3.6.2. Timing of distributions

Question

When should distributions be made?

Explanation

Distributions are generally expected to be made as soon as possible after an investment has been realised and proceeds have been received by the fund. In practice, funds whose strategies result in ongoing income from multiple sources may pool such amounts while distributing the more infrequent capital returns as soon as practicable. Prompt distributions improve the internal rate of return of a fund.

Recommendation

Distributions should be made in accordance with the relevant provisions in the fund documents.

Before making a distribution, the GP should consider the fund's reserves for follow-on investments and current and foreseeable liabilities and assets (including liabilities for tax, escrow and clawback provisions and contingent liabilities such as those under warranties and indemnities). Distributions should not be made if this would cause the fund to become insolvent or unable to meet its reasonable future liabilities.

Before making a distribution in-specie, any restrictions on transfer of the relevant investments should be considered.

3.7 LP RELATIONS

Good relations between LPs and GPs are the essence of a strong partnership. Ongoing relations with LPs are a vital issue for the GP to address to ensure continuing good governance. Implementing appropriate processes will also allow the GP to operate more efficiently, by reducing the number of ad hoc enquiries that the GP receives from LPs. In many jurisdictions there will be obligations imposed on the GP to report to LPs, although on commercial grounds many GPs exceed these obligations.

3.7.1. Reporting obligations to LPs

Question

What reports should the GP make to LPs?

Explanation

Reporting obligations are important for LPs wishing to monitor the status of their investment. The nature of funds means that valuing an investment on an ongoing basis is difficult and, without information from the GP, LPs cannot effectively monitor the performance of the fund or report to their beneficiaries in a satisfactory manner.

Recommendation

The new Invest Europe Investor Reporting Guidelines and IPEV Valuation Guidelines, included in this Handbook, should be followed.

It is typical for all LPs to be sent a list of all partners in the fund following final closing but confidentiality requirements of individual LPs may prevent this.

The fund documents should contain provisions regarding the GP's obligations to provide reports to LPs. These provisions should address the following matters:

- the frequency of reports to be made;
- the information to be contained in these reports;
- the form and frequency of responsible investment reporting;
- the basis of valuation that will be used for such reports;
- the manner in which the reports are to be made (e.g. in writing, by email, via a secure website).

GPs should also note that applicable legal rules (including under the AIFMD) may require periodic and ad hoc reporting and disclosure to LPs.

3.7.2. Transparency to LPs

Question

What general conduct issues should the GP consider with regard to LP relations?

Explanation

In its relations with LPs, a GP should be proactively transparent within the confines of its obligations toward others, including a general principle of equal treatment of stakeholders. Established reporting obligations occasionally need to be supplemented by disclosure of significant issues or even consultation with LPs. The GP must take care not to breach confidentiality obligations, whether contractual or regulatory, and that its disclosures do no harm to the interests of portfolio companies.

3.7 LP RELATIONS

Recommendation

The GP should seek transparency in its relationship with LPs by ensuring that all LPs receive all significant information regarding the fund in a clear and timely manner, provided that communicating such information is permitted by law. The GP should not breach confidentiality obligations binding on it but should seek to be relieved of such obligations if they prevent proper reporting to LPs.

Certain LPs and types of investor will require different information, or information presented in a different way, to satisfy their own tax, regulatory, commercial or responsible investment policy (including information in line with the ESG Disclosure Framework) obligations. GPs should be receptive to such requests, but should also take care not to compromise fiduciary duties to portfolio companies (and thereby their other investors).

GPs should also consider the extent to which external specialist assistance (such as tax advice) is a cost to be borne by all LPs in aggregate or by those parties requiring the non-standard level of reporting. When committing to fulfil a special request on an ongoing basis, the GP should consider updating its general information to LPs accordingly, or alternatively disclosing special arrangements to other LPs, all in the interest of securing parity of treatment of LPs and timely disclosure of information.

3.7.3. LP relations generally

Question

What other arrangements should the GP make with regard to LP relations?

Explanation

A transparent and trust-based relationship between the LPs and the GP is key, and this requires good and clear communication throughout the fund's life.

Recommendation

Suitable arrangements should be made to respond to queries from LPs promptly as they arise, as well as complying with the obligations in the fund documents on reporting and, if relevant, meetings. The use of due diligence data rooms can be an effective and efficient way to provide information to prospective LPs.

It is recommended that an annual meeting of LPs be held. An annual meeting provides an excellent opportunity for the GP and LPs to meet together in person. There is no fixed agenda for annual meetings. As a guide, however, the general aim should be to update LPs on the progress of the fund(s) and provide an overview of developments in the market, responsible investment issues along with any relevant updates on the GP's team or processes. It can be helpful to consult with LPs when preparing for the annual meeting to get a sense of the best balance to be achieved between overview and detail. It is also advisable to inform LPs, subject to confidentiality requirements, of investments and divestments as and when they occur. Where practical, consideration should be given to providing access through video, conference call or other, secure, interactive methods for those LPs who are unable to attend in person.

Regular conference calls or webcasts are an efficient method of keeping all LPs up-to-date between annual meetings. Having a secure area on the GP's website, or using one of the secure electronic data site providers is an increasingly common way for GPs to make documents and notices available to LPs.

3.7.4. LP conflicts of interest

Question

How should conflicts of interest between LPs within a fund, or between different funds managed by the same GP, be handled?

Explanation

Most of the time LPs' interests will be fully aligned with each other. On some occasions, however, situations can arise where LPs' interests can conflict. For example, if an investment has been made by two funds of different vintages managed by the same GP, then a conflict may arise between the funds (and hence the different LPs in each) with regards to the timing of the exit, or in relation to making any follow-on investment. Similarly, if an investment is being sold by one fund managed by the GP and bought by another that the GP manages, then conflicts may arise between the two funds over the valuation placed on the portfolio company.

If some LPs have co-invested in a portfolio company alongside the fund's GP, circumstances could arise in which these LPs' interests may conflict with those of LPs who have not co-invested.

Recommendation

Whenever any conflicts arise, it would be expected that the GP will consult with the LPAC of the relevant fund(s) and, where advisable from a limited liability perspective, seek its approval.

When LPs are consulted by the GP on a situation likely to involve a conflict of interest between any of the LPs, they should promptly disclose all conflicts they may have to the GP and the other LPs of the relevant fund(s). In this way the situation can be discussed in an open manner, subject to applicable confidentiality obligations. The context in which views are expressed can be better understood, so enabling conclusions to be arrived at which are based on as full an understanding of everyone's position as possible.

3.7.5. LP Advisory Committee

Question

What role should the LP Advisory Committee ("LPAC") play?

Explanation

One of the ways the industry facilitates an interactive relationship between the GP and LPs is through the use of an LPAC. A well-functioning LPAC should help ensure good governance of the fund by addressing conflicts of interest and be a helpful resource for the GP. Just as GPs bring the benefit of their wider investment experiences to portfolio companies, LPs can provide useful insight from their fund investing experience to the GP on the basis of the more detailed information provided to LPAC members.

In some jurisdictions, maintaining the limited liability of LPs makes it important that LPs do not become involved in the management of a fund, i.e. LPs should not be involved in making investment or divestment decisions. This should be the sole responsibility of the GP. LPAC members provide advice in the best interest of the fund but they do not have fiduciary duty to other LPs.

Recommendation

The LPAC is most effective when it acts as a sounding board for the GP on all matters which impact the governance of the fund. The LPAC ought to be consulted on all conflicts of interest and other significant matters as set out in the fund documentation. In many cases the LPAC will be required to give its consent to the treatment of certain governance issues including conflicts of interest under the terms of the fund documents.

The LPAC should not become a barrier to the GP communicating directly with all LPs in the fund. For example, while the LPAC can provide a useful forum for discussion and feedback to the GP, changes which will impact all LPs need ultimately to be put to all LPs.

To be of greatest value to the GP, the composition of the LPAC should be thought about carefully to ensure a balanced range of perspectives are included. The individual members of the LPAC should have an appropriate level of fund investing experience so that a full contribution to discussions can be made.

The role and constitution of the LPAC should be described in the fund documents. It is usual for members of the LPAC to be indemnified by the fund and for it to be clear that there is no fiduciary duty owed by members of the LPAC to the rest of the LPs in the fund.

There should be a separate LPAC for each fund raised by the GP.

LPACs should be run on a good governance basis, with the agenda and supporting papers circulated ahead of the meeting. Members should declare any conflicts at the start of the meeting and formal minutes should be taken and circulated in a timely fashion. The minutes of any LPAC meeting may also be made available to all LPs.

LPAC meetings should be held at least once a year and should be capable of being convened, at the request of the GP or any of the LPs, at other times.

The LPAC may be chaired by either the GP or one of the LPs. The names of those LPs on the LPAC should be made known to all LPs in the fund. LPAC meetings should provide for discussion without the GP being present.

The number of members on the LPAC should be appropriate for the size of the fund but not so large as to make effective discussion difficult.

LPs on the LPAC must be careful to respect the confidentiality of the information received and discussions held in these meetings.

3.7.6. Key Person provisions

Question

What issues should be addressed regarding Key Person provisions in the fund documents?

Explanation

A very important aspect of LPs' due diligence before deciding to commit to a fund is determining the investment skill of the people managing/advising the fund. During the long life of a fund it is possible that some of the key members of the team may leave. If this happens it may result in a material change to how LPs regard the quality of the team managing/advising the fund.

Recommendation

The fund documents should identify the key individuals in the GP responsible for the day-to-day management of the fund. They are likely to be the most experienced people who are key to managing that specific fund.

Key Persons are expected to devote substantially all their business time to the fund. It would be normal that this includes provision for spending appropriate time with predecessor funds and, in due course, with successor funds. If it is agreed between the GP and LPs that a senior member of the GP is included in the Key Person provisions, who is perhaps not so directly involved in the day-to-day management of that particular fund, then a lesser time allocation is usually agreed.

The consequences and procedures for dealing with the situation when a Key Person ceases to devote the necessary time to a fund (the triggering of the Key Person provisions) should be clearly set out in the fund documents.

Usually the triggering of Key Person provisions causes a temporary suspension of the investment period. The procedures for what happens next should enable the situation to be resolved promptly. The GP will normally tell all LPs promptly when the Key Person provisions have been triggered and set out the plan to address the situation. LPs should engage promptly with the GP to achieve a timely resolution. It is common to include provisions to enable a Key Person to be replaced and so avoid the Key Person provisions being triggered, or to resolve the situation if the Key Person provisions have been triggered.

It is normal to require a majority vote of all LPs or a decision of the LPAC to agree to any Key Person replacements, or to lift the suspension of an investment period. It is important for the good governance of the fund that LPs participate when a vote is required.

3.8 SECONDARIES

The expression "secondaries" may be used in different contexts in the industry. The first context discussed under 3.8.1. is a transfer of an interest in a fund by an LP to another LP, which may be either an existing LP or an LP new to the fund. The second context (section 3.8.2.) relates to the sale of several investments in a fund's portfolio in a single transaction to a new entity backed by different LPs – a 'secondary direct' transaction.

3.8.1. LP secondary transactions

Question

What procedures should be followed in a secondary sale of an LP interest?

Explanation

In most cases, fund interests are illiquid investments (unless, as is sometimes the case, the fund is established as a publicly traded company). It is likely that some LPs at some point during the life of the fund may wish to or need to seek to sell their participation in the fund. This can arise for a variety of reasons and need not have anything to do with the performance of the fund. The selling LP or transferor will normally approach the GP, whose consent is usually required to complete the transfer. The GP (and remaining LPs) will be concerned in particular to ensure confidentiality provisions are observed in any such transfer to protect the interests of the fund and its portfolio companies. Accordingly the GP would normally agree with the transferor a list of potential transferees who may be approached (which would typically include existing LPs) and ensure appropriate confidentiality undertakings are obtained from those being approached.

Where the fund is not traded, typically a privately negotiated secondary sale contract will be formed between transferor and transferee. Rights and obligations under the fund documents must be properly transferred to the buyer, so that the fund may continue to function with the replacement investor in place; hence the need to obtain the GP's consent to any transfer.

The GP will also need to ensure the transfer is handled properly in accordance with both the procedures and requirements set out in the fund documentation and general law, including rights of first refusal, if any, and anti-money laundering requirements. The LP buying the participation will need to satisfy all of the requirements relating to a participation in the fund.

In funds with a high number of LPs, the GP may also need to be mindful of the obligations under general law. For example, the GP may need to limit the number of secondary transactions which may take place in any one year in order to retain the fund's status as exempt from public offering requirements.

Recommendation

It is standard for any LP transfer to be subject to the GP's consent. In order to ensure that such consent is forthcoming, when an LP is seriously considering selling its participation, it should contact the GP at the earliest opportunity and the GP should confirm the confidentiality and other procedures to be complied with and documentation to be completed before any transfer can be finalised.

The GP and LP (or its advisers) should discuss what information about the fund and its investments can be shared with whom and at what point in the process of executing the secondary sale. Disclosure should, in accordance with industry practice and protocol, ideally be timed to take account of the fund's financial, investment and general reporting cycle. This helps to minimise disruption to the fund's operations, and also expenses incurred in connection with the transfer, as well as to ensure fairness to all stakeholders.

On the transfer of any asset, professional advice should be sought to make sure no existing rights are contravened and that all obligations are properly transferred.

Normally, costs related to an LP transfer should be borne by the transferor, transferee or both, rather than the fund.

3.8.2. Secondary direct transactions

Question

What particular measures should GPs take when preparing for and executing a secondary direct sale?

Explanation

With the development of an increasingly sophisticated private equity secondary market and an increased focus on providing liquidity, more complex solutions are available to provide liquidity for LPs. Particularly towards the end of a fund's term, or if a GP undergoes disruptive change, GPs and/or LPs may seek to accelerate the realisation phase, through a purchase of all or a substantial portion of the fund's remaining portfolio in a single transaction, a "secondary direct."

Such purchases may also involve the GP remaining involved in the ongoing management of the assets, which raises a potential conflict with its existing LPs. In some cases, some LPs may also be offered the opportunity to re-invest in the assets, raising conflict issues relative to those that choose not to participate in the transaction.

If the fund documents and conflict resolution procedures require decisions to be made by the LPAC, the role and interests of the LPAC members as a group and of the LPAC members individually may impact on how such decisions are framed, documented and approved. Fund documents may also require direct LP votes, or the development of specific transaction mechanisms for LPs to elect whether to realise or to continue investing in the assets. Certain LPs may be affected by conflicts of interest that do not apply to the LP body as a whole.

While selling assets one by one allows the GP to focus solely on realising its return objectives for the portfolio company, in a secondary direct sale of a number of assets there is greater potential for conflicts and heightened scrutiny of the decision-making process should be expected.

Recommendation

A secondary direct sale of a number of assets together will require detailed planning to ensure that all conflicts are properly identified and dealt with. The GP should carefully assess, process and document the potential conflicts and ensure these are fully addressed, as set out in this Handbook, subject to applicable law and the fund documents.

Throughout the process, the GP should remain prepared for developments which may require adaptations of the original plan.

3.9 EXTENSION AND WINDING UP OF A FUND

Funds will typically have a fixed life. Often, the fund documents will provide mechanisms and the terms for extending this life should all investments and any contingent or escrow consideration not be realised by the initial end point. It is important that the fund is managed with these constraints in mind and that any extension period is undertaken to improve the possible return to the LPs when compared to not extending the life of the fund.

Funds that still have assets after their life has expired or funds that have disposed of their portfolio companies and ceased activity before this time will enter a period of liquidation. The operation of this period is governed by law and the details are also often addressed in the fund documents.

3.9.1. Fund extension

Question

What factors should a GP consider in assessing the possibility of extending the fund life?

Explanation

A fund will typically be "closed ended" and therefore have a finite life. However, it is not always possible to invest, manage and exit from all portfolio companies in the planned fund life. Therefore, in order to maximise the return from the fund to LPs, the fund documents usually provide for the mechanisms and terms to extend the life by a pre-agreed period. It is also possible for the

3.9 EXTENSION AND WINDING UP OF A FUND

GP and its LPs to subsequently agree further extensions to the fund's life although these extensions are not explicitly covered in the fund documents.

Recommendation

A GP should seek to invest, manage and exit from all portfolio companies within the agreed life of the fund where this can be achieved and is in the best interests of the LPs. Where an extension is to be sought, the GP should seek early consultation with LPs in order to set expectations as to the likely final termination date of the fund and the implication of continuing the fund beyond the initial life, in particular providing further clarity on the expected exit process for the remaining portfolio companies. Where extensions beyond any agreed provisions are proposed, GPs and their LPs should seek to agree the required length of extension, details of revised management fees in the extension period and any applicable terms. The GP should ensure that it has the resources to enable it to continue to manage the fund in the best interests of the LP during the extension period, notwithstanding the revised financial and contractual terms that may apply.

3.9.2. Liquidation

Question

What issues should the GP address on liquidation?

Explanation

The liquidation of a fund will, generally, mean that all remaining assets of the fund will be realised and the proceeds used to repay all fund liabilities. Any cash (or other assets) remaining after the repayment of the fund liabilities will then be distributed to LPs in one final distribution, and any undrawn commitments cancelled. In certain jurisdictions, the liquidation process requires the formation of appropriate reserves for reasonably foreseeable obligations in the future. In all cases, the liquidation of a fund must be undertaken with care to ensure that neither the fund, the LPs, nor the GP are exposed to unacceptable potential liabilities following liquidation.

Recommendation

On liquidation, the GP (or the liquidator, if different) should make a thorough assessment of the risk of claims against the fund and should ensure suitable sums are held in escrow or subject to clawback arrangements to meet such claims. The escrow provision should also apply to a portion of the carried interest, or alternatively the carried interest should be subject to clawback for a specified period following the end of the life of the fund.

3.9.3. Fund documents

Question

What provisions should the fund documents include on liquidation?

Explanation

The GP's powers and responsibilities on liquidation, if the GP is to act as liquidator, will usually be set out in the fund documents and, in most jurisdictions, be subject to a detailed legal framework. It is important that these provisions are clear and exhaustive to reduce the likelihood of disputes on liquidation.

Recommendation

The fund documents should include provisions on liquidation addressing:

- the GP's power to realise the fund's investments;
- the extent of LPs' and carried interest holders' liability following liquidation;
- escrow and/or clawback arrangements to cover potential future liabilities.

3.10 MANAGEMENT OF MULTIPLE FUNDS

A successful GP will often manage more than one fund in the same market. This can give rise to conflicts of interest and make it difficult for the GP to act in the best interests of all of the funds it manages.

3.10.1. Conflicts of interest

Question

What should a GP do when a conflict of interest arises between funds that it manages?

Explanation

Conflicts of interest can arise where a GP manages multiple funds. For example, one fund managed by a GP may seek to acquire an investment being disposed of by another, or an opportunity for follow-on investment in a portfolio company in which more than one fund has invested may arise that cannot be exploited by both funds.

Conflicts can also arise when multiple funds hold investments in a portfolio company and a disposal opportunity arises. It is possible that it may not be in the best interests of all funds to dispose of the investment at that point in time (e.g. where one invested on terms that mean disposal would crystallise a loss to that fund, while another fund would realise a profit).

Recommendation

The GP should discuss and seek to resolve all conflicts of interest with the LPACs of both funds before making any decision about the best course of action to take. The GP should establish procedures to promptly identify, disclose and manage conflicts of interest. These should be set out in the respective fund documents.

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There may also be regulatory requirements dealing with conflicts of interest (for example, the AIFMD). Fund managers should be aware of applicable requirements and should comply with them.

3.10.2. Establishment of new funds

Question

When should the GP establish further funds?

Explanation

The GP could prejudice the interests of LPs in an existing fund by establishing a fund with a similar investment strategy too soon after establishing the existing fund. Doing so can compromise the GP's ability to implement the existing fund's investment policy and thus dilute the return to LPs in the existing fund. It can also give rise to conflicts of interest if an investment in a portfolio company is split between different funds.

Fees on prior funds generally reduce when the fund is substantially invested or a new fund is raised.

Recommendation

In general, a new fund should not be established until the existing fund is substantially invested/committed. Specific limits on or triggers when a new fund may be marketed or closed should be set out in the fund documents.

A GP should generally seek to avoid making investments in a portfolio company from more than one fund which it manages. In situations where a GP is investing from more than one fund, it should take into consideration the recommendations set out in section 3.7.4. "LP conflicts of interest".

For the purposes of this section 3.11, management are those members of the board or an executive committee who have executive roles within the GP's organisation and those other employees who work with the executives to deliver the business strategy of the GP. Their responsibilities in relation to governance of the business include responsibility for the effective implementation of the strategy of the GP, the management of risk and compliance with applicable regulatory requirements and industry standards.

The GP has a responsibility to ensure that it has adequate resources to execute its investment strategy, manage the fund and its overall business in full compliance with applicable regulations, and fulfil its reporting and other contractual duties to its investors.

3.11.1. Corporate governance in the GP context

Question

What are the features of corporate governance in the context of the industry and the GP?

Explanation

In the private equity environment, there are several layers of governance considerations.

First, the GP's business should have its own internal processes and procedures concerning corporate governance, which should be kept under continuous assessment to ensure that they remain appropriate. The frequency and detail of review will be different for different GPs depending on their size, complexity, LP base, geographical reach and a range of other factors.

Second, governance at fund level should be taken into consideration by GPs both at the fund structuring stage and also during the life of the fund. LPs will not be involved in the management of the fund, but do however have a role to play in relation to certain decisions to be made, such as whether or not to remove the GP under the so-called fault/no-fault divorce provisions, to approve amendments to the fund terms, to terminate the fund, etc.

A number of LPs may also play a role as members of an LPAC (see section 3.7.5.). LPs sitting on the LPAC will usually be asked to consider issues concerning conflicts of interest, Key Person events, approval of valuations, etc. The LPAC has a role to play in governance, however, governance is not just limited to those LPs on the LPAC; as mentioned above, all LPs have a role to play.

Good governance implies that conflicts of interest should not be left to the discretion of the GP. Conflicts can arise in a variety of situations, including GPs (or GP staff) holding an interest in a company which the GP recommends for investment to the fund, co-investments by GP staff alongside the fund, the GP acting for multiple funds, deal allocation between different funds managed by the GP, etc.

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Sometimes conflicts can also arise between LPs, such as when some LPs have more than one interest in funds managed by the GP, especially if those LPs hold a majority on the LPAC. LP conflicts of interest are considered in more detail in section 3.7.4. While LPs do not owe any fiduciary duties to one another, it is the GP's duty to manage such conflicts when they arise and to treat all LPs fairly while acting in the best interests of the fund as a whole.

Third, the governance of a portfolio company needs to be considered by the GP. Once an investment is made, portfolio company governance should be kept under continuous assessment to ensure that it remains appropriate. However, the frequency and detail of review will be different for different companies. This is explored more fully in section 3.4.4.

Recommendation

The GP should implement and monitor corporate governance processes and procedures at the GP level. Oversight of the GP's governance should encompass elements of independence, such as segregation of duties and reviews, proportionate to the size and nature of the GP entity. The processes should also be discussed with the LPAC and communicated to all LPs.

The GP should ensure LPs are involved in the governance of the fund by establishing an LPAC, conducting regular meetings with LPs and ensuring reporting to and communication with LPs is of a high standard.

As set out in section 3.4.4., the GP should also work with its portfolio companies to establish monitoring programmes, which, as a minimum, ensure that all elements of the corporate governance framework are reviewed at least annually.

3.11.2. Management is responsible for establishing the control environment

In order to promote regulatory uniformity between various sectors of the financial services industry, the concept of a "control environment" has been introduced to the industry. The concept consists of the sum of the various protective measures taken, often referred to as "control activities", to ensure that actions taken on behalf of an entity are taken to further the stated purposes of the entity and not against those stated purposes or for the benefit of others: fixed decision-making processes, documentation of compliance with said processes, separation of functions and oversight mechanisms (reporting, financial audit, operational audit, custodian/depositary oversight, regulatory oversight).

Question

How should management approach establishing the control environment?

Explanation

Management is responsible for ensuring that throughout the GP organisation employees recognise and respond to the need for integrity and ethical behaviour in the GP's own organisation and throughout the portfolio. A high standard of corporate governance sets the framework to meet this goal effectively.

Recommendation

Management should identify, select and adopt an appropriate governance and control framework taking into account the size and complexity of the business and should communicate the key features of that framework, applying it consistently and effectively. In doing so, the GP needs to be fully aware of relevant regulatory requirements (including those established by the AIFMD, where that applies to the GP) which will dictate certain aspects of the control environment.

3.11.3. Management is responsible for control activities

Question

How can management fulfil its obligations in respect of control activities?

Explanation

Control activities are those protective measures in business and financial processes which help prevent errors and omissions from occurring or which detect when errors or omissions have occurred.

In a well-governed organisation, all members of the management team are aware of the importance of control activities and acknowledge their responsibilities for control activities in their particular area, ensuring the importance of these is communicated to members of their team. Control activity is not just the remit of one particular function within the organisation, e.g. compliance and risk or finance, and it is important for all members of the management team to acknowledge this and place the necessary internal emphasis on its importance.

Recommendation

Management should ideally conduct a review of control activities on a regular basis covering both the design and operation of those activities and ensure that the conclusions and any necessary remedial actions are discussed and followed up at an appropriately senior level of the GP's governance structure.

3.11.4. Management is responsible for addressing risk measurement

Question

What procedures should be established for appropriate ongoing risk measurement?

Explanation

Risk measures from a GP point of view

As equity investors operating in an environment surrounded by uncertainties, GPs are faced with a set of risks that may hinder the completion of their objectives. At each key phase of the investment, GPs are responsible for implementing processes designed to identify and assess the primary risks. In assessing the return potential of an investment, consideration should be given to the associated risks. To achieve an attractive risk-return ratio, three essential features should be considered:

- assessment of business risks during Due Diligence phases by including in the scope of investigation country risk, financial risk, management organisation, business ethics, interest rate risk, ESG risk factors, monitor with appropriate KPIs those identified risks and put an appropriate action plan with the portfolio company management to manage those identified risks;
- assessment of financial risks stemming from debt leverage at acquisition and during the life of the investment vs cash-flow generation by the portfolio company;
- involvement of the executive officers and employees, at their respective levels of responsibility and authority to establish a strong risk management culture.

GPs are expected to prevent and mitigate significant risks through organizational and operational measures, within their own organization and facilitate this for their portfolio companies. These may include: improvement objectives, training, awareness raising, risk mapping, action plans, questionnaires, supply chain audits, whistleblowing mechanisms, operational procedures, development and integration of ESG policy and internal audit.

Recommendation

Management should make sure appropriate risk measurements and procedures are in place to assess the key risks that could evolve during the lifetime of each investment. Once risks have been identified management should make sure executive officers and employees are appropriately involved.

In addition, applicable laws (including the AIFMD) make specific provisions concerning GP and portfolio risk management.

Question

What can a GP expect from an LP regarding risk management?

Explanation

A GP can expect extensive due diligence on its risk management and processes to be conducted by the LPs. The following points could be assessed:

- Has the GP established a risk management function?
- How is risk management organized at the GP?
- Does the GP have an ESG policy?
- Is the GP's team structure sustainable and is there a key man risk clause in the LPA?
- Does the LPA contain a limit on concentration risk?
- Are political, regulatory, country, tax risks considered in the LPA?
- Have all conflicts of interests been considered and identified and properly addressed in the LPA?

Furthermore, a Limited Partner should assess and measure its own private equity portfolio risks, which includes:

- Investment risks (e.g. expected return scenarios, FX, alignment, risk/return profile, etc.)
- Funding and liquidity risk
- Market risk
- Capital risk

Risk measurement guidance on these topics is provided in the EVCA Risk Measurement Guidelines as published by Invest Europe in January 2013.

Recommendation

Management should be open to facilitate the assessments by LPs in an open and constructive manner in the due diligence process and throughout the monitoring of the investments by LPs.

3.11.5. Management is responsible for establishing procedures for risk assessment and management

Question

What procedures should be established for appropriate ongoing risk assessment?

Explanation

Risk assessment includes determining an appropriate risk appetite, identifying specific legal, commercial and reputational risks, assessing the effectiveness of mitigating actions and controls over specific risks and comparing residual risk to the overall appetite for risk that has been agreed, and adjusting the mitigating actions and controls as necessary. As the business environment is frequently evolving, effective procedures for risk assessment will necessitate a regular and rolling review of strategic and operational matters.

Many areas of risk touch on specific and often technical issues. A GP may need support from external specialists when dealing with specific risk areas such as legal risk, market/public relations risk, treasury risk, tax risk, financial crime risk, labour relations risk, regulatory risk or information technology risk.

Guidance on the application of the Code
Guidance for Placement Advisers
Investor Reporting Guidelines
IPEV Valuation Guidelines

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Question

What procedures should be established for appropriate ongoing risk management?

Explanation

Preferably and where practically possible a GP should establish a fully or substantially independent risk management role within their firm. The risk manager should act as a second line of defense, making sure all risks are measured and assessed to the highest standards, complete and in all parts of the process. Where possible it is preferred that the risk manager provides his/her independent opinion on the risks assessed in all decision making processes concerning the GP's investments. The risk manager should be as independent as possible, to make sure he/she is not influenced in his/her judgment or is feeling dependent upon other parts of the GP organization to give his/her opinion.

Recommendation

The assessment of risk should be a regular ongoing process that identifies, measures, monitors and mitigates risks, and which should combine risk management judgment by the GP with quantitative measures to support such judgments.

The assessment should involve the senior management of the firm and encompass risks at the fund level as well as those of the GP's own business.

Any processes or procedures introduced to an organisation should normally be subjected to an analysis comparing cost, benefit and any potential regulatory implications.

The introduction of any new risk assessment infrastructure or procedures by an organisation should acknowledge that much of what happens in existing business processes is likely to include the proactive assessment and mitigation of risk and that therefore the introduction of procedures is partly a matter of making explicit what is already in place. This is particularly true in the case of private equity firms that are likely to have well-developed risk assessment and mitigation approaches and processes already embedded in their investment decision-making process.

A GP should seek external support from specialists as required when dealing with specific risk areas beyond its internal competences.

3.11.6. Human resources

Question

What responsibilities does a GP have with regard to human resources?

Explanation

Employees and others engaged by the GP are a vital resource. If this resource is not adequate or is not maintained and appropriately managed, the GP may not be able to implement the fund's investment policy.

Recommendation

The GP should, at all times, have a staff of adequate size and appropriate skills and competence to ensure that it is able to fulfil its obligations, including to all funds under management. These staff should be appropriately allocated.

The GP should implement human resources management processes to administer appropriate functions (such as payment of taxation and social security contributions) and to implement any training and development policies together with policies and procedures that ensure compliance with employment law.

The GP should implement and maintain arrangements requiring its employees to act with integrity and to conduct themselves in an appropriate and professional manner.

The GP should ensure that it implements appropriate succession planning arrangements to ensure that the quality and experience of its key personnel is maintained over time.

The GP should ensure that it has sufficient skill and experience to manage and maintain LP and other key stakeholder relationships.

Diversity is becoming an increasingly important consideration including amongst regulators and GPs should stay prepared and carefully consider the issue of diversity in developing their human resources policies.

3.11.7. Incentivisation

Question

How should the GP incentivise its staff?

Explanation

An incentivised and motivated team is vital to the success of the GP. By adopting appropriate policies to maintain a stable and motivated team, the GP is likely to improve its performance and returns to LPs.

The AIFMD and/or other regulatory provisions applicable to the GP may have an impact on the structure of remuneration within the GP and the GP should ensure that it fully complies with any such rules. For example, the AIFMD requires managers to ensure that their remuneration policies and practices are consistent with and promote sound and effective risk management and do not encourage risk-taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the funds they manage.

The LP community is also increasingly benchmarking remuneration practices against the requirements and principles set out in the AIFMD, similar regulations or standards.

Recommendation

The GP should ensure suitable remuneration for its staff. An important factor in the development and structuring of a remuneration scheme will be to ensure that it creates an alignment of interests between the employee, the GP and the LPs in the fund, including appropriate attitudes to risk and risk management. The GP should ensure that its remuneration policy and practices are consistent with its responsible investment objectives. The GP should ensure that carried interest and similar arrangements are structured in a balanced manner to motivate, retain and incentivise the team and its key members throughout the life of the fund. The GP should also ensure that there are provisions that set out the extent to which individuals are permitted to participate in carried interest arrangements upon leaving the employment of the GP.

3.11.8. Financial resources

Question

What financial resources should the GP maintain?

Explanation

According to the local regulatory environment of the GP (including, where applicable, the AIFMD) or any of the entities through which it is authorised or carries on its management activities, minimum levels of capital adequacy and/or liquidity may have been prescribed. The AIFMD for example provides that both capital and cash or readily realisable securities must be higher than specific thresholds related to fixed overheads and assets under management as well as requiring the AIFM to maintain professional liability risk cover through appropriate insurance or additional own funds.

It is important that the GP plans its own financial resources to ensure that they remain sufficient to allow the GP to operate effectively and to implement the investment policies of the funds under management, over their entire life. Particularly as management fees typically decline later in a fund's life, adequate planning over the life of the fund is needed.

Prior to their making a commitment some LPs may request due diligence information on GPs' financial resources.

Recommendation

The GP should maintain adequate financial resources to allow it to continue to operate during the life of all funds under management.

The GP should implement internal financial reporting procedures to ensure that it effectively monitors its financial position on an ongoing basis.

In addition, GPs should be prepared to respond to requests for information on its financial resources.

3.11.9. Segregation of fund assets

Question

Should the GP make particular arrangements regarding segregation of fund investments and cash under its control?

Explanation

In the event of the GP becoming insolvent or being the subject of legal proceedings, it is essential that assets it holds or controls on behalf of funds are protected and cannot be used to discharge the liabilities of the GP.

Any GP which is fully authorised by the AIFMD will require a depositary to carry out three core duties: cash management, safekeeping of assets and general oversight of the AIF. In very broad terms, the role of the AIFMD depositary is to safeguard the fund's assets by verifying that no assets (cash or otherwise) are transferred in or out of the fund without appropriate documentation for the transaction.

Recommendation

The GP must make appropriate arrangements to ensure that fund assets (including cash) are segregated from its own assets at all times.

When the GP achieves this by lodging assets with an external custodian, the GP should ensure that such assets are appropriately protected by the custodian and that there is a suitable written agreement with the custodian.

AIFMD-affected GPs should ensure their internal procedures fulfil the various requirements including, subject to certain conditions, the appointment of a depositary.

3.11.10. Procedures and organisation

Question

What other procedures and organisational measures should the GP implement?

Explanation

While the efficient operation of the GP will be supported by adhering to general principles of good governance and effective business management, there are certain matters that are specific to the industry that the GP should address.

Recommendation

The GP should implement procedures to address the following matters (which are in no particular order):

- personal dealing in investments by GP staff and connected persons and if necessary, with other parties with whom the GP is dealing;
- decision-making on investments in target companies and disposals of portfolio companies on behalf of the funds;
- storage (and as required, confidential destruction) of documents and record-keeping;
- outsourcing of material functions (particularly where they may impact on the management of funds);
- anti-corruption rules, the prevention of money laundering and other forms of financial crime;
- anti-trust law requirements, in particular bid-rigging;
- business continuity in the case of a business interruption;

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- insurance requirements to protect both the GP and the funds it manages, for example Directors & Officers insurance for executives appointed as directors or non-executive directors on portfolio company boards and professional indemnity insurance, if applicable;
- the protection of the fund and the GP in the event of key employee departures;
- any other required regulatory procedures as outlined in, for example, FATCA and AIFMD.

3.11.11. Internal reviews and control

Question

What internal reviews and controls should be established to ensure that the interests of LPs are protected and the terms of the relevant agreements adhered to?

Explanation

LPs place a high degree of trust in a GP, committing their capital and in effect "locking it up" over the medium to long term.

The best assurance and control mechanisms for an LP are the regular flows of information, communication and face-to-face meetings with GP's senior management. Formal procedural steps should however also be put in place that provide a reasonable level of assurance that the terms of the agreements and any particular laws are being adhered to.

Recommendation

A GP should make provision for internal review procedures which allow the board of the GP to gain a high level of comfort that the terms of the agreement with any LP or customer and any applicable legal requirements are being followed.

These procedures should be overseen by a member of staff of sufficient seniority and independence and with sufficient resources to ensure that they are undertaken effectively.

3.11.12. Management is responsible for the organisation's information and information systems and for communications within and outside the organisation

Question

What are management's responsibilities in relation to information?

Explanation

Effective management by the GP depends on the ability of individuals to make well-informed decisions. The accuracy, timeliness and relevance of information on which to base decisions is therefore of paramount importance.

Businesses generate large amounts of information: about customers and markets; historic, current and future financial and non-financial performance; profitability, efficiency and effectiveness; and about risk and the management of risk. One of the key roles of the GP's executives is the assimilation of the data and management information being generated at a portfolio company level. Analysis and assessment of this information is critical to gaining a clear insight into the portfolio company and as a result ensuring the most effective management of the portfolio company at a strategic, tactical and operational level.

Recommendation

Management should ensure that the organisation's information is:

- accurately compiled;
- clear and unambiguous;
- kept secure and confidential;
- available in a timely and appropriate format and manner.

Question

What are management's responsibilities in relation to information systems?

Explanation

Business is largely dependent on up-to-date computer and software technologies for the recording, storing, processing and reporting of information. The suitability, efficiency and security of information systems are vital to the ability of the business to function effectively.

Recommendation

Management should regularly assess the suitability, security and reliability of the business information systems used by the GP. It should also consider those same factors in relation to the systems used by third parties to whom functions are outsourced.

Question

How should management approach communication of information?

Explanation

Management needs to communicate both internally within the GP and externally with LPs, advisers and other stakeholders.

For example, management will inform GP employees about strategy and expected performance and will give LPs and, as relevant, other stakeholders trading updates and other information.

Recommendation

Internal and external communications should be:

- based on accurate information and honest interpretation;
- clear, unambiguous and suitable for the target audience;
- delivered in a timely manner.

Members should contribute such data about themselves and their portfolio companies as may be requested by Invest Europe from time to time and which is to be used on an aggregated and anonymous basis.

It is good practice to nominate a member of management to take overall responsibility for the GP's public relations strategy.

3.11.13. External communication

Question

How should management approach external communication with a wider stakeholder group?

Explanation

A greater understanding among the general public of the private equity industry, its working methods and what it brings to the real economy enhances the industry's ability to match investment capital with investment opportunities. The more the industry communicates, the greater will be the understanding of its activities.

The rapid growth of the industry over the past decade implies that an increasing number of people are today employed by companies that are wholly owned or controlled by the industry. An even wider group is increasingly impacted as stakeholders in portfolio companies. This creates the need for a greater level of transparency and disclosure of information by individual GPs and the industry to a wider stakeholder group.

When a GP is undertaking an investment in a portfolio company or implementing a new strategy or change programme for the business, the need for communication with the portfolio company's stakeholders is even greater. It is an integral and important part of the value creation process as the GP seeks to create buy-in and align interests to enable it to advance its strategic and business goals.

Recommendation

GPs should have an appropriate communication strategy, reflective of their operations and scale. A website is the starting point to provide information regarding themselves and their investments in a timely fashion.

The GP's website could include information on:

- description of the firm and key elements of its organisation;
- senior management or senior investment professionals;
- size and investment strategy of the different funds;
- investments made with the following information about each portfolio company:
  - date of investment
  - date of divestment
  - type of industry
  - link to the portfolio company's website
- policies regarding responsible investment;
- press releases issued by the GP;
- public relations contact details.

The GP should also pay attention to local transparency requirements in considering the information made available.

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3.11.14. Market transparency – Invest Europe Research and Data

Question

How should members of Invest Europe contribute toward ensuring the transparency of the industry?

Explanation

With the growth of the private equity industry comes increased public attention. Politicians and regulators call for increased transparency. They also propose regulatory initiatives that require all industry participants, both GPs and LPs, to operate on a documented basis of shared information. The industry's ability to respond is enhanced by its access to a reliable and respected set of data collated by a non-commercial provider. Many data providers operate in the field but have varying resources to allocate to data collection and all rely on voluntary, intermittent submissions, mainly from GPs.

Due to Invest Europe's structure as a co-operation between GPs and LPs, the Invest Europe Research and Data department is uniquely positioned to collect, analyse and disseminate data on all relevant components of the private equity industry throughout Europe. However, in order to make the most of this position, the Research and Data department relies on submissions from all member groups. All collected data will only be reported in the aggregate to ensure full confidentiality and no commercial purpose is pursued. The scope of data collected includes: activity data on fundraising (including category and geography of LPs), investments and divestments; performance data to inform fund-level and portfolio company-level aggregate benchmarks on the industry; and economic impact data relating to employment and performance of portfolio companies.

Recommendation

LPs and GPs should structure their contractual arrangements so as to allow for the submission of information to the Invest Europe Research and Data department and should generally encourage industry participants to contribute to establishing Invest Europe Research and Data as an information provider that is trusted by industry participants, academia and regulators.

3.11.15. External assistance

Question

What other resources should the GP have available?

Explanation

GPs vary in their size and experience but no GP is likely to have all the internal resources necessary to deal with every possible matter for which it is or becomes responsible.

The establishment of a fund and its operation frequently involve specialist considerations in many jurisdictions.

Recommendation

A GP should obtain appropriate specialist and technical advice in order to carry out its duties. Legal, tax and accountancy advice will almost always be necessary and sometimes other specialist consultants (e.g. environmental, scientific, social and technological) may be required.

3.11.16. Considerations relating to monitoring of governance – GP governance

Question

What will prospective investors consider when carrying out due diligence on a GP's governance procedures?

Explanation

As part of the due diligence process of a GP by a prospective investor during, for example, fundraising, a number of factors in relation to the operation of the GP will be carefully scrutinised. The due diligence process will normally look at the GP's:

- corporate governance processes, culture and values;
- policies and procedures (including in the field of responsible investment);
- investment, divestment and portfolio company decision-making processes;
- reporting processes;
- compliance and risk management processes;
- business continuity plans;
- conflicts of interest management and resolution procedures (likely to include conflicts between employees and the GP, third parties and the GP, the GP and the LPs and between the LPs themselves).

Recommendation

It is important that a core team, typically including representatives from across the GP's operational areas, regularly reviews the requests being made by LPs for information on processes, policies and controls and that the information being supplied is kept current and is provided in a consistent manner. Ideally this information should be held in an electronic format that can be easily collated depending upon the request and to the extent possible is compatible with the LP's own systems.

A record should be kept of when and what information has been supplied to each LP. This group should review and agree to new requests or requests for information that has not been supplied in the past. Where possible and practicable, the GP should benchmark the type and level of information it is supplying against its peers as transparency and a willingness to provide such information can be one of the factors an LP will use when deciding which GP(s) will receive a capital allocation.

Question

How regularly should the GP review the performance and appropriateness of its own corporate governance procedures, those of the fund and at the level of the portfolio company?

Explanation

The industry is continuously evolving. ESG considerations are becoming more prominent and increasingly integrated into all aspects of the GP's activities. At the same time, the formal regulatory environment is evolving, not only with the AIFMD, FATCA and similar initiatives, but also with developments impacting corporate governance and responsibilities in general. Whether directly applicable to the GP or not, the emerging standards impact the expectations of LPs for all of their GP relationships.

Recommendation

The GP's corporate governance processes and procedures should be reviewed by the GP on a regular basis to ensure policies are reflective of current standards, laws and regulations, are up-to-date and are being implemented and followed.

GLOSSARY

AIF

Under the AIFMD, an AIF (Alternative Investment Fund) is a 'collective investment undertaking' that is not otherwise subject to the UCITS (Undertakings for Collective Investment in Transferable Securities) regime, which raises capital from a number of investors with a view to investing it in accordance with a defined investment policy for the benefit of those investors. Both open-ended and closed-ended vehicles and listed and unlisted vehicles can be AIFs for the purposes of the AIFMD. The definition captures a large breadth of vehicles that would be regarded as "funds", including all non-UCITS investment funds, wherever established and regardless of their legal structure (including limited partnerships, limited liability partnerships and limited liability corporations). AIFs include hedge funds, private equity funds, retail investment funds, investment companies and real estate funds. Single investor vehicles are generally not viewed as AIFs as they would not be seen as collective investment undertakings. For the purpose of this Handbook, the term "AIFs" is used to refer to "private equity AIFs".

AIFM

Under the AIFMD, an AIFM is defined as an entity that provides, at a minimum, portfolio management and risk management services to one or more AIFs as its regular business irrespective of where the AIFs are located or what legal form the AIFM takes. The AIFM can either be an external manager appointed by or on behalf of the AIF, or the AIF itself (any delegate managing assets should not therefore be an AIFM). The Directive applies to:

- EU AIFMs managing one or more EU AIFs/non-EU AIFs (irrespective of whether or not they are marketed in the EU);
- Non-EU AIFMs managing one or more EU AIFs (irrespective of whether or not they are marketed in the EU);
- Non-EU AIFMs marketing EU AIFs/non-EU AIFs in the EU.

AIFMD

TheAlternative Investment Fund Managers Directive (AIFMD) is an EU Directive that took effect on 22 July 2013, subject to a one-year transitional period that expired on 22 July 2014. The AIFMD obliges managers falling within its scope to be authorised by their national competent authorities.

Carried interest

A share of the gains of the fund which accrue to the GP/Manager. The calculation of carried interest is set out in the fund formation documents.

The GP is required to invest in the fund in order to be entitled to receive carried interest. Carried interest is generally regarded as the main incentive to the GP and is a key mechanism for aligning the GP and LP interests in a fund.

Carried interest is typically a fixed percentage of the fund's net gains. Fund documents typically specify the "waterfall" of fund distributions between the GP and LPs, setting out when the carried interest is payable to the GP. Generally, carried interest is payable to the GP after LPs have been repaid an amount equal to their drawn down commitments plus a "preferred return." Thereafter, the GPs typically have the right to "catch-up" their percentage share of distributions made to LPs that represent the preferred return, before distributions are shared in the intended ratio between the LPs and GP. Carried interest is sometimes referred to as "carry".

Clawback

GP clawback is the repayment of any excess carried interest received. It is designed to protect LPs and requires those who receive carried interest to return amounts received, in excess of the amount they should have received. The mechanisms used to achieve such repayment include the use of escrow arrangements (where a certain portion of the carried interest is put into an escrow account to safeguard the clawback obligation), periodic or annual true-up mechanisms or personal guarantees by the ultimate recipients of the carried interest.

Note that a "true-up" is a calculation to determine how much carried interest is due to the GP based on all cash flows to the date of calculation. An "interim true-up", generally only seen in deal-by-deal distribution models, is one which is calculated during the life of the fund and takes into account the value of unrealised investments. A "final true-up" takes place either at the end of the life of the fund, when all proceeds have been distributed, or at such later time as investors are required to return distributions to the fund pursuant to an LP clawback. If the amount of carried interest due to the GP, based on the true-up calculation, is less than the amount the GP has actually received, then the excess amount is required to be returned to LPs.

An LP clawback is a mechanism which requires LPs to return distributions to cover potential fund liabilities, including indemnification obligations, and can be payable after the end of the life of the fund.

Code

The Invest Europe Code of Conduct, which is as follows:

1. Act with integrity
2. Keep your promises
3. Disclose conflicts of interest
4. Act in fairness
5. Maintain confidentiality
6. Do no harm to the industry

Compliance with the Code is mandatory for all Invest Europe members and it is expected that the member procures that its affiliates working with it will also adhere to the Code.

Co-investment(s)

In relation to an LP co-investment, this is a co-investment by an LP in a portfolio company alongside a fund, where the LP is an investor in such fund.

The term co-investment may also be used to refer to an external syndication of a private equity financing round.

In contrast, the terms "consortium deal" or "club deal" are typically used to describe a situation where two or more funds with different GPs work together to acquire a stake in a portfolio company.

Commitment(s)/Capital commitment(s)

An LP's contractual commitment to provide capital to a fund up to the amount subscribed by the LP and recorded in the fund documents, also known as such LP's fund interest. This is periodically drawn down by the GP in order to make investments in portfolio companies and to cover the fees and expenses of the fund.

Distribution(s)

All amounts returned by the fund to the LPs. This can be in cash, or in shares or securities (in the latter case known as "distribution(s) in-specie").

Drawdown(s)

LP commitments to a fund are drawn down as required over the life of the fund, to make investments and to pay the fees and expenses and other liabilities of the fund. When LPs are required to pay part of their commitment into the fund, the GP issues a drawdown notice. Drawdowns are sometimes referred to as "capital calls".

Environmental, Social and Governance ("ESG")

ESG stands for the environmental, social and governance factors that can impact (the performance of) a portfolio company and/or an investment, including the GP itself[11]. It is a phrase commonly used alongside responsible investment.

11 For examples of the types of ESG factor that can impact a portfolio, please refer to: https://www.unpri.org/private-equity/a-general-partners-guide-to-integrating-esg-factors-in-private-equity/91.article

ERISA

The US Employee Retirement Income Security Act of 1974, as amended.

Exit(s)

The realisation of an investment made by a fund. This will normally take the form of a sale or flotation (IPO) of the portfolio company.

Fund(s)

Fund or private equity fund is the generic term used to refer to any designated pool of investment capital targeted at any stage of private equity investment from start-up to large buyout, including those held by corporate entities, limited partnerships and other investment vehicles, established with the intent to exit these investments within a certain timeframe. A closed-ended Limited Partnership is a common structure used for such a fund, but other legal forms are also used, e.g. FCPR, KG, SICAR, AB, BV and NV, etc.

Fund documents

The entire set of legal documents, including the Limited Partnership Agreement (LPA) or equivalent legally binding document and side letters agreed by the investors and the fund manager. Matters covered in the legal documentation include the establishment of the fund, management, and winding up of the fund and the economic terms agreed between the investors and the fund manager.

Fundraising and fundraising team

The process by which money is raised to create a fund. Funds are typically raised by a team of identified professionals within the GP that may include investor relations, fundraising and investment professionals (together, the "fundraising team"). The fundraising team may choose to work in conjunction with an intermediary (usually called a placement agent or placement adviser) particularly when looking to establish relationships with new LPs, as well as legal and other outside service providers.

GP

General Partner (GP) is the term typically used to refer to the different entities and professionals within a private equity firm which source, analyse, negotiate and advise on potential transactions as well as invest and manage the fund. It is this definition which is used for the purposes of this Handbook. More specifically, it means the general partner of a Limited Partnership. The term GP may also be used to refer to the manager or investment adviser of a fund, depending on the fund structure.

Holding period

The length of time an investment remains in a fund.

Industry

Refers to the private equity, venture capital and infrastructure industry, which includes GPs, LPs and the service providers to its participants. For the purposes of this Handbook, "industry" is used as a generic term to refer to and to encompass the full industry, including venture capital, infrastructure and private equity.

Investment agreements

These are the set of agreements relating to the acquisition of a portfolio company by the fund. They typically include a Share Purchase Agreement, regulating the actual purchase of interests in the company, and ancillary agreements, such as a Shareholders Agreement, setting out the understanding among the portfolio company's shareholders with respect to the management and governance of the portfolio company post transaction. Investment Agreements may also include the arrangements with the management of the portfolio company.

For the purposes of section 3 of this Handbook, reference to Investment Agreement also includes the articles of association of the portfolio company, shareholder loan agreements, investor rights' agreements and other such agreements between the portfolio company shareholders.

Investment Committee

It is normal for a GP to have an Investment Committee, which is the board of the GP or a specific body within the GP making the ultimate investment and divestment decisions. It will typically also make ownership-related decisions during the holding period of those investments, including follow-on investment decisions.

Investment period

Typically the initial few years of a fund's term, during which time it is intended that the fund will make its investments.

IRR

The Internal Rate of Return or "IRR" is one of the calculations used to measure the return of a private equity fund. IRRs are used in private equity instead of time-weighted returns ("TWRs"), which are more common in other asset classes.

Technically, the IRR is defined as the discount rate which, when applied to all the cash flows in the fund and the fair value of the fund's assets at a point in time, would produce a net present value of zero. In other words, the IRR represents an absolute measure of the cash flow return of a fund at a point in time. It is therefore one of the most common measures for comparing the performance of different funds covering different time periods.

The IRR can be calculated on a net basis (meaning net of fees, expenses and carried interest) or a gross basis (meaning before fees, expenses and deduction of carried interest).

The IRR is calculated as an annualised compounded rate of return, using actual cash flows and annual valuations.

Key Person and Key Person provisions

The key senior investment professionals actively involved in the sourcing, analysis, negotiation and subsequent monitoring of potential investments made by a fund are typically identified and named in the fund documents as Key Persons. Provisions are made regarding what happens should any of these individuals cease to devote sufficient time to the fund; so-called Key Person provisions.

LP

A Limited Partner (LP) is an investor in a fund. More specifically, it means the limited partner in a Limited Partnership. LPs in a fund include sophisticated investors, such as pension funds/retirement systems, insurance companies, experienced high-net-worth individuals and entrepreneurs, sovereign wealth funds, endowment funds, foundations and family offices.

Limited Partnership

A legal structure commonly used by many private equity funds. It is used especially when catering for broad categories of international investors looking to make cross-border investments. The partnership is usually a fixed-life investment vehicle, and consists of a general partner (the GP/manager of the fund which has unlimited liability) and limited partners (the LPs which have limited liability and are not involved with the day-to-day operations of the fund).

LP Advisory Committee ("LPAC")

The LPAC is typically comprised of a cross-section of LPs in a fund. The role of the LPAC is essentially to be consulted by the GP on material matters affecting the fund and on conflicts of interest. More generally, it acts as a sounding board for the GP.

Management fee(s) or Priority profit share

These are the terms that are used to refer to the fee/profit share paid by the fund to the GP. For the GP to be able to employ and retain staff in order to invest and properly manage the fund until such time as profits are realised, it will typically receive, on a quarterly basis, an advance from LPs to cover the fund's overhead costs. This management charge, generally funded out of LP commitments, is generally equal to a certain percentage of the committed capital of the fund during the investment period and thereafter a percentage of the cost of investments still held by the fund.

Most Favoured Nation

The Most Favoured Nation (or "MFN") clause is a common protection sought by LPs in which the GP assures the LP that it will also benefit from any provisions granted to other LPs. The MFN provision usually carves out specific provisions that relate to tax or regulatory considerations of individual LPs. The MFN may be found in the constitutional documents of the fund or in side letters agreed between an individual LP and the GP.

Placement adviser

A person or entity acting as an agent for the fundraising team in raising investment funds. Placement advisers should comply with Invest Europe's separate Guidance for Placement Advisers (see page 65).

Portfolio company(ies)

A company or companies in which a fund has made an investment.

Private equity

Private equity provides funding in equity form from funds to acquire a majority or minority stake in portfolio companies in different stages of development across a wide range of sectors.

The term is widely used and, for the purposes of this Handbook, is used as a generic term to encompass venture capital (typically a minority stake invested in an early-stage or pre-profitable business), through to growth capital or larger 'buyouts' (a minority or majority stake invested in portfolio companies at critical points of their development), as well as infrastructure investments.

Responsible investment

'Responsible investment' involves an investment approach that integrates ESG factors into corporate conduct, investment decisions and ownership activities. A responsible investor will commonly be interested in the ESG conduct, impact or performance of a portfolio company it invests in, and in case of an LP, this may also include ESG aspects related to the GP.

Stakeholder

The private equity industry has a range of stakeholders. In addition to GPs and LPs, this includes (and is not limited to) portfolio companies, their employees, trade unions, customers, suppliers, regulators, and the wider community.

Transfers of interest and Secondary investments

"Transfers of interest" is a term typically used to refer to the transfer of an LP's contractual commitment and interest in an existing fund to another LP. It may also be referred to as a secondary investment. In contrast, the term "secondary direct sale" is used to describe the sale by a fund of its interests in one or more portfolio companies to a fund managed by a different GP.

Transaction fee(s) and Broken deal fees

A transaction fee is a fee charged by the GP, or its related party, in relation to the purchase or sale of a portfolio company. Increasingly, transaction fees also include any directors', monitoring, or other fees charged by the GP or its related parties in connection with portfolio companies during the holding period of the investment. The treatment of transaction fees is agreed in the fund documentation, usually requiring their offset (either wholly or in part) against the management fee.

Broken deal fees (also referred to as "abort costs") are costs incurred by the GP in pursuing a deal that does not reach completion (e.g. accountants, lawyers, due diligence costs, etc.).

Venture capital

Funding typically provided in equity form to companies in the early stages of their life cycles, i.e. seed, early-stage, development, or expansion.

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SECTION 4

GUIDANCE FOR PLACEMENT ADVISERS

Acknowledgements
Invest Europe would like to thank the members of the working group for their valuable input and contributions during the development of this Guidance.

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GUIDANCE FOR PLACEMENT ADVISERS

Preamble

Invest Europe promotes the highest ethical and professional standards within the private equity, venture capital and infrastructure industry[12]. Its Professional Standards Handbook brings together the key elements of governance, transparency and accountability that are expected of industry participants. The Handbook provides accessible, practical and clear guidance on the principles that should govern professional conduct and the relationships between all those engaged in the industry.

This Guidance provides specific guidance and recommendations on best practices to member firms of Invest Europe the business of which encompasses acting as a placement or fundraising adviser (referred to throughout this Guidance as "Firms" or "Placement Advisers") to ensure adherence to the Invest Europe Code of Conduct.

Guidance for placement advisers

The role of the placement adviser has developed significantly over time and is seen as an important and positive component within the industry. They play an increasingly important role in successful capital raisings for, inter alia, alternative assets, including private equity, venture capital and infrastructure.

In this document, Placement Advisers are defined as Invest Europe member firms to the extent that they are engaged in fundraising advisory services for which they are remunerated.

Invest Europe first resolved to introduce a specific document for Placement Advisers in 2009 (a) to reflect the established institutionalisation of the placement and fundraising business model; (b) to highlight the importance of such role in alternative asset fundraising; (c) to maintain and publish benchmarks in the practices of placement advisers for the benefit of all member firms; (d) to encourage the furtherance and continued support of strong ethical principles in this segment of the market by placement advisers and those that engage them; (e) to emphasise the necessity of adherence to high standards of compliance and regulation wherever a member firm operates; and (f) to set out requirements as to transparency and accountability of dealings with its clients (referred to throughout as "Clients").

This version was completed in 2017. Invest Europe will continue to monitor and update as appropriate the Guidance, including as part of its regular review of the full Handbook.

Invest Europe recommends that Firms make this Guidance available to all Clients at the outset of any new mandate.

12 For the purposes of this Guidance, "private equity" and "industry" are used as generic terms to refer to and to encompass venture capital, infrastructure and private equity.

1. Regulation and Authorisation

1.1 To the extent required by local laws, a Firm must be registered and/or authorised in each jurisdiction in which it undertakes activities.

1.2 A Firm should, on request, disclose to its Clients its regulatory status and any restrictions on its ability to act for the Client in any particular geography or capacity.

1.3 A Firm's representatives should possess the licences or certifications to the extent required by legal, governmental, regulatory or self-regulatory organisations to which the placement adviser or its representatives are subject for the performance of regulated activities, including, as required, the more stringent certifications for those acting in a supervisory capacity.

1.4 A Firm should operate in an environment with established compliance and supervisory procedures appropriate to the scope and geographical reach of its business.

1.5 Subject to the terms of its engagement and approval by the Client's legal counsel, a Firm should assist its Clients in developing a marketing plan which complies with applicable marketing regulations such as the Alternative Investment Fund Managers Directive (and applicable implementing legislation across the EEA) and Regulations D and S of the Securities Act of 1933, by offering its experience of applicable markets and marketing regulations.

2. Conduct of business (Generally and with Clients)

Conduct Generally

2.1 A Firm conducting placement or fundraising advisory services must be in the routine and dedicated business of acting as a placement adviser.

2.2 A Firm is expected to maintain high standards of probity, integrity and professionalism in the conduct of its business and not to do anything which would bring the industry into disrepute.

2.3 Employees of a Firm should be appropriately qualified, authorised and supervised commensurate with the capacity in which they are employed, the jurisdictions in which they operate and their seniority in the Firm.

2.4 A Firm should maintain professional relationships with a meaningful number of investors that seek to invest in alternative assets, and typically (unless limited in scope by geography or similar) should be retained to raise capital from all or a significant sub-set of such investors.

2.5 A Firm should not make or offer to make any payment or provide any benefit to induce a third party to enter into contractual negotiations or do business with a Client. The standard for what is improper is captured in applicable law or regulation or available investor policy and may include inducements such as disproportionate hospitality.

2.6 A Firm should keep records of the performance of its duties for a minimum period of five years (or such longer period required by applicable law).

2.7 A Firm should establish and implement written policies and procedures to identify and mitigate conflicts of interest appropriate to the scope of its business. A Firm should make available its policy upon request by its Clients.

Conduct with Clients

2.8 A Firm should enter into a written contract with a Client specifying the nature of the relationship, scope and term of the service, regulatory status, reporting obligations and the fee arrangement, and confirming the Firm will adopt and adhere to the Code of Conduct and this Guidance, to the extent applicable.

2.9 A Firm should perform reasonable and appropriate due diligence in respect of a Client commensurate with the scope of its engagement and its regulatory obligations. Such diligence should ensure that the Firm and its employees have adequate knowledge and understanding of the Client and the product to fulfil the assignment.

2.10 A Firm should take appropriate steps where required, which may include delegation to a third party, to identify an investor's professional status, domicile (and/or registered office) and source of funds for Know Your Customer and anti-money laundering purposes and compliance with applicable marketing regulations. A clear understanding between the Firm and the Client on the responsibility borne by the Firm for these procedures and whether they are being undertaken for the Client should be set out in the terms of the engagement, including where the Firm is not undertaking any such activities for the Client.

2.11 Prior to undertaking any assignment, a Firm should consider, discuss with and disclose to its client or potential client any conflicts of interest arising from other activities or assignments of the Firm.

2.12 When requested, a Firm should provide strategic and other advice to Clients on an impartial basis, taking into account their expertise, market awareness and what it considers to be the most favourable course of action for the Client given the then prevailing circumstances.

2.13 In a situation such as an oversubscription, where there is a choice between admitting to the fund an investor for which a fee would be payable to the Firm or an investor for which no fee would be payable, a Firm should identify the conflict to the Client for it to decide on its preferred action.

2.14 A Firm should report to its Clients as to its activities in accordance with the client agreement and its regulatory obligations in a way which is clear, complete, fair and not misleading.

3. Transparency and Disclosure

3.1 A Firm should disclose, either upon the request of a processing or existing investor who is subject to appropriate confidentiality obligations or to the extent (if at all) required by applicable law, regulation or internal policy, a summary of the fee arrangement the Firm has agreed with a prospective or existing Client or its manager in respect of such investor's investment in such Client or its funds (if any). The Firm should disclose to a prospective or existing Client any other payments received or made by it in connection with its activities on behalf of that Client.

3.2 A Firm should put in place a policy with respect to the making ofpolitical donations by the Firm or any related person, and makethe policy available to Clients and their investors at their request.

3.3 Any Firm engaging any former employee of a government pension plan or anyone in the decision-making chain of command regarding an investment by such government pension plan in a Private Investment Fund must make full disclosure of such engagement to its prospective and existing Clients and Clients' investors and such person must agree not to solicit such government pension plan if and to the extent required by applicable law or regulation.

3.4 Where a sub-placement adviser is appointed by the Firm, the Firm shall take reasonable steps to procure that: (i) such appointment is disclosed to the Client and (as appropriate) to the Client's prospective and existing investors; and (ii) the sub-adviser undertakes to comply with the Code of Conduct and this Guidance to the extent applicable, failing which, the Firm must cease to act for the Client or terminate the appointment of the sub-placement adviser.

3.5 The role of the Firm and, subject to the opinion of the Client's legal counsel, any sub-placement adviser should be disclosed in marketing materials issued in connection with the Client's fundraising.

3.6 A Firm should exercise a proper standard of care and use its best efforts to identify to the Client and include in all marketing materials any disclosures required under relevant marketing regulations.

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SECTION 5

INVESTOR REPORTING GUIDELINES

Acknowledgements
Invest Europe would like to thank the members of the Invest Europe Working Group on Accounting Standards, Valuation and Reporting (a sub-Committee of the Invest Europe Professional Standards Committee) for their valuable input during the development of the Investor Reporting Guidelines.

The Working Group reflects the membership of Invest Europe so comprises representatives from an international set of private capital market participants including GPs, LPs and professional advisers.

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1. INTRODUCTION

In the ten years since the global financial crisis, Private Capital has continued to play an ever more important role in assisting economic growth and developing stronger, more durable businesses and business models across the world.

In that period the pressure from all stakeholders for greater transparency and understanding has also increased. Ensuring that the level of information available is sufficient to be helpful but not so voluminous that it is a hindrance to those stakeholders has become critical. In a world where change is ever present and more rapid, the ability for investors to be able to understand, digest and conclude on information in a sensible time frame is the goal of these Investor Reporting Guidelines.

The Working Group has drawn heavily from Invest Europe's unique membership which covers all aspects of the industry across multiple jurisdictions. The Group comprises GPs, LPs, Advisers and Portfolio Company experts to ensure that these Guidelines balance the ever increasing demands for information with the goal of developing sensible and understandable information at all times.

The terms General Partner, GP or manager, and Limited Partner, LP or investor are used interchangeably throughout this document.

These Guidelines are not intended to specifically cover legal and regulatory reporting requirements; where applicable, however, they should be read in conjunction with such reports and consistency between the contents of such reports would be expected.

Furthermore, these Guidelines do not cover information to be included in the fundraising documents, annual investor meetings, meetings of the LP Advisory Committee ("LPAC") and other conference calls or ad hoc communication with investors. However, as with the legal and regulatory reports, all such information should be broadly consistent and not contradictory to the reporting required from these Guidelines.

This document presents **two forms of guidance:**

1. **Requirements that must be applied**, where relevant for a fund, to enable a fund manager to claim compliance with the Guidelines. These Requirements will ensure that investors are able to monitor their investment in a fund, assess the progress of the fund and the portfolio companies in which it invests and understand the developments within the geography, sector and industry in which each of the portfolio companies operate.

2. **Additional possible disclosures**, whose adoption is not considered necessary for a fund manager to claim compliance with the Guidelines. These items are sometimes provided by fund managers to convey more in-depth information to investors but are considered not to be key in nature in order to be compliant with the Guidelines.

This version of the guidelines augments the version released in 2015 and continues to develop our approach to be the "voice" of all Private Capital. Private Capital managers across Europe and globally are increasingly targeting more diversified risk adjusted returns by launching new fund vehicles to provide financing to businesses. The evolution of the private equity sector into such new asset classes gives rise to the need for modified reporting and valuation requirements specific to the nature of such investments.

As a result of this the guidelines now contain specific sections for the following types of fund in addition to the "standard" direct Private Equity fund contemplated in the previous Guidelines:

- Real Estate
- Private Debt (including Credit funds)
- Infrastructure
- Venture Capital
- Fund of Funds
- Secondary Funds

The specific sections for the above fund types have been included to allow managers of those funds to comply with the Invest Europe Guidelines whilst still maintaining the expected style, form and content that investors in those funds would require. All Requirements set out in other parts of these Guidelines are expected to be followed, in full, by all fund managers wishing to state compliance with Invest Europe Guidelines.

In performing the current update, the Working Group has considered other best practice and template guidance in the sector including those published by ILPA. A detailed comparison has been performed against the most recent ILPA guidelines and a section covering the differences in required content is included in section 2.4. As a result of this, it is the view of the Working Group that compliance with these Guidelines (including certain of the Additional possible disclosures) means that a manager will be substantially compliant with all ILPA information requirements.

The guidelines have also been updated to cover key emerging issues such as Fund Bridge and Leverage Facilities and enhancements to ESG reporting. Our aim remains to ensure that the Guidelines remain among the most advanced and user friendly guidance in the Private Capital sector.

As with most aspects of their relationships, the managers (GPs) of Private Capital funds and their investors (LPs) negotiate the required disclosures in their funds on a bilateral basis during the fundraising process. As such, it is not the intention that these Guidelines should in any way restrict the disclosures made and information transferred especially where that information flow is already established. However, these Guidelines are designed to assist in the negotiations and form a strong baseline level of information flow on a regular basis.

In the same way, the examples included in the Guidelines are not intended to be "standard" or "generic" templates used by all funds but are sensible starting points, particularly for new GPs in the sector.

Change is constant and whilst the Working Group has sought to include many new emerging issues in reporting there will inevitably be more arising in the coming months and years and therefore a further update to the guidelines is anticipated in 2020. However, these guidelines may be updated in advance of that date for any critical changes in the sector to ensure that the level of information presented to investors remains at an optimal level to facilitate accurate analysis of a manager, a fund and the investments in that fund.

These Guidelines replace all former versions released by Invest Europe. For GPs wishing to claim compliance with these Guidelines, adoption is required for the quarter/half-year ending 31 December 2018.

Contents

2. PRINCIPLES OF REPORTING

2.1. General Considerations

These Guidelines are principally designed for use by General Partners ("GPs") reporting to their Limited Partners ("LPs") on closed-ended funds investing using Private Capital alternative investment strategies. The information described in these Guidelines should generally be reported on a whole fund basis. In cases where a fund comprises parallel partnerships, particularly where they have different contractual terms, the GP may also provide details on a legal entity basis in addition to providing whole fund information. Further, as appropriate, disclosure of portfolio company information should be aggregated and presented on a whole fund basis in order that LPs can see the total investment under management by the GP.

Some funds invest in multiple securities or tranches of the same portfolio company. The disclosures described in these Guidelines are expected to be shown on the same basis that the manager would transact. If the manager expects to transact all positions in the same underlying portfolio company simultaneously, then disclosures would be for the aggregate investment in the portfolio company. If the manager expects to transact separately, for example selling a debt position independently from an equity position, then disclosure for each individual instrument will be more appropriate.

It is recognized that in some instances, disclosure of detailed information regarding a particular portfolio company or investment may give rise to issues of commercial sensitivity for that company/investment, for example when it is in or close to a sale process. The GP may in such circumstances need to exercise discretion in the level of detail provided in the report, bearing in mind the extent to which reports are available to a wide selection of parties including investors, administrators, custodians, advisers etc.

2.2. Timing

Purpose

Investor reporting is needed on a timely basis to enable investors to perform their investment analysis appropriately. Reported information should therefore be delivered in a form agreed with the fund's investors. It is typical for a GP to develop standardised reporting of information for their LPs at the outset so that over the life of the fund reporting is performed to a consistent format and timetable. However, there should always be the ability to enhance and modify the content of such reports over the life of the fund. This is particularly important where external legal, regulatory and stakeholder interactions lead to a change in the accepted norms for reporting to investors.

It is common for GPs to provide the quarterly information in one reporting package which includes both narrative and financial information. Where reports are presented separately, these Guidelines are designed to cover the requirements of both parts.

GPs will need to consider, and where appropriate agree with the LPs, what time periods their reports should cover. Current period (i.e. quarter or six months depending on the frequency of reporting) and data since inception are likely to be required, with either financial year-to-date or last twelve months' data as an additional possible disclosure.

Exact timings, notification periods to investors and content of the reporting as well as audit requirements and applicable financial reporting frameworks (GAAP) are usually agreed within the fund formation documents. It is very rare that this changes over the life of a fund except where new accounting standards require such a change.

Requirements

At a minimum reporting should be in accordance with the fund formation documents. For funds holding direct investments, current market practice is for quarterly reports to be issued no later than 60 calendar days after the quarter end and annual accounts to be issued no later than 90 days after the year end. For other types of vehicle such as fund-of-funds, these timeframes will inevitably be longer, typically an additional 30 days. The extent to which information requires an audit will be determined by the fund formation documents and local regulation.

Additional possible disclosures

It is common practice for GPs to provide updates to LPs on significant new investments, divestments/exits and major portfolio company events, e.g. IPOs or major acquisitions by the Portfolio Asset (e.g. bolt-ons).

Such reports should ideally be sent to LPs contemporaneously with any press release/publication.

ESG reporting should ideally be integrated into the annual/quarterly reporting cycle, rather than operating on a separate timeline.

2.3. Structure of Investor Reporting

The following deliverables, frequency and timeframes for investor reporting are meant to serve as a suggestion only. They encompass the current market expectations for a private capital fund, however, they will be subject to the type of fund and the fund formation documents.

The table below sets out the position for quarterly reporting.

Reporting Deliverable	Frequency of Reporting*
Fund Information	
1 Fund Overview	Quarterly
2 Executive Summary	Quarterly
3 Fund Performance Status	Quarterly
4 Fund Financial Statements	Quarterly (as required by the fund formation documents)
5 GP Fees, Carried Interest and Fund Operating Expenses	Quarterly
6 Fund Bridge and Leverage Facilities	Quarterly
Investment Portfolio Information	
1 Portfolio Summary	Quarterly
2 Portfolio Asset Detail	Six-monthly with updates for significant events quarterly**
Investor Information	
1 Capital Account	Quarterly
2 Drawdown Notices	Each transaction
3 Distribution Notices	Each transaction

* Larger and mid-sized firms typically report on a quarterly basis. Some firms, due to their nature, may report on a half-yearly basis.

** Significant events include new investments, exits and material events in portfolio investments not otherwise covered in the Executive Summary.

2.4. Summary overview of Invest Europe Investor Reporting Guidelines compared to ILPA Reporting Best Practices

The Invest Europe Guidelines have been designed with the input of both GPs and LPs so as to create a user friendly and adaptable set of reporting guidelines which ensure that LPs' information requirements are satisfied within the context of a framework appropriate for GPs.

In drafting this 2018 revision to the Invest Europe Guidelines the Working Group has taken into account the requirements of other standard setters and jurisdictions, notably ILPA's Reporting Best Practices, including its Quarterly Reporting Standards, Capital Call and Distribution Notice Template and Fee Reporting Template.

In our view, GPs may consider themselves as compliant with all the information requirements of ILPA's Reporting Best Practices if they adopt these Guidelines. This is following a detailed comparison of these Guidelines and ILPA's Reporting Best Practices. Our comparison identified only four ILPA information requirements that are not recommended in these Guidelines (which seek to define what information should be reported while not being prescriptive as to the layout or format in which such information should be presented). These four requirements have not been added as they were not deemed to materially enhance LPs' understanding of the fund's current position or performance.

These are:

ILPA Reporting Best Practices	ILPA information requirements not recommended in these Guidelines
Quarterly Reporting Standards	
Schedule of Investments	Disclosure of gross TVPI in the prior period
Executive Summary	Disclosure of the advisor/ manager's AUM, "active" funds and "active" portfolio companies across the funds managed / advised
Executive Summary	Fund KPI's - distributions to be expressed as a % of total commitments as well as DPI
Executive Summary	Progression of Net IRR of the fund to be expressed graphically
Capital Call Template	None
Distribution Template	None
Fee Reporting Template	None

Furthermore, it is noteworthy that these Guidelines give due consideration to specific strategies within the Private Capital industry, namely private equity, real estate, private debt, infrastructure, venture, fund of funds and secondaries, and recommend reporting particular to those types of funds.

Additionally, there are a number of reporting aspects where the requirements of these guidelines surpass ILPA's Reporting Best Practices. Examples of these include:

- 3.1. Fund Overview:
  - Details of Bridge Finance and Fund Leverage facilities (where applicable);
  - Summary of investment parameters and restrictions;
  - Re-investment/recycling policy;
  - ESG reporting;
  - Disclosure of service providers such as banker, independent valuation expert and depository.
- 3.2. Executive Summary – disclosure of significant changes affecting the GP/Manager.
- 4.1. Portfolio Summary:
  - The % of the business exited in the event of partial investment realisations;
  - Investment holding periods.

3. FUND INFORMATION

3.1. Fund Overview

Purpose

The Fund Overview provides LPs with general information about the fund allowing them easy access to the fund's terms and "standing data" without requiring them to consult the fund formation documents. Many GPs utilise structures which include parallel funds to meet the needs of individual LPs; however, the Fund Overview would normally be expected to cover the total fund position aggregating all parallel funds, unless there are different contractual terms which may require additional disclosure.

The Fund Overview is designed to be a one-page summary of the fund structure. Where effective disclosure is incompatible with one-page disclosure, it may be appropriate to include only a cross-reference to the fund formation documents or other sources.

Requirements

General

- Fund full name;
- First closing date;
- Final closing date;
- First investment date;
- Vintage year;
- Term (and last date when GP can call capital, if different);
- Investment period criteria and end date;
- Extensions permitted;
- Total commitments (whole fund including parallel partnerships and GP commitment) and separate disclosure of each constituent part;
- Year end;
- Domicile;
- Legal form (partnership, corporate, other);
- Outline of structure (e.g. details of the limited partnership structure, co-invest vehicles, parallel vehicles and other forms of side vehicle). Such disclosure may be appropriate here or in the capital account statement;
- Fund currency;
- General Partner/Carried Interest Partner/Manager/Adviser;
- Investor Relations contact;
- Open or closed-ended fund structure;
- Maximum investment size;
- Other investment restrictions;
- Re-investment policy/recycling of investments;
- Maximum permitted fund Bridge Finance facility and/or Fund Leverage facility as detailed in fund formation documents;
- Accounting principles;
- Valuation policy including compliance with the IPEV Valuation Guidelines where applicable;
- ESG policy and, if applicable, ESG restrictions;
- Link to any ESG reporting, if provided separately;
- Statement of compliance with Invest Europe Investor Reporting Guidelines.

Investment focus by

- Stage;
- Sector;
- Geography.

Key economic terms of GP

- Management fees;
- Transaction and other fees and whether 100% or less will accrue to the fund. If such amount will accrue to the fund, then disclose mechanism for reimbursement such as through a management fee offset;
- Management fees provision: within/outside commitment;
- Carried interest (including outline of catch up and escrow criteria).

Operations and governance

- Auditor;
- Administrator;
- Legal counsel;
- Bank(s), Bridge Finance provider, Fund Leverage provider;
- Tax and regulatory;
- Regulator of manager;
- Country of registration;
- Depositary;
- Independent valuation expert;
- Independent risk manager.

Additional possible disclosures

- Website address;
- Location of head office;
- LPAC members;
- Other professional advisers.

Example 7.1 provides an illustration of a Fund Overview.

3.2. Executive Summary

Purpose

The Executive Summary gives the GP an opportunity to provide LPs with information concerning key developments and current activity in the fund over the reporting period without the need for the LP to review the whole report to discover significant items. The relevant reporting period will either be the current quarter, the year-to-date period or both depending on the circumstances of the fund.

This will enable LPs to assess at a high level the progress of the fund and its investments over the reporting period.

Requirements

Commentary on:

- New investments, including brief description of the nature of business, key metrics and, if appropriate, stage of investment;
- Follow-on investments, and planned further funding;
- Realisations, including key metrics and comparison with last reported fair value;
- Significant events in the portfolio, both financial and non-financial, including relevant material ESG matters;
- Overview of investment performance, including changes in fair value;
- Portfolio analysis as deemed relevant by the GP (e.g. invested capital or NAV analysed by sector and geography);
- Material opportunities for and/or risks to the performance (financial or otherwise) of the fund not included elsewhere in the report.

Where relevant:

- Significant changes affecting the GP (for example, changes in the senior investment personnel, especially key person events);
- Notification of annual meeting;
- Changes in fair value policies, processes and procedures, including any change in the use of independent valuation expert;
- Changes to fund formation documents;
- Changes in the fund's investment strategy;
- Statement of any non-compliance with the fund's investment policy;
- Status of current fundraising if reporting before final close;
- Information on defaulting investors where there are implications for other investors;
- Any developments in the GP's approach to managing ESG-related opportunities and risks in the fund (e.g. changes to ESG-related policies, strategies, and/or management systems, etc.);
- Update on major events since the period end (including material ESG incidents);
- Explanation of any significant non-compliance with the Invest Europe Investor Reporting Guidelines.

Additional possible disclosures

- A fund performance chart in the form of either:
  - Value progression chart, showing the change in value of the fund over its life, analysed into total contributed capital, cumulative distributions, and residual fund value net of management fees and carried interest, or
  - Fund TVPI progression chart, or
  - Fund Value Bridge
- Key findings in adviser/administrator's compliance/control report if they could significantly impact the fund;
- Commentary on the economic and market environment for the fund or its investments and any significant changes;
- Commentary on deal flow and pipeline where relevant;
- AGM date, location and any registration requirements;
- Status of fundraising for successor funds;
- Description of significant LPAC decisions, including resolution of conflicts of interest.

Example 7.2 provides an illustration of formats for fund performance charts.

3.3. Fund Performance Status

Purpose

The Fund Performance Status should aim to provide LPs with sufficient information to assess the performance of the fund as a whole as well as details of the remaining commitments and the expected investment timeframe.

Requirements

A summary of:

- Total commitments to the fund;
- Cumulative paid-in capital to date;
- Total unfunded commitments available for drawdown (analysed, if desired, between undrawn original commitments and recallable distributions);
- Cumulative management and other fees drawn down outside commitment (where not funded from commitments);
- Cumulative distributions to the investors;
- Recallable distributions, if applicable;
- Total fair value of the current portfolio;
- Total cash, borrowings, other assets and liabilities;
- Total net asset value;
- Gross IRR;
- Gross multiple of cost;
- Fund Net IRR (i.e. after accrual for carried interest and fees), optional during the two years after the first investment;
- Distributions to paid-in capital (DPI);
- Residual value, net of management fees and carried interest, to paid-in capital (RVPI);
- Total value to paid-in capital (TVPI);
- Paid-in capital to committed capital (PiCC);
- Total invested in portfolio companies;
- Total additional capital commitments to portfolio companies.

Additional possible disclosures

- Comparative figures as relevant;
- Best estimate of potential drawdowns and distributions for the next reporting period;
- Total additional planned/reserved for follow-on investments;
- Guarantees made by the fund to or on behalf of portfolio companies, and their impact on fund fair value, if any;
- Net IRR and TVPI adjusted to exclude the impact of the use of bridge/credit facilities.

Example 7.3 provides an illustration of a Fund Performance Status table.

3.4. Fund Financial Statements

Purpose

A set of Financial Statements is a fundamental part of any reporting package, demonstrating good financial control and giving an overview of the performance and financial position of the fund. Such statements should be reported at the appropriate level (i.e. partnership/entity or whole fund) within the overall fund structure.

It would be typical for a manager to provide only annually a set of comprehensive financial statements that meet local regulatory requirements. However, abridged financial information will be more appropriate. This abridged financial information should be based on Fair Value but need not be in GAAP format/layout.

Requirements

Reports to investors should normally include a set of abridged financial statements for the period in question with relevant comparatives:

- Statement of comprehensive income (total return statement);
- Statement of financial position (balance sheet);
- Cash flow statement;
- Summary of accounting and valuation policy.

The statements should be presented so as to allow the reader to distinguish between portfolio/investment-related matters (e.g. gross investment return) and those related to the fund structure (e.g. fees, carried interest, expenses etc.).

Additional possible disclosures

Ideally, the abridged financial statements should allow the investor to see aggregate performance both on a whole fund basis as well as at the level of the partnership/entity in which they are invested. This is to ensure that, when read in conjunction with the investor's capital account (as illustrated in Section 7.5), the investor can track information from the whole fund level down to their individual share of the fund.

3.5. GP Fees, Carried Interest and Fund Operating Expenses

Purpose

Information on amounts earned by the GP from the fund and portfolio companies together with the fund operating expenses should be disclosed in order to verify compliance with the fund formation documents. In addition, management fees, transaction and other fees and carried interest arrangements are unique to each fund and such disclosure provides transparency to investors.

Requirements

The information below should be reported for the current reporting period, year to date (or last twelve months) and, if available, since inception. In addition, where a material difference has been identified between the audited accounts and the relevant report, a reconciliation of the difference should be disclosed and explained.

Amounts earned by the GP from the fund and portfolio companies

Management fees

- Management fees paid or payable to the GP by the fund should be disclosed together with the basis of calculation;
- In some funds, any transaction fees and other fees earned by the GP from the portfolio company (see below) are offset against the management fees either in full or in part. If this is applicable then the disclosure of management fees should show the gross management fees paid or payable to the GP, the amount of the offset applied in respect of the transaction and other fees, and the net management fees. It should be clear from the disclosure what percentage offset applies.

Transaction and other fees

- The nature and source of all benefits and fees paid directly or indirectly by portfolio companies to the GP and/or any related entities/individuals (such as employees, operating partners, advisers or similar) should be disclosed. Typically, these items will include but not be limited to arrangement fees, underwriting fees, directors' and monitoring fees and transaction fees (including those earned at the time of investment and sale, where relevant). The treatment of such fees will be specific to each individual fund, often determined in the fund formation documents and the reporting should show clearly the treatment adopted.

Carried interest

- Disclosure of whether the hurdle rate has been exceeded;
- Carried interest earned on the realised and unrealised portfolio should be disclosed with a breakdown of the following items:
  - Total amount of carried interest earned from realisations, indicating how much has been distributed
  - If undistributed carried interest is held in escrow, then the amount in question should be disclosed
  - Total amount of carried interest payable on unrealised investments assuming they are realised at the current fair value
  - Value of any potential clawbacks of carried interest (this is unlikely where the fund is structured with whole fund carry).

Fund operating expenses

- Disclosure of the fund's operating expenses providing a breakdown by category as is appropriate. This would typically include expenses such as audit, tax, Portfolio Asset legal, Fund legal and Annual Investor Meeting costs. Separate disclosure should be made, where relevant, for fund formation costs, fund borrowing costs (including interest expense and fees) and aborted deal costs. (The information may be disclosed in the fund financial statements.)

Additional possible disclosures

- Where disclosures are being made of information in accordance with the fund formation documents, consideration should be given to annotating references to specific sections of the fund formation documents where relevant;
- Transaction and other fees may also be analysed by Portfolio Asset.

Example 7.7 provides an illustration of a GP Fees, Carried Interest and Fund Operating Expenses disclosure.

3.6. Bridge Finance & Fund Leverage Facilities

Purpose

In recent years it has become common practice for GPs to use Bridge Finance facilities within fund structures. These are used by GPs for a range of efficiency reasons including reducing the volume of drawdowns made to and from LPs and avoiding the need to draw funds from LPs for temporary investments. Some funds, typically Debt Funds and Secondary Funds, are also using Fund Leverage. However, such facilities are not universally used, nor is their use uniform from one fund to another, and disclosure on their use has typically been relatively light. Such lack of comparability and transparency makes it difficult to compare underlying performance across funds and for LPs to establish their underlying exposures in each fund. As a result of the proliferation of these facilities and in order to enable both proper comparability between funds and greater transparency, the following Requirements and Additional possible disclosures have been added to these Guidelines.

Requirements

Disclosure should comprise details of any Bridge Finance, Fund Leverage and other credit facilities (including borrowings that are within a fund level SPV), which may include:

- Name of the entity or entities providing the facility and whether there are any other relationships between the GP and this entity/entities (e.g. provision of co-investor loans to GP members);
- Size and duration of the facility including ability to extend or rearrange the facility during the fund life;
- Interest rate/margin, arrangement fees, commitment fees;
- Covenants, guarantees and any other similar financial liabilities arising from the facility;
- Nature of security for the lender;
- Fund Leverage (i.e. leverage that allows the fund to make investments in excess of 100% of LP commitments) should be disclosed separately;
- If no facility is in place, a statement to that effect (in the Fund Overview).

On a quarterly basis, the GP should disclose, either as part of disclosure under 3.3 Fund performance status (Example 7.3), as part of 3.5 GP Fees, Carried Interest and Fund Operating Expenses (Example 7.7), or alternatively as part of a separate disclosure:

- The amount outstanding at the quarter end date;
- The scheduled date(s) for the amount outstanding;
- The percentage of total undrawn commitments that this amount represents;
- The maximum amount and average the Fund had drawn over the period (calculated on a daily basis through the period) and the % of undrawn commitments these represent;
- The interest charge and fees paid for the period;
- Events of default notified to the lender, if any, and if none, a statement to this effect.

Additional possible disclosures

- The Net IRR without the use of the facility (whether Bridge Finance or Fund Leverage);
- The number of days outstanding of each drawdown;
- A short description of how each drawdown has been used (e.g. to bridge capital calls for investment or expenses, in advance of distributions etc.);
- The expected repayment dates of any amounts outstanding;
- Other services provided in the reporting year by the credit provider, e.g. GP financing;
- Note of any other exposure of the fund (i.e. guarantees, charges, warranties, indemnities or other contingent liabilities).

Example 7.8 provides an illustration of a Bridge Finance and Fund Leverage Facilities disclosure.

3.7. Related Party Transactions and Conflicts of Interest

Purpose

Fund formation documents will typically describe the mechanisms for disclosure of related party transactions and disclosure of and resolution of conflicts of interest, which will involve reporting either to LPACs or to all LPs as appropriate.

Related party transactions in respect of fees earned by the GP are considered in Section 3.5.

Any such reporting should ensure the LPAC or LPs are provided with sufficient information to judge the appropriate treatment of such matters.

Requirements

The information below should be reported for the current reporting period. References to specific sections of the fund formation documents should be made where relevant.

- Overview of related parties and nature of relationship;
- Comprehensive statement of related party transactions, for example co-investment arrangements, interests in portfolio companies held by other funds managed by the same GP, significant suppliers or customers of portfolio companies controlled by related parties of the GP, fees paid by portfolio companies on behalf of the fund;
- Conflicts may arise throughout the life of the fund and where not addressed in advance in the fund formation documents, will typically need to be dealt with promptly through LPAC discussion. Resolution of any material conflicts by the LPAC should be disclosed to all LPs in the next quarterly report.

4. INVESTMENT PORTFOLIO INFORMATION

In certain circumstances, most notably in the case of a Venture fund, some of the information below may be considered confidential and therefore not disclosed; however, such non-disclosure should be agreed with LPs to ensure appropriate disclosure is still being made.

4.1. Portfolio Summary

Purpose

A Portfolio Summary of a fund provides information on the individual investments that have occurred over the life of a fund. Typically, such a summary should be in the form of a table, covering one or two pages, with footnotes as appropriate.

A summary of the portfolio should include the following details for each investment, recognising that some information may need to be provided by way of footnotes/disclosed separately.

Requirements

- Portfolio company name;
- Date of initial investment;
- Disposal date(s), where applicable, and, if a partial exit, percentage exited;
- Holding period;
- Geography;
- Industry/Sector (e.g. Invest Europe sectoral classification);
- Current percentage ownership as at reporting date;
- Total return for the investment, broken down by:
  - Cumulative income to date
  - Cumulative capital proceeds to date, where applicable
  - Total cost invested since inception
  - Current cost
  - Current fair value
  - Unrealised gains/losses and total return
  - Multiple of invested capital
  - Gross IRR
- If proceeds include deferred proceeds, escrow accounts and earn-outs or, if there are contingent liabilities, these should be quantified in a note;
- Notification of the amount of investors' commitments excused from this investment, where relevant.

Additional possible disclosures

- Where relevant:
  - income broken down between interest and dividends
  - cost broken down between capital invested and rolled up income
- If an investment is made in a currency other than the reporting currency of the fund, then the gross multiple and IRR in the currency of the investment may also be reported.

Example 7.4 provides an illustration of a Portfolio Summary disclosure.

4.2. Portfolio Asset Detail

Purpose

The Portfolio Asset Detail section in a fund report is designed to give LPs detailed information in both a quantitative and qualitative format on each of the fund's current portfolio companies / assets/ funds (referred to hereafter as 'Portfolio Investments'). The volume of information may vary depending on the size of the Fund's investment relative to the whole fund and the number of investments in the fund, but typically each individual Portfolio Investment report should cover one or two pages. To aid effective and efficient presentation these Guidelines have divided the types of information to be presented into four key sections:

- Basic information;
- Fund's investment;
- Trading and financial overview;
- Valuation.

Typically, such Portfolio Asset Detail reports should be presented at least annually, and preferably six-monthly, with updates on key developments, e.g. exits and new investments, included quarterly.

a. Basic information

Requirements

- Legal and/or trading names of Portfolio Asset, including any name changes;
- Location of head of office or management;
- Website address;
- If quoted, the ticker symbol and the number of shares held at the reporting date;
- Brief description of the industry, business, marketplace, sector, geography covered;
- Stage of initial investment (e.g. seed, venture, growth, buyout, etc. with reference to Invest Europe's definitions of Investment Stages), for multi-strategy funds;
- Where relevant, the fund's role in the Portfolio Asset (lead, co-lead, etc.) at the time of the first investment;
- Portfolio Asset's reporting currency.

Additional possible disclosures

- Information on the GP's deal team members responsible for making the investment and monitoring the Portfolio Asset;
- Current stage (with reference to Invest Europe definition of stages);

b. Fund's investment

Requirements

- Initial investment date;
- Total amount invested by the fund at reporting date:
  - Total amount committed to investment
  - Total invested since inception
  - Current cost
  - Realised proceeds since inception
- Fund's current percentage ownership as at reporting date, fully diluted percentage (if different) and percentage of control (if different) and board representation (if any) by the fund;
- For new investments made during the reporting period:
  - Investment thesis
  - Co-sponsors (including individual percentage), where relevant
  - Investment amount committed but undrawn.

Additional possible disclosures

- Breakdown of cost including allocation across equity and debt instruments, if relevant;
- For new investments made during the reporting period:
  - Sources and uses of funds, including deal costs
- Where relevant, number of financing rounds (including number of financing rounds overall and those where the fund has participated, if different).

c. Trading and financial overview

Requirements

- Historic revenue, EBITDA and net debt or other appropriate performance indicators listing comparative information from date of investment, typically in a table of performance;
- Budget or forecast revenue, EBITDA and net debt or other appropriate performance indicators for the current year, if permissible and not in conflict with regulatory requirements;
- A narrative assessment of the Portfolio Asset's recent performance, including comparison to previous expectations, budget, prior period or original investment thesis;
- Disclosure of any significant extraordinary items including legal and regulatory compliance matters;
- Commentary on key developments in the business including:
  - Key personnel changes
  - Strategy changes and changes in the risk profile
  - Acquisitions and disposals
  - Achievements, certifications, approvals, key events
- Commentary on Portfolio Asset debt, where significant/relevant, and covenant breaches;
- Material forecast cash requirements and expected source of funding, where relevant;
- Description of environmental, social or governance risks and opportunities specifically affecting the Portfolio Asset (including ESG incidents) and measures taken by the GP to manage them, if relevant. This may include specific ESG KPIs relevant to the sector the Portfolio Assets operates in, the GP's assessment of the ESG progress made by the portfolio company since acquisition, as well as a description of specific ESG topics, including reputational risk items and any ESG incident follow-up and resolution[13];
- Exit plans, where applicable and not commercially sensitive, for example timing and exit route.

Additional possible disclosures

- Key performance metrics used by the GP to monitor the investment;
- Schedule of debt maturity and information regarding significant debt covenants, if relevant.

13 For further detail please refer to Part 2 of the ESG Disclosure Framework for Private Equity, March 2013

d. Valuation

Valuation information should include key details on the inputs and methodology used to value each investment and any non-compliance with the IPEV Valuation Guidelines.

Requirements

Specific information on each investment should include:

- Fair value at reporting date and prior date;
- Increase/decrease in fair value during the period and explanation of the movement in valuation (e.g. improved trading performance, changes to benchmark companies and/or indices, changes to capital structure, forex movements, etc.);
- Any additional investments made during the period;
- Proceeds during the period;
- Realised gain/loss during the period;
- Specific methodology used in accordance with the IPEV Valuation Guidelines (e.g. earnings multiple, discounted cash flow);
- Interest and dividends received since inception (may be disclosed in the fund Portfolio Summary table);
- Gross IRR and multiple of invested cost (may be disclosed in the fund Portfolio Summary table);
- For partially realised investments, the percentage of the fund's investment sold.

Where relevant:

- Explanation of changes in valuation techniques or methodologies from previous period;
- The unit price for actively traded quoted shares/investments. Where, in exceptional circumstances, a discount is applied, the basis for that discount;
- Any realisation restrictions for the investment (i.e. lock-up period on listed shares);
- Currency when the investment is denominated in a currency other than the fund's currency and exchange rate used;
- Other exposures of the fund to the Portfolio Asset, for example follow-on funding commitments, guarantees and contingent liabilities.

Additional possible disclosures

- Disclosure of important metrics and assumptions used to determine fair value (e.g. enterprise value, multiple, EBITDA, revenue, last round funding, comparable companies, discount rate, share price, number of shares, gross asset value, net debt);
- Breakdown of fair value allocation across equity and debt instruments.

4.2.1 Private Equity Portfolio Company Detail

In addition to the Requirements listed in 4.2. Portfolio Asset Detail, for a Private Equity Portfolio Company the following additional disclosures will be relevant as part of the one-to two page reports on each Portfolio Asset:

c. Trading and financial overview

Additional possible disclosures

- Number of employees employed by the Portfolio Company, plus any other relevant ESG KPIs e.g. gender diversity statistics;
- Value creation in Portfolio Company since investment (e.g. increase to EBITDA, multiples or debt payback).

4.2.2 Real Estate Asset Detail

Purpose

In addition to the Requirements listed in 4.2. Portfolio Asset Detail, for a Real Estate asset the following additional matters should be disclosed as part of the one to two page for each Portfolio Asset:

Requirements

a. Basic information

- Location of asset(s)
- Tenure (leasehold/freehold)
- Usage (commercial/residential)
- Project description/strategy (i.e. refurbishment/construction)
- Type (i.e. greenfield/brownfield/refurbishment/unchanged use)
- Capital structure, financing and hedging
- Tax status (noting any structure complexity)

b. Fund's investment

- No additional disclosures

c. Financial overview

- Initial yield
- Current yield
- Key performance metric (i.e. number of tenants/percentage let/percentage completed)
- Reversionary yield (forecast)
- Projected returns/target returns
- Net operating income
- Capex to date and projected
- Financing costs

d. Valuation

- External valuation expert
- Rotation policy
- Any conflict of interest (e.g. to ensure independence between bringing deals and performing valuations)

4.2.3 Private Debt Investment Detail

Purpose

Since Private Debt is simply an alternative type of financial instrument through which a fund may be exposed to a portfolio company, the basic information that should be provided for a Private Debt instrument is very similar to that information that would be disclosed for a Private Equity Portfolio Asset.

In addition to the Requirements listed in 4.2. Portfolio Asset Detail, for each Private Debt investment in the fund the following additional matters should be disclosed as part of the one to two page reports:

a. Basic information

Additional possible disclosures

- Any credit rating applicable to the company.

b. Fund's investment

Requirements

- The name of the Private Debt instrument (e.g. Term Loan A)
- The date of the initial investment in the Private Debt instrument
- Whether the investment was acquired through an origination process or a secondary trade
- The notional amount invested and the price as a percentage of par value paid at the date of the original investment
- The notional amount outstanding and separately the amounts of all accrued interest as of the reporting date
- The implied credit spread or yield based on the price paid at the date of the original investment
- Any origination or administrative fees received
- The economic terms of the Private Debt instrument:
  - Origination date and/or trade date
  - Contractual maturity date
  - Coupon (including specifics about base rate, spread over base rate, margin ratchets, etc.)
  - Interest period
  - Amortisation schedule and/or any scheduled amortisation payments and dates
  - Prepayment provisions
  - Key financial covenants
  - Any unique features such as exit fees, cash flow sweeps, conversion options, fees on unfunded portion, associated warrants and equity features etc.

c. Trading and financial overview

Requirements

- Capital structure of issuer, including the terms and rights of other financial instruments in the issuer's capital stack, and any relevant leverage and interest coverage ratios
- Trading update – particularly as it relates to any cash flow sweeps or margin ratchets
- Covenant compliance update
- Any default (e.g. non-payment of interest)

Additional possible disclosures

- Equity cushion

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d. Valuation

Private Debt instruments should be reported at Fair Value in accordance with IPEV Guidelines.

Requirements

- Fair Value expressed in nominal terms and as a percentage of par value (specifying whether pricing is on a 'clean' or 'dirty' basis convention)
- Implied spread or yield based on reported Fair Value
- Valuation methodology utilised
- Instrument-level credit ratings (if available)

4.2.4 Infrastructure Investment Detail

Purpose

Because infrastructure investing is a close variant of traditional Private Equity, the basic information that should be provided for an Infrastructure investment is largely similar to that information that would be disclosed for a more traditional Private Equity Portfolio Asset.

In addition to the Requirements listed in 4.2. Portfolio Asset Detail, for an Infrastructure investment the following additional matters should be disclosed as part of the one to two page reports:

a. Basic information

Additional possible disclosures

Given that infrastructure investments are often subject to government regulation, additional disclosures may be relevant as follows:

- Authoritative body (or bodies) under which the investee company is regulated
- Significant laws, directives and/or statues which impact the operations of the investee company
- Material regulations which impact the price(s) which the investee company is able to charge for its product(s) or service(s) or the rate of return which the investee company is permitted to earn.

d. Valuation

Requirements

In contrast to the market approach generally favoured by traditional Private Equity managers (in accordance with the IPEV valuation guidelines), the income approach is more often the key methodology used in the valuation of infrastructure businesses. Specifically, a free cash flow to equity ("FCFE") or dividend discount model ("DDM") are favoured for valuing the equity of infrastructure businesses particularly those which generate more stable, often government-regulated returns. Because such valuation methodologies can be more elaborate, and require a larger number of inputs and assumptions, the following Additional possible disclosures may be appropriate:

- Discount rate, whether a weighted average cost of capital (or WACC) or cost of equity, as well as the components of the discount rate:
  - Risk free rate
  - Equity risk premium
  - Beta
  - Any premia/discounts applied to cost of equity
  - Cost of debt
  - Gearing
- Exit assumptions
  - Exit asset yield
  - Exit multiple

4.2.5 Venture Portfolio Company Detail

Purpose

Where a fund has invested in Seed, Start-up or a Later-stage financing (see Glossary for the Invest Europe Development Stage definitions of such investments) the following additional disclosures to those set out in 4.2. Portfolio Asset Detail may be required to reflect the particular characteristics of such Venture Portfolio Company investments:

a. Basic information

Requirements

- Stage of initial investment (e.g. seed, start-up, other early stage, etc. – as described in the Invest Europe Development Stage definitions) for multi-stage funds;

Additional possible disclosures

- Current stage (with reference to Invest Europe Development Stage definitions);

b. Fund's investment

No additional disclosures

c. Trading and financial overview

Requirements

- Description of environmental, social or governance risks and opportunities specifically affecting the portfolio company and measures taken by the GP to manage them. In the case of early stage businesses this should be proportionate in relationship to its development, but should nevertheless reflect legal obligations.
- Commentary on key developments in the business including:
  - Status on major milestone(s)
  - Scientific/technical/regulatory developments
  - Achievements, certifications (e.g. patents), approvals, key events

Additional possible disclosures

- Key performance metrics used by the GP to monitor the investment (e.g. current cash balance, current cash burn rate).

d. Valuation

Additional possible disclosures

- Disclosure of important metrics and assumptions used to determine fair value (e.g. financial terms of the last round funding discount rate, share price, etc.);
- Achievement/failure of milestones.

4.2.6 Fund of Funds Investment Detail

Purpose

Funds of Funds ("FoFs") invest as LPs into funds managed by other fund managers. FoFs hold multiple fund interests ("Portfolio Funds") with potentially hundreds or even thousands of underlying investments in Portfolio Assets. This impacts their reporting in different ways:

- Due to the nature of FoF investing, the primary investment asset is – in contrast to primary or direct Private Equity funds – not a Portfolio Asset, but a Portfolio Fund. Several of the metrics for monitoring Portfolio Fund investments differ from those applied to Portfolio Assets referred to in 4.2 as noted below.
- The reporting timeline for a FoF naturally lags 30 to 45 days behind the average reporting timeline of its underlying Portfolio Funds (which in reality usually means 90 to 120 days after quarter end). In practice FoFs sometimes offer their investors accelerated ("cash-adjusted" or "roll-forward" – see Glossary for definition) simplified valuations in order to speed up their reporting cycles. Investors should be familiar with the assumptions of a cash-adjusted/roll-forward valuation method and assess whether it meets their needs (e.g. trade-off accuracy versus speed of reporting).
- FoFs often have to agree to NDAs with their underlying fund managers placing limits on the disclosure of information on the Portfolio Companies their Portfolio Funds have invested in. Given this limited degree of transparency, the FoF may not be able to report on all disclosures regarding Portfolio Assets to the extent that a primary or direct Private Equity Fund would report. Thus FoF reporting on underlying Portfolio Assets will be limited and/or will be based on aggregated figures or on a no-name basis to comply with such legal requirements.

a. Basic information

Requirements

- A meaningful aggregate exposure analysis covering all Portfolio Funds. Disclosures may differ by investment strategy and focus of the FoF and should be determined between the Fund Manager and its LPs but typically should include some or all of the following:
  - Exposure diversification by geography or region (based on NAV and/or Cost)
  - Exposure diversification by currency (based on NAV and/or Cost)
  - Exposure diversification by vintage year/year of investment (based on NAV and/or Cost)
  - For multi-strategy funds: Exposure diversification by strategy (based on NAV and/or Cost)
  - Top five exposures (based on NAV and/or Commitment and/or Fund Managers)
  - Drawdowns/Distributions over a materiality threshold to the FoF with an explanation of the activity driver.

Additional possible disclosures

- Comparison of Gross and/or Net IRRs to market/top quartile/ other meaningful benchmarks

b. Fund's investment

A FoF will typically report its investments on two levels: first on the Portfolio Fund level (section b.1.) and second on the (look-through) Portfolio Asset level (section b.2.).

b.1. Portfolio Fund level

FoFs should disclose the following information for each individual Portfolio Fund:

Requirements

- Portfolio Fund name
- Vintage year of the Portfolio Fund
- Geographic focus of the Portfolio Fund
- Strategy of the Portfolio Fund
- Amount Committed/Total committed capital of the Portfolio Fund
- Total amounts drawn down/contributions/Invested Capital of the Portfolio Fund
- Total amounts distributed
- Remaining unfunded commitment to the Portfolio Fund
- Net Asset Value of the Portfolio Fund
- Net IRR of the Portfolio Fund
- TVPI of the Portfolio Fund
- Split between primary and secondary investments (if applicable)

Additional possible disclosures

- TV of the Portfolio Fund (NAV + Total Distributed)
- DPI of the Portfolio Fund
- Gross multiple of cost of the Portfolio Fund
- Gross IRR of the Portfolio Fund
- Exposure to individual Funds/managers (e.g. NAV plus uncalled commitments)
- Split of total amounts distributed between recallable and non-recallable
- Split of remaining unfunded commitment between original unfunded and recallable
- For FoFs with significant foreign exchange exposure it might be beneficial to show the key performance indicators of the Portfolio Funds both in local currency of the Portfolio Fund and in reporting currency of the FoF
- Actual or estimated management fees of underlying Portfolio Funds (if available)

b.2. Portfolio Asset level (look through reporting)

FoFs should disclose the following aggregated information for all Portfolio Assets held indirectly through their Portfolio Funds:

Requirements

- Portfolio Asset diversification by industry (based on NAV and/or Cost)
- Portfolio Asset diversification by geography or region (based on NAV and/or Cost)
- Portfolio Asset diversification by currency (based on NAV and/or Cost)
- Portfolio Asset diversification by vintage year/year of investment (based on NAV and/or Cost)
- Portfolio Asset diversification by strategy (based on NAV and/or Cost)

Additional possible disclosures

- Largest Portfolio Assets by NAV (if allowed by NDA)
- Largest additions/realisations in the underlying Portfolio Assets
- Portfolio Assets at/above/below cost (aggregated based on total number and/or NAV and/or Invested Cost)

c. Trading and Financial overview

Other than the metrics above, FoFs typically do not disclose financials of underlying Portfolio Funds nor Portfolio Assets.

d. Valuation

Requirements

Given the limited degree of transparency into the underlying portfolio companies held within the Portfolio Funds in which the FoF holds an interest, the FoF is usually inadequately positioned to comment upon the valuation basis of the underlying Portfolio Assets in their Portfolio Funds. However, the FoF should disclose the following:

- Whether a Portfolio Fund valuation is valued at reported NAV or at "cash-adjusted" or "roll-forward" NAV, and
- Valuation standards/guidance applied by the managers of the underlying portfolio funds, e.g. US GAAP, IFRS, IPEV

Additional possible disclosures

- Whether the FoF manager has made its own adjustments to the reported NAV of a Portfolio Fund and an explanatory narrative;
- The date of the reported Portfolio Fund NAV if not the Fund of Fund's reporting date.

4.2.7 Secondary Fund Investment Detail

Purpose

Private Equity secondary funds typically buy and sell pre-existing investor commitments to Private Equity and other alternative investment funds. Private Equity secondary transactions ("Secondaries") are often complex and occur either in a proprietary negotiation, via the use of an intermediary or in an auction process.

Historically, the Secondaries market comprised the sale and purchase of limited partnership fund commitments ("LP interests") in individual funds or portfolio of funds. Whilst LP interests remain the largest component, the Secondaries market has evolved to include portfolios of direct investments in operating companies not held in standard fund structures ("Direct Secondaries"), minority co-investments in single operating companies ("Co-investment Secondaries") and increasingly GP-led liquidity transactions involving sale of the assets from, or restructuring of, older vintage private equity funds ("GP Restructurings").

Whilst secondary funds transact in very different ways to FoFs, they do however share many of their characteristics, particularly in terms of their legal structure and operation and also in that they represent the LP in a GP/LP relationship.

Accordingly, reporting for secondary funds should be consistent with that of FoFs as set out in section 4.2.6 with the following key differences:

- Similar to FoF, typically the primary asset for a secondary fund will not be equity in a Portfolio Company but an interest in a Portfolio Fund. However, uniquely, secondary funds may commonly acquire whole portfolios of fund interests rather than single fund interests, usually at a discount to the aggregated Fair Market Value of the acquired funds. Secondary fund GPs may wish to report such portfolio transactions as a single aggregated investment for the following reasons:
  - Discounts negotiated, or acquisition costs incurred, cannot be meaningfully applied to each individual Portfolio Fund acquired, preventing secondary funds from calculating and reporting performance for each individual Portfolio Fund
  - Secondary transactions, particularly 'off-market' exclusive transactions, are frequently characterised by a need for confidentiality by the vendor or underlying fund GPs, governed by NDAs, thereby limiting disclosure of full information on the Portfolio Funds acquired
  - Performance and KPI calculation for an underlying Portfolio Fund should be adjusted to account for the premia/discount and/or other costs paid by the Secondary Fund for its investment and thus will differ from other investors in the same Portfolio Fund that have been invested in the Portfolio Fund since inception (Primary Investment)

Given the above, consideration should be given to the following Additional possible disclosures where relevant:

Additional possible disclosures

- Premia/discounts paid by investment and a weighted average across the investment portfolio
- Transaction details including broker/intermediary where relevant

Investor Reporting Guidelines
IPEV Valuation Guidelines

5. INVESTOR INFORMATION

5.1. Capital Account

Purpose

The Capital Account information presented for the current period and since inception provides each LP with current and cumulative information on their individual commitment in the fund and allows analysis of income and capital allocations.

The descriptions below reflect a typical limited partnership structure for the fund vehicle. Accordingly, the format may need adapting to accommodate other legal structures such as those used in continental Europe involving allocation of returns to different classes of shares.

Requirements (for both current period and since inception)

Each LP should receive a statement of their own capital account together with relevant information for either the whole fund or the entity/partnership in which they have invested (or both) to include the following information:

- LP's percentage ownership in the fund/partnership at the reporting date. In the case of funds that are made up of parallel structures, the whole fund position should be included if applicable;
- Total commitment, split between different instruments if appropriate at the reporting date;
- Total contributions;
- LP unfunded commitment at the reporting date;
- LP's share of any outstanding Bridge Financing balance;
- Cumulative distributions;
- Amount of cumulative distributions recallable by the manager at the reporting date;
- Realised portfolio gains/losses;
- Unrealised portfolio gains/losses;
- Allocation to the carried interest partner;
- Non-portfolio income and expenses;
- Management fees;
- Capital account at fair value at the beginning of the period (for current period report);
- Capital account at fair value at the reporting date;
- Confirmation that LP's NAV is reported net of unrealised carried interest attributable to the General Partner and the amount of the unrealised carried interest deducted; alternatively, show unrealised carried interest assuming that all investments are realised at their reported Fair Value at the reporting date.

Example 7.5 provides an illustration of an Individual Capital Account statement. Sole investor specific information is increasingly required by investors; however, in funds where investors do not have confidentiality concerns over sharing their capital account information with others in the fund, the example in 7.6 is an illustration of an alternative whole fund since inception format.

Additional possible disclosures

- Cash flow schedule detailing dates and amounts of drawdowns and distributions, either showing amounts for the individual LP or for the fund/partnership as a whole;
- Analysis of distributions for the current period by source (i.e. between return of cost, capital gains/losses, dividends and interest) and/or by nature (i.e. cash vs. in-specie);
- LP's share of individual investments (particularly where individual LPs are excluded from certain investments);
- Breakdown of expenses between establishment costs and ongoing operational costs;
- A table showing the bridge between the opening and closing capital account balance.

Example 7.9 provides an illustration of a Fund Cash Flow Schedule.

5.2. Drawdowns and Distributions

Purpose

Drawdown and distribution notices should be issued to investors in accordance with the fund formation documents with cross-references to the specific sections of these documents.

Standard practice is for drawdown notices to be accompanied by a covering note explaining how the funds will be used, for example for an investment, for management fees or for fund running costs. Where such notices relate to an investment, the date and nature of the investment transaction being undertaken and the following should also be covered:

- The company or companies being acquired;
- The investment thesis;
- Total financing;
- Other material deal parameters.

However, General Partners may need to restrict disclosure where commercial sensitivity is required, particularly if a drawdown is being undertaken prior to the closing of an investment, or where a drawdown is being made in advance of multiple investments some of which may not yet have been identified.

Distribution notices should be accompanied by a covering note listing the company or companies divested, and giving relevant details such as the exit route, timing, any escrows or contingencies and the fund's gross multiple and IRR for this investment. For partially exited investments and refinancings, the cost basis and value of the remaining investment may be relevant.

Where a drawdown and distribution are performed in the same notice resulting in a net payment or receipt, the gross balances should be disclosed and accounted for as such.

a. Drawdown notices

Drawdown notices should include the following information:

- Due date;
- Amount being drawn down, at the investor and fund level (whole fund in cases where there are parallel vehicles);
- The investor's commitment;
- Cumulative capital drawn down to date and capital remaining to be drawn;
- The total unfunded commitment;
- Payment instructions for the drawdown;
- Reason for the drawdown including an analysis where applicable of the individual components of the drawdown;
- Where applicable, describe any LPAC or investor consents or waivers sought or granted as required by the LPA in order for this for this drawdown/the underlying investment to proceed.

b. Distribution notices

Distribution notices should include the following information:

- Payment date;
- Amount being distributed, at the investor and partnership/fund level (whole fund in cases where there are parallel vehicles). This should disclose the amount of any recallable distributions;
- Cumulative capital distributed at the investor and fund level, analysed, where possible, between recallable and non-recallable;
- Payment instructions held for the investor showing the bank to which the distribution will be paid;
- An analysis of the distribution between return of cost, capital gain, interest and dividend and disclosure of amounts withheld to cover fees, carried interest and other expenses;
- Withholding tax deducted;
- For distributions in specie, the name of instrument being distributed, Ticker symbol (where relevant), number of shares, historical cost, value and basis of value (if necessary an estimate, to be followed up with the actual value ascribed when finalised), any settlement details and any restrictions affecting the shares distributed.

6. PERFORMANCE MEASUREMENT AND REPORTING

6.1. Internal Rate of Return and Net Fund Multiples

The most common measure of performance within the private equity industry is the Internal Rate of Return ("IRR"). Such performance can be calculated both prior to deduction of fees, expenses and carried interest (gross) and after such deductions (net).

Additional frequently used measures of net performance are the multiples to investors of:

- Distributions to paid-in capital (DPI);
- Residual value to paid-in capital (RVPI);
- Total value to paid-in capital (TVPI).

Invest Europe recommends the IRR and the multiples mentioned above as being the most appropriate and commonly used performance indicators.

Where GP capital which does not pay carried interest or fees is a small percentage of the fund, it can be included in the net performance calculations, but where it is a significant percentage, it should be excluded and the resulting net performance figures footnoted to make it clear that GP capital has been excluded from the calculations.

6.2. Gross and net IRR

To enable the gross and net IRRs to be comparable, all relevant components (variables) must be treated in an identical manner. It is for this reason that the standard principles have been developed, which are set out below.

a. Gross IRR

This measures the return earned by the fund from its investments, and takes account of:

- All the cash outflows (investments) and inflows (divestments, including realisation values, interest and dividends, repayments of principal of loans, etc.) which take place between the fund and all of its investments, independently, whether realised or not;
- The valuation of the unrealised portfolio. By definition, the unrealised portfolio excludes cash and other assets held by the fund.

This return does not include the impact of carried interest or charges of any kind, such as management fees paid to the private equity firm by the investor, fees paid by a portfolio company either to the fund or the private equity firm, and fees paid or due to lawyers, accountants and other advisers (except where such fees specifically relate to a particular investment).

b. Fund Net IRR

This measures the return earned by the investors in the fund, and takes account of:

- The actual cash flows which take place between the fund and all the LPs;
- The LPs' share of the fund's remaining net assets, which includes the valuation of the unrealised portfolio, cash and other net assets or liabilities, after an appropriate accrual for carried interest.

When the portfolio is fully realised/fully distributed, the fund net IRR reflects the 'cash-on-cash' return to the investors, and will implicitly be net of:

- The management fees paid to the fund manager (whether funded from investor drawdowns or out of investment income);
- The fund manager's carried interest;
- All other applicable professional and ancillary charges which are paid out by the fund in the course of investing, managing, and divesting from the investment portfolio.

The fund net IRR should accordingly represent a "blended" net IRR of all the investors. It is noted that this figure may be greater than or less than the net IRR attributable to an individual investor.

c. Net IRR to an individual LP

This is calculated as for the fund net IRR, but based on the cash flows, carried interest and valuations attributable to the individual LP.

It should be noted that net IRR can only be calculated for an entire interest in a fund and not for individual investments. Deal-by-deal net IRRs would require allocations of costs and fees and are thus not typically appropriate measures of performance.

6.3. Gross Multiple of Cost

The multiple of investment proceeds received plus current fair value of the unrealised portfolio divided by the total original cost of the investments (including follow-ons).

6.4. Net IRR modified for Bridge Finance/ Fund Leverage

The net IRR calculated as if drawdowns from LPs had been made on the date drawdowns were made on the Bridge Finance facility, rather than the date drawdowns were made from LPs, adjusting for the interest and other costs associated with the Bridge Finance and any consequent impact on carried interest.

The net IRR calculated as if no Fund Leverage had been available, with drawdowns from LPs replacing the drawdowns from the Fund Leverage facility and adjustments made to remove interest and other costs and any consequent impact on carried interest.

6.5. Modified IRR (MIRR)

MIRR, a relatively new metric, modifies the traditional IRR approach in that it no longer assumes cash flows are re-invested at the same rate. This methodology allows the user to input their own, implied re-investment rate. Whilst this may resolve some of the known flaws of the traditional approach relating to multiple cash flows on various dates both into and out of a fund, it requires the user to input a re-investment rate appropriate to their circumstances. Such re-investment rates are likely to vary according to the individual circumstances of each investor, and require detailed knowledge of that investor's individual circumstances and opportunities for re-investment. Accordingly, it is not recommended as a metric for reporting by a GP generally to its investors.

Use of MIRR should be restricted to situations where an LP who has (i) the information to calculate their own re-investment rate and (ii) the detail of the underlying cash flows for each of the funds in which they have invested and which they wish to compare. In such circumstance, it provides an alternative methodology for comparing the performance of those funds.

Where a Modified IRR is calculated, the implied re-investment rate should always be disclosed alongside the MIRR. MIRRs should only be compared to other MIRRs calculated using the same re-investment rate. Comparison of MIRRs with traditional IRRs is never appropriate.

6.6. Public Market Equivalent (PME)

Public Market Equivalent is a methodology designed to compare performance of a fund against a public market benchmark. To do so, the historic cash flows into and out of the fund are mirrored by equivalent amounts invested into a public market index. Accordingly, drawdowns into the fund are matched with investments into the public market on the same date and distributions from the fund are matched with withdrawals from the public markets on the same date, based on the valuation of the index at that date. Finally, a comparison is made at the reporting date between the value that is left in the fund versus the value remaining in the public market equivalent.

In order to be a valid comparator such an index should be one based on re-investment of dividends.

The fundamental challenge for a PME is finding an appropriate public index whose risk/return characteristics are relevant to the fund's investment strategy. This is a subjective area and accordingly Invest Europe does not require reporting of PME measures. Where they are reported, details on the public index used should also be disclosed.

6.7. Principles of calculating returns

a. Commitments made by a fund to a Portfolio Asset

The cash outflows should be taken to be the amount actually invested in a Portfolio Asset at a given point in time, i.e. on a gross return basis. A fund may commit itself to making a series of investments in a Portfolio Asset over an extended period of time. In such circumstances, the timing and amounts of only the individual past cash flows should be taken into account.

b. Equity received in lieu of cash

Any equity received by a fund in lieu of cash in respect of services rendered to a Portfolio Company (for instance, services of directors, provision of guarantees) should be recognised at the Fair Value of the consideration received.

c. Commitments made by an investor to a fund

An LP will commit itself to making a series of investments in a fund over a period of time, up to their committed capital. The cash flows from investors should be taken to be the amount actually drawn down by a fund at given points in time. In such circumstances, the timing and amounts of only the individual past cash flows should be taken into account.

d. Net return to investors; carried interest and the unrealised portfolio

When calculating the net return to the investor, as regards the valuation of the unrealised portfolio, appropriate provision should be made for the deduction of carried interest calculated on the basis of the assets being realised at the carrying value.

e. Realisations

Distributions in-specie

Depending upon the provisions of the fund formation documents, shares in companies / assets which are listed and distributed in-kind should be treated as set out by the fund formation documents as to when they are treated as realised.

Other exits

As regards the calculation of the gross return on realised investments only, a written-off investment should be considered as having been realised as soon as the earliest of any of the following or like events takes place: when bankruptcy proceedings are instigated against a Portfolio Company/asset; when a Portfolio Company ceases to trade; when a Portfolio Company enters into arrangements with creditors which result in the investment being written down to zero; or when insolvency proceedings are begun.

Treatment of realisations with deferred consideration

Investments which have been completely sold, subject to a proportion of deferred consideration/earn-out, should be defined as realised investments. An estimate of the fair value of deferred proceeds or earn-out should be included at the reporting date.

f. Taxation

Interest payments, dividends and capital gains received from portfolio companies that are paid net of tax withholdings should be grossed up so as to be treated as pre-tax cash flows for the measure of gross return. Withholding tax which would not be recoverable by a typical tax exempt investor should be excluded from such grossing up.

g. Timing of cash flows

IRRs are recommended to be calculated on the basis of daily or monthly cash flows. Daily cash flows should use the exact value date of the cash flow. When calculated on a monthly basis, the date attributed to each cash flow should be the same day of each month (e.g. the last day of the month).

Example 7.10 provides a worked example illustrating the principles of calculating fund multiples referred to above.

7. EXAMPLES

These examples are intended to illustrate a range of possible layouts which may assist managers in designing their reporting. These include both Requirements and Additional possible disclosures, and should not be taken as a minimum or mandatory requirement.

7.1. Fund Overview

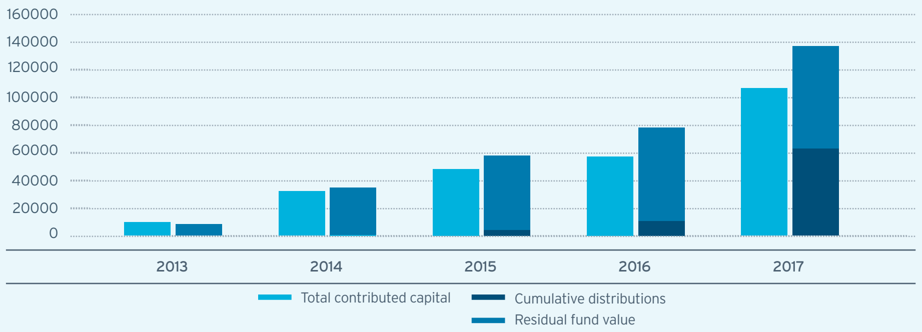
General	
Fund full name	Invest Private Equity Fund
First closing date	Tuesday, 8 January 2013
Final closing date	Monday, 21 January 2013
Vintage year	2013
First investment date	Friday, 25 October 2013
Term	10 years to 8 January 2023
Investment period	5 years to 8 January 2018
Extensions	Up to three one year extensions, the first two at the manager's discretion
Fund currency	Euro
Total commitments	€100 million
Year end	31 December
Domicile	UK
Legal form	Two English Limited Partnerships Invest Private Equity Fund A LP Invest Private Equity Fund B LP
Outline of structure	1 General Partner, 10 Limited Partners
Manager	Invest Private Equity Manager
Client Contact	Mrs Investor Relations. Investor.relations@IPE.com
Adviser	Invest Private Equity Adviser
General Partner	Invest Private Equity Commitment €1 million
Open/closed-ended	Closed-ended
Maximum investment	15% of total commitments
Other investment restrictions	Maximum 10% outside EU
Reinvestment policy/Recycling of investments	Reinvest up to 100% of acquisition cost of assets disposed of during Investment period
Maximum Bridging	20%
Accounting principles	IFRS
Valuation policy	International Private Equity & Venture Capital Valuation ('IPEV') Guidelines
ESG restrictions	No alcohol or weaponry
ESG policy	See LP portal on www.IPE.com
ESG reporting	See LP portal on www.IPE.com

Investment focus by	
Stage	Buyout
Sector	Industrial, Healthcare, Consumer Services
Geography	Europe
Key economic terms	
Management fees	1.75% on committed capital during the Investment Period, 1.50% on aggregate acquisition cost of unrealised assets thereafter
Fee offsets	80% of Partnership's share of fees received by the manager
Management fees	Within commitment
Carried interest	Whole fund. 20%, subject to a return of 100% of Paid-in Capital plus an 8% hurdle. 100% catch up
Carried Interest Partner	Invest Private Equity
AIFMD	
Manager's regulator	Financial Conduct Authority
Depositary	AIFMD Depositary Corporation
Country of registration	UK
Independent valuer	Valuations Company
Independent risk manager	AIFMD Risk Manager
Service providers	
Auditor	Auditor LLP
Administrator	Administration Corporation
Legal Counsel	Invest Lawyer
Banking Facilities	A.N.Other Bank Corporation
Bridging provider	Bridge Bank Corporation
Leverage provider	N/A
Tax & Regulatory	Tax & Regulatory Advisers
LP Advisory Committee (additional possible disclosures)	
Members of LP Advisory Committee (if not against legal or LPA restrictions)	A LP, B LP, C LP, D LP

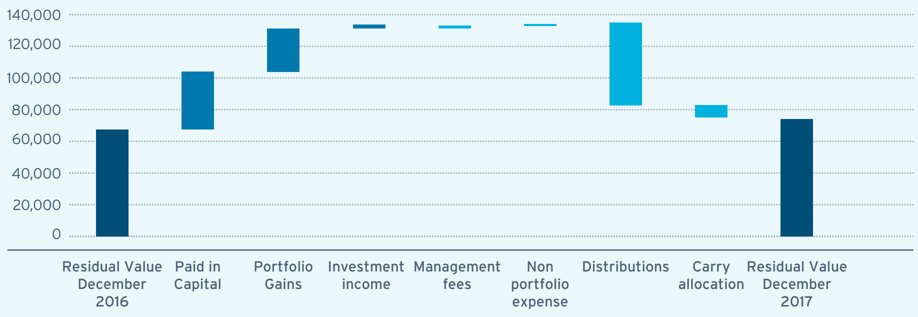
This report is in compliance with Invest Europe Guidelines

7.2. Fund Performance Charts

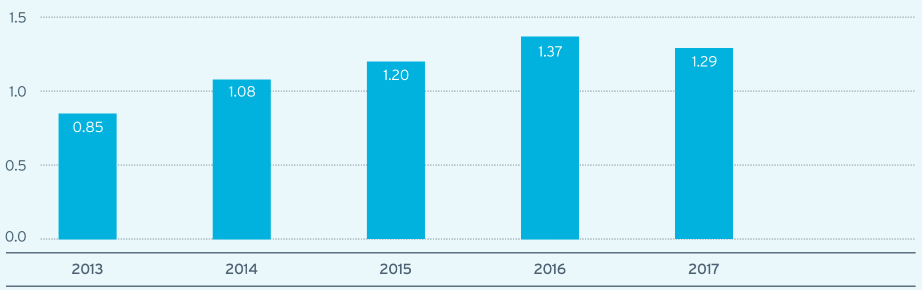
Value Progression (€000)



Fund Value Bridge (€000)



Historical Fund Performance (TVPI)



7.3. Fund Performance Status

	2017 €000	2017 % Committed Capital	2016 €000	2016 % Committed Capital
Total Commitments to the Fund	€100,000	100%	€100,000	100%
Cumulative Paid In Capital	€106,331	106%	€69,961	70%
Cumulative Distributions to the Investors	€62,736	63%	€10,592	11%
Of which – Recallable Distributions	€35,830	36%	€3,157	3%
Total Unfunded Commitment available for Drawdown	€29,499	29%	€33,196	33%
Total invested in portfolio companies	€96,331	96%	€61,761	62%
Total additional commitment to portfolio companies	€15,000		€0	
Total fair value of the current portfolio	€81,702		€69,432	
Total cash, borrowings, other assets and liabilities	€0		€0	
Total net asset value (NAV)	€81,702		€69,432	
Gross IRR	24.5%		25.0%	
Gross multiple to cost	1.50		1.12	
Fund Net IRR (after accrual for carried interest and fees)	14.8%		15.1%	
Fund Net IRR modified for Bridge Finance	14.2%		14.4%	
Distributions to Paid In Capital (DPI)	0.59		0.19	
Residual Value to Paid In Capital (RVPI)	0.70		1.18	
Total Value to Paid In Capital (TVPI)	1.29		1.37	
Total Value to Paid In Capital (TVPI) modified for Bridge Finance	1.29		1.38	
Funded Commitment to Committed Capital	0.71		0.67	
Paid In Capital to Committed Capital (PICC)	106.3%		70.0%	

7.4. Portfolio Summary

At 31 December 2017

								Cash Flows				Current Portfolio		Returns			
Investment name	Date of first investment	Date of exit	Holding period (yrs)	Exit method	Geography	Industry	Current fully-diluted %age ownership	Total original cost	Proceeds/ repayments	Cash income	Total cash realised	Cost	Fair Value	Total cash realised + Fair Value	Total return	Multiple to cost	Gross IRR
								€000	€000	€000	€000	€000	€000	€000	€000		
Fully Realised Investments																	
Investment A	Jan-13	Apr-16	3.2	Trade sale	France	Healthcare		3,157	5,421	732	6,153			6,153	2,996	1.9x	34%
Investment B	Feb-13	Aug-17	4.5	Secondary	Germany	Manufacturing		5,100	8,311	857	9,168			9,168	4,068	1.8x	14%
Investment C	Mar-14	Sep-17	3.5	Trade sale	UK	Consumer Retail		2,580	4,650	229	4,879			4,879	2,299	1.9x	22%
Investment D	May-14	Nov-17	5.5	Trade sale	Spain	Manufacturing		6,434	3,800	211	4,011			4,011	(2,423)	0.6x	n/a
Investment E	Aug-14	Dec-17	4.4	Secondary	Italy	Oil & gas		11,614	19,826	3,626	23,452			23,452	11,838	2.0x	26%
								28,885	42,008	5,655	47,663			47,663	18,778	1.7x	17%
Current Investment Portfolio																	
Investment G	May-16		4.7	n.a.	France	Manufacturing	86%	5,703	-	70	70	5,703	7,863	7,933	2,230	1.4x	30%
Investment H	May-16		3.2	n.a.	Germany	Business services	75%	14,344	530	74	604	13,814	18,650	19,254	4,910	1.3x	34%
Investment I*	May-15		2.7	IPO	Poland	Healthcare services	21%	12,829	12,623	1,160	13,783	6,414	13,489	27,272	14,443	2.1x	37%
Investment J**	May-17		0.7	n.a.	Sweden	Hotel & Casino	95%	17,500	-	521	521	17,500	25,317	25,838	8,338	1.5x	79%
Investment K	Sep-17		0.3	n.a.	UK	Manufacturing	68%	9,214	-	70	70	9,214	8,527	8,597	(617)	0.9x	n/a
Investment L	Nov-17		0.2	n.a.	Germany	Consumer retail	84%	7,856	-	25	25	7,856	7,856	7,881	25	1.0x	n/a
								67,446	13,153	1,920	15,073	60,501	81,702	96,775	29,329	1.4x	39%
Totals								96,331	55,161	7,575	62,736	60,501	81,702	144,438	48,107	1.5x	25%

Notes

* Listed on 25 July 2014 when 21% of the company was realised leaving 21% still held

** An investor was excluded from this investment, with equalisation on the following investment

If there are parallel vehicles this should represent the whole fund.

7.5. Individual Capital Account Statement

Investor Statement for Investor No. 4 for the quarter ending 31 December 2017

1. Commitment	Inception to 31 Dec 2017 Fund	Vehicle	Investor No. 4	Q4 2017 Investor No. 4
	€000	€000	€000	€000
Commitment	100,000	75,000	10,000	3,731
Paid in Capital	(106,331)	(79,748)	(10,633)	(831)
Recallable Distributions	35,830	26,873	3,583	50
Unfunded Commitment available for Drawdown at 31 December 2017	29,499	22,124	2,950	2,950
Ownership % of Fund		75%	10%	
Share of outstanding bridging facility				-

2. Capital account	Quarter to 31 Dec 2017 Fund*	Investor No. 4	Year to 31 Dec 2017 Fund*	Investor No. 4	Inception to 31 Dec 2017 Fund*	Investor No. 4
Current Investment Portfolio	€000	€000	€000	€000	€000	€000
Capital Account at Fair Value opening balance	87,800	8,780	69,432	6,943		
Paid in Capital from Investors	8,306	831	36,370	3,637	106,331	10,633
Distributions to Investors	(24,947)	(2,495)	(52,144)	(5,214)	(62,736)	(6,274)
Realised portfolio gains/(losses)	5,578	558	17,067	1,707	19,331	1,933
Unrealised portfolio gains/(losses)	4,624	462	10,373	1,037	21,201	1,208
Investment income/ (expense)	791	79	2,404	240	7,575	719
Management fees	(438)	(44)	(1,750)	(175)	(8,750)	(875)
Non portfolio income/ (expense)	(13)	(1)	(50)	(5)	(1,250)	(125)
Net change in provision for carried interest**		(211)		(561)		(580)
Capital Account at Fair Value as of 31 December 2017	81,702	7,959	81,702	7,609	81,702	6,640

3. Investment Schedule	Investments at Cost Fund*	Investor No. 4	Investments at Fair Value*** Fund*	Investor No. 4
Current Investment Portfolio	€000	€000	€000	€000
Investment G	5,703	570	7,863	786
Investment H	13,814	1,381	18,650	1,865
Investment I	6,414	641	13,489	1,349
Investment J****	17,500	-	25,317	-
Investment K	9,214	2,671	8,527	2,472
Investment L	7,856	786	7,856	786
Total Current Investment Portfolio	60,501	6,050	81,702	7,258
Carried interest accrual				(580)
Share of funds other net assets			-	(39)
Capital Account at Fair Value as of 31 December 2017			81,702	6,640

* If there are parallel vehicles this should represent the whole fund. The specific vehicle that the investor is in may also be shown.

** The provision for carried interest is calculated based on the hypothetical share of profits, taking into account the cash already distributed from the fund and the unrealised fair value of its assets in accordance with the terms of the limited partnership agreement.

*** The Fair Value of investments were determined in accordance with International Private Equity and Venture Capital Valuation Guidelines.

**** An investor was excluded from this investment, with equalisation on the following investment.

7.6. Capital Account

Statement for all LPs – Capital account since inception to 31 December 2017

Investor	% Ownership	Commitment	Paid in Capital from Investors	Distributions to Investors	Realised portfolio gains/ (losses)	Unrealised portfolio gains/ (losses)	Investment income/ (expense)	Management fees	Non portfolio income/ (expense)	Carried Interest allocation	Capital account at Fair Value	% Ownership	Recallable Distributions	Unfunded Commitment available for Drawdown	Share of outstanding bridging
		€000	€000	€000	€000	€000	€000	€000	€000	€000	€000		€000	€000	
Investor No. 1	25%	25,000	26,583	(15,684)	4,833	5,554	1,905	(2,188)	(313)	(1,956)	18,734	25%	8,958	7,375	-
Investor No. 2	20%	20,000	21,266	(12,547)	3,866	4,443	1,524	(1,750)	(250)	(1,565)	14,987	20%	7,166	5,900	-
Investor No. 3	8%	8,000	8,506	(5,019)	1,546	1,777	609	(700)	(100)	(626)	5,995	8%	2,866	2,360	-
Investor No. 4	10%	10,000	10,633	(6,274)	1,933	1,208	719	(875)	(125)	(580)	6,640	10%	3,583	2,950	-
Investor No. 5	6%	6,000	6,380	(3,764)	1,160	1,333	457	(525)	(75)	(469)	4,496	6%	2,150	1,770	-
Investor No. 6	7%	7,000	7,443	(4,392)	1,353	1,555	533	(613)	(88)	(548)	5,245	7%	2,508	2,065	-
Investor No. 7	9%	9,000	9,570	(5,646)	1,740	1,999	686	(788)	(113)	(704)	6,744	9%	3,225	2,655	-
Investor No. 8	5%	5,000	5,317	(3,137)	967	1,111	381	(438)	(63)	(391)	3,747	5%	1,792	1,475	-
Investor No. 9	5%	5,000	5,317	(3,137)	967	1,111	381	(438)	(63)	(391)	3,747	5%	1,792	1,475	-
Investor No. 10	4%	4,000	4,253	(2,509)	773	889	305	(350)	(50)	(313)	2,997	4%	1,433	1,180	-
General partner	1%	1,000	1,063	(627)	193	222	76	(88)	(13)	(78)	749	1%	358	295	-
Total for Investors	100%	100,000	106,331	(62,736)	19,331	21,201	7,575	(8,750)	(1,250)	(7,621)	74,081	100%	35,830	29,499	-
Carried interest partner										7,621	7,621				
Total	100%	100,000	106,331	(62,736)	19,331	21,201	7,575	(8,750)	(1,250)	-	81,702				

7.7 GP Fees, Carried Interest and Fund Operating Expenses

		Q4 2017	Year to 31 Dec 2017	Inception to 31 Dec 2017
		€000	€000	€000
Management fees				
Gross management fees (1.75% of commitments)		438	1,750	8,750
Transaction and other fees offset at 80%		(138)	(190)	(1,592)
Net management fees		300	1,560	7,158
Transaction and other fees				
Transaction fees		150	150	1,200
Underwriting fees		-	-	-
Monitoring fees		14	56	560
Directors fees		8	32	230
Other fees		-	-	-
Total benefits and fees paid from portfolio companies to the manager		172	238	1,990
Payments to related parties or associates of the manager		-	-	-
Carried interest				
Hurdle rate exceeded	Yes			
Distributions sufficient to trigger carry payments	No			
Carried interest earned from realisations		-	-	-
Carried interest paid		-	-	-
Carried interest earned but not distributed*		-	-	-
Change in Carried interest accrual		2,109	5,609	7,621
Accrued Carried interest balance at start of period		5,513	2,013	-
Accrued Carried interest balance at the end of the period		7,621	7,621	7,621
* Amount held in escrow		-	-	-

	Q4 2017	Year to 31 Dec 2017	Inception to 31 Dec 2017
	€000	€000	€000
Fund operating expenses			
Audit fees	6	25	58
Tax	7	21	379
Legal	82	107	678
Other expenses	2	5	25
Fund operating expenses	97	158	1,140
Fund formation costs		-	1,000
Aborted deal costs	-	-	260
Bridging interest	49	61	250
Bridging fees	4	21	191
Fund expenses and costs	150	240	2,842

7.8 Bridge Finance and Fund Leverage Facilities

Bridging and Leverage facilities	
There is no leverage facility in place.	
There is a bridging facility in place as follows:	
Name of Bank	Bridge Bank plc
There is no relationship between this entity and the GP	
Size of facility	10% of commitments
Maximum bridging	€10m
Maximum bridging permitted in the LPA	€20m
Rollover date	6 Months
Facility term	5 Years
Expiry Date	31 March 2018
Interest rate	x%
Undrawn commitment fee	U%
Arrangement fee	A%
Covenants/restrictions	Max of 50% of undrawn commitments
Guarantees/security	Undrawn commitments

Bridging facility	Q4 2017	Year to 31 Dec 2017	Inception to 31 Dec 2017
	€000	€000	€000
Any covenant breaches	None	None	None
Interest	49	61	250
Fees	4	21	191
Maximum drawn in the period	9,664	9,664	9,664
% of undrawn commitments this represents	9.7%	9.7%	9.7%
Average drawn in the period	6,555	2,061	1,678
Amount of bridging outstanding	Nil	Nil	
% of undrawn commitments this represents	0%	0%	
	Date	€000	
Scheduled dates for bridging repayment	n/a	n/a	

7.9. Fund Cash Flow Schedule and Fund Net IRR calculation

Commitments to Fund €100,000,000

Date of cash flow	Paid in Capital from investors	Distribution to investors	Residual Value (RV)	Investor cash flows and RV
	€000	€000	€000	€000
10 January 2013	(1,450)	-	-	(1,450)
21 January 2013	(3,157)	-	-	(3,157)
25 February 2013	(5,100)	-	-	(5,100)
07 March 2014	(3,830)	366	-	(3,464)
01 July 2014	(6,884)	211	-	(6,673)
12 August 2014	(11,614)	-	-	(11,614)
02 January 2015	(1,900)	3,200	-	1,300
14 May 2015	(13,279)	366	-	(12,913)
01 October 2015	(15,900)	-	-	(15,900)
11 December 2015	15,000	-	-	15,000
22 April 2016	(900)	5,847	-	4,947
26 September 2016	(9,447)	629	-	(8,818)
28 April 2017	(27,650)	457	-	(27,193)
23 June 2017	(450)	674	-	224

Date of cash flow	Paid in Capital from investors	Distribution to investors	Residual Value (RV)	Investor cash flows and RV
	€000	€000	€000	€000
03 August 2017	(2,250)	20,934	-	18,684
26 September 2017	-	4,650	-	4,650
27 November 2017	(9,664)	3,800	-	(5,864)
19 December 2017	(7,856)	21,602	-	13,746
31 December 2017	-	-	74,081	74,081
	(106,331)	62,736	74,081	30,486
Fund Net IRR				14.8%
Fund Net IRR modified for Bridge Finance				14.2%
Multiples				
Distributions to Paid In Capital "DPI"				0.59
Residual Value to Paid In Capital "RVPI"				0.70
Total Value to Paid In Capital "TVPI"				1.29
Total Value to Paid In Capital "TVPI" modified for Bridge Finance				1.29

7.10. Calculation of Fund Multiples

Whole Fund	Investor net cash (paid to fund)/from fund*	Calculation of: Paid in Capital	Unfunded Commitment	Distributions
	€000	€000	€000	€000
Investor Commitment/Committed Capital			100,000	
Type of Cash Flow				
Capital Call/Drawdown for completed or proposed investments, management fees and expenses:	(121,331)	(121,331)	(121,331)	
Return of Capital Calls/Drawdowns for temporary, bridging or aborted investments:	15,000	15,000	15,000	
Distributions of portfolio proceeds to date which are considered permanent:	26,906			26,906
Distributions of portfolio proceeds to date which are considered recallable/recyclable:	35,830		35,830	35,830
Total	(43,595)	(106,331)	29,499	62,736
		A	B	C
"Residual Value"	74,081	D		
		Calculations		
Distributions to Paid In Capital "DPI"	0.59	C / A		
Residual Value to Paid In Capital "RVPI"	0.70	D / A		
Total Value to Paid In Capital "TVPI" = DPI + RVPI	1.29	(C+D) / A		

* (Or flow of other assets in the case of contributions/distributions in-specie).

8. GLOSSARY

Bridge Finance

Financing at the fund level secured on LP commitments and intended for the purpose of temporarily financing investments or expenses of the fund in advance of drawdown from LPs.

Buyout investment

Financing provided to acquire a company. It may use a significant amount of borrowed capital to meet the cost of acquisition. Typically, by purchasing majority or controlling stakes.

Capital call/Drawdown

Funds drawn down into the fund by the manager from investors. Both the amount and the timing of the notice of any drawdown must be in accordance with the fund formation documents.

Carried interest

A share of the gains of the fund which accrue to the GP/Manager. The calculation of carried interest is set out in the fund formation documents.

Cash-adjusted or roll-forward valuation

The latest available NAV as shown in the capital account from the underlying fund's manager plus drawdowns less distributions from the underlying fund to the fund of funds between the last available NAV date and reporting date, assuming the reporting date is later

Commitment/Committed capital

An investor's contractual commitment to provide capital to a fund up to the amount subscribed by the investor and recorded in the fund documents.

Distribution

Payment of any amount in cash or the value of any distribution in-specie by the fund to the investor, excluding amounts returned in relation to temporary, bridging or aborted investments and net of any distributed amounts which have subsequently been clawed back, e.g. for warranty claims.

Distributions to paid-in capital (DPI)

This is the ratio of the cumulative distributions to LPs to paid-in capital.

Environmental, Social and Governance ("ESG")

ESG stands for the environmental, social and governance factors that can impact (the performance of) a portfolio company and/or an investment, including the GP itself. It is a phrase commonly used alongside responsible investment.

Final closing

Date on which the fund admits its last LP and closes to any further subscriptions of interest from LPs.

First closing

Date on which the first LPs are admitted into a fund.

Fund

Fund or private equity fund is the generic term used in these Guidelines to refer to any designated pool of investment capital targeted at any stage of private equity investment from start-up to large buyout, including those held by corporate entities, limited partnerships and other investment vehicles, established with the intent to exit these investments within a certain timeframe.

Funded commitment to commitment (FCC)

This is the ratio of committed capital less unfunded commitment to committed capital.

Fund formation documents

The entire set of legal documents, including the Limited Partnership Agreement (LPA) or equivalent legally binding document and side letters agreed by the investors and the fund manager. Matters covered in the legal documentation include the establishment of the fund, management, and winding up of the fund and the economic terms agreed between the investors and the fund manager.

Fund Leverage

Borrowings over and above the amount of LP commitments which is intended to increase the investment capacity of the fund beyond the level of aggregate LP commitments and which is intended to be permanent in nature

General Partner/GP/Manager

The person or entity with the responsibilities and obligations for the management of the fund, as set out in the fund formation documents.

Growth investment

A type of private equity investment (often a minority investment) in relatively mature companies that are looking for primary capital to expand and improve operations or enter new markets to accelerate the growth of the business.

Investor/Limited Partner/LP

Person or entity holding an investment interest (as distinct from a management interest) in a private equity fund.

Later-stage financing

Financing provided for an operating company, which may or may not be profitable. Late stage venture tends to be financing into companies already backed by VCs. Typically, in C or D rounds.

LPA or Limited Partnership Agreement

A legally binding document setting out the operating rules for a fund together with the rights and responsibilities of the parties subscribing to it; see Fund formation documents.

LPAC

The LPAC is the Advisory Committee comprising a cross-section of representative investors of the fund. The role of the LPAC is essentially to be consulted by the GP on material matters affecting the fund and on conflicts of interest. More generally, it acts as a sounding board for the GP.

NDA

Non-disclosure agreement governing disclosure of information either generally or to specified parties

NAV

Net asset value of the fund arrived at after taking all assets and deducting all liabilities and provisions.

Total original cost

Total capital invested including follow-on investments but excluding rolled up income and temporary or bridge financing.

Paid-in capital

Cumulative payments that have been called by the manager in accordance with the fund formation documents, net of commitments drawn and returned in relation to temporary, bridging or aborted investments and excluding any amounts clawed back, e.g. to fund warranty claims. For the avoidance of doubt, paid-in capital may be composed both of amounts funded from original commitments and those amounts which have been recalled from previous distributions. Consequently, paid-in capital can exceed commitment.

Paid-in capital to commitment (PiCC)

This is the ratio of paid-in capital to committed capital.

Recallable distributions

A recallable distribution is an amount distributed to investors that may be recalled subsequently in accordance with the fund formation documents, e.g. in relation to management fees funded in the early years of a fund from capital calls.

The determination of whether an amount is a return of a temporary investment or investment proceeds distributed and subject to recall or recycling will be set out in the fund formation documents.

Replacement capital investment

Minority stake purchase from another private equity investment organisation or from another shareholder or shareholders.

Rescue/Turnaround investment

Financing made available to an existing business, which has experienced financial distress, with a view to re-establishing prosperity.

Residual value

This is the remaining undistributed net asset value of the fund after carried interest has been allocated.

Residual value to paid-in capital (RVPI)

This is the ratio of the residual value attributable to LPs (net of carried interest) to paid-in capital.

Responsible investment

Responsible investment involves an investment approach that integrates ESG factors into corporate conduct, investment decisions and ownership activities. A responsible investor will commonly be interested in the ESG conduct, impact or performance of a portfolio company it invests in, and in case of an LP, this may also include ESG aspects related to the GP.

Seed investment

Funding provided before the investee company has started mass production/distribution with the aim to complete research, product definition or product design, also including market tests and creating prototypes. This funding will not be used to start mass production/distribution.

Start-up investment

Funding provided to companies, once the product or service is fully developed, to start mass production/distribution and to cover initial marketing. Companies may be in the process of being set up or may have been in business for a shorter time, but have not sold their product commercially yet. The destination of the capital would be mostly to cover capital expenditures and initial working capital.

Total value to paid-in capital (TVPI)

The sum of the distributions to paid-in capital (DPI) and residual value to paid-in capital (RVPI).

Unfunded commitment

This is the total capital that remains eligible to be called from an investor. Typically, this will be the total commitment less any drawdowns during the life of the fund except for short-term commitments returned and any recallable (recyclable) distributions.

Unfunded commitment can be split between the amount that has never been drawn from an investor ("undrawn original commitment") and amounts that have been distributed but are open to being recalled ("recallable distributions").

Vintage year

Vintage year is generally the year of the first closing or, if later, the year in which management fees commence.

6

SECTION 6

IPEV VALUATION GUIDELINES

IPEV VALUATION GUIDELINES

International Private Equity and Venture Capital Valuation Guidelines

Edition December 2015

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International Private Equity and Venture Capital Valuation Guidelines

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International Private Equity and Venture Capital Valuation Guidelines

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International Private Equity and Venture Capital Valuation Guidelines

Preface

The International Private Equity and Venture Capital Valuation (IPEV) Guidelines ('Valuation Guidelines') set out recommendations, intended to represent current best practice, on the valuation of private equity Investments. The term "private equity" is used in these Valuation Guidelines in a broad sense to include Investments in early stage ventures, management buyouts, management buyins, infrastructure, mezzanine capital and similar transactions and growth or development capital.

The Valuation Guidelines, as presented in Section I, are intended to be applicable across the whole range of Alternative Investment Funds (seed and start-up venture capital, buyouts, growth/development capital, credit, etc.; hereafter collectively referred to as Private Equity Funds) and financial instruments commonly held by such Funds. They also provide a basis for valuing Investments by other entities, including Fund-of-Funds, in such Private Equity Funds. The Valuation Guidelines have been prepared with the goal that Fair Value measurements derived when using these Valuation Guidelines are compliant with both International Financial Reporting Standards (IFRS) and United States Generally Accepted Accounting Principles (US GAAP). Other jurisdictions that use a similar definition of Fair Value, such as "willing buyer and willing seller" may also find these Valuation Guidelines applicable. It should be noted that these Valuation Guidelines may for good reason differ from guidance published by others with respect to valuing privately held securities issued as compensation.

Individual Valuation Guidelines are outlined in Section I. Section II, presents the Valuation Guidelines themselves surrounded by a border and set out in bold type, with accompanying explanations, illustrations, background material, context and supporting commentary, to assist in the interpretation of the Valuation Guidelines. Section III provides application guidance for specific situations.

Where there is conflict between the content of these Valuation Guidelines and the requirements of any applicable laws or regulations or accounting standard or generally accepted accounting principles, the latter requirements should take precedence.

No member of the IPEV Board, any committee or working party thereof can accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any party as a result of anything contained in or omitted from the Valuation Guidelines nor for the consequences of reliance or otherwise on the provisions of these Valuation Guidelines.

These Valuation Guidelines should be regarded as superseding the previous 2012 Valuation Guidelines issued by the IPEV Board and are considered in effect for reporting periods beginning on or after 1 January 2016. Earlier adoption is encouraged.

International Private Equity and Venture Capital Valuation Guidelines

Introduction

Private equity managers may be required to carry out periodic valuation of Investments as part of the reporting process to investors in the Funds they manage. The objective of these Valuation Guidelines is to set out best practice where private equity Investments are reported at 'Fair Value' and hence to help investors in Private Equity Funds make better economic decisions.

The increasing importance placed by international accounting authorities on Fair Value reinforces the need for the consistent use of valuation practices worldwide and these Valuation Guidelines provide a framework for consistently determining valuations for the type of Investments held by Private Equity Funds.

Private Equity Funds are typically governed by a combination of legal or regulatory provisions or by contractual terms. It is not the intention of these Valuation Guidelines to prescribe or recommend the basis on which Investments are included in the accounts of Funds. The IPEV Board confirms Fair Value as the best measure of valuing private equity portfolio companies and investments in Private Equity Funds. The Board's support for Fair Value is underpinned by the transparency it affords investors in Funds which use Fair Value as an indication of performance of a portfolio in the interim. In addition, institutional investors require Fair Value to make asset allocation decisions and to produce financial statements for regulatory purposes.

The requirements and implications of global financial reporting standards and in particular IFRS and US GAAP have been considered in the preparation of these Valuation Guidelines. This has been done in order to provide a framework for Private Equity Funds for arriving at a Fair Value for Investments which is consistent with accounting principles.

Financial reporting standards do not require that these Valuation Guidelines be followed. However while Valuers must conclude themselves whether or not their Fair Value measurements are compliant with relevant financial reporting standards, measuring Fair Value in compliance with relevant financial reporting standards can be achieved by following these Valuation Guidelines.

These Valuation Guidelines are intended to represent current best practice and therefore will be revisited and, if necessary, revised to reflect changes in regulation or accounting standards.

These Valuation Guidelines are concerned with valuation from a conceptual, practical, and investor reporting standpoint and do not seek to address best practice as it relates to internal processes, controls and procedures, governance aspects, committee oversights, the experience and capabilities required of the Valuer or the audit or review of valuations.

A distinction is made in these Valuation Guidelines between the **basis of valuation** (Fair Value), which defines what the carrying amount purports to represent, a **valuation technique** (such as the earnings multiple technique), which details the method or technique for deriving a valuation, and **inputs** used in the valuation technique (such as EBITDA).

International Private Equity and Venture Capital Valuation Guidelines

Private equity by its nature utilizes confidential, non-public information. However, Investors in Private Equity Funds need sufficient, timely, comparable and transparent information from their Managers which allows Investors to:

- Exercise fiduciary duty in monitoring deployed investment capital
- Report periodic performance to ultimate Investors, beneficiaries, boards, etc., as applicable
- Prepare financial statements consistent with applicable accounting standards.

Investors may also use the Fair Value information to:

- Make asset allocation decisions
- Make manager selection decisions
- Make Investor level incentive compensation decisions.

Readers should note that these Valuation Guidelines address financial valuation issues only. The IPEV Board, after thorough discussion and consultation, has concluded that matters relating to the reporting and evaluation of non-financial factors or inputs in the context of a Fund's responsible investment practices, including environmental, social and governance factors, are conceptually included in these Valuation Guidelines where their impact is financial, but are otherwise outside the scope of this document.

This 2015 edition of the Valuation Guidelines includes the following changes from the 2012 edition:

1. Clarifying edits made to improve readability and reduce potential confusion::
    a. Minor edits made throughout the document to improve readability and clarity of understanding.
    b. Deleted reference to the IPEV Investor Reporting Guidelines as the responsibility for Reporting Guidelines has reverted back to Invest Europe (formerly the European Private Equity & Venture Capital Association).
    c. Addition of Section II subheadings to improve readability

2. Technical Clarifications:
    a. Update on IASB Unit of Account Progress
    b. Added new guideline 1.6 to emphasize the need for consistency.
    c. Modified footnote 4 of guideline 2.4 to clarify how to consider the value of debt for purposes of determining the value of equity.
    d. Minor edits to guideline 2.2, 2.4 (iii) & 2.6 to improve understandability.
    e. Added new guideline 2.7 to describe backtesting.
    f. Added new guideline 3.2 (ii) to clarify valuation techniques.
    g. Guideline 3.4 reworded to differentiate between earnings multiples and revenue multiples.
    h. Guidelines 3.5 through 3.9 reordered to improve the logical flow.
    i. Removed the negative bias towards DCF and highlighted accounting guidance with respect to considering the number of valuation techniques.
    j. Section II clarifying edits and expanded discussion of changes in valuation techniques, calibration, backtesting and the use of multiples
    k. Specific Considerations expanded to include:
        i. 5.10 Non-control minority positions
        ii. 5.11 Mathematical Models (guidance updated)
        iii. 5.12 Sum of the Parts

Financial Reporting Standards

United States and International financial reporting standards (used interchangeably with accounting standards) were amended in 2011 resulting in a common definition[1] of Fair Value and a common approach to measuring Fair Value. Other jurisdictions use a definition of Fair Value which is substantially similar with US GAAP, IFRS and the definition used in these Valuation Guidelines.

The measurement of Fair Value under US GAAP and IFRS is dictated by *Accounting Standards Codification* (ASC) Topic 820, *Fair Value Measurement* as issued by the Financial Accounting Standards Board (FASB), and IFRS 13, *Fair Value Measurement* as issued by the International Accounting Standards Board (IASB). Other accounting standards dictate when Fair Value is required or permitted. In the United States, FASB ASC Topic 946, *Investment Companies* requires assets of Investment Companies to be reported at Fair Value. Various IFRS require or permit certain financial instruments to be reported at Fair Value.

On October 31, 2012, the IASB amended IFRS 10, 12 and 27 such that IFRS, under specific circumstances, now requires "control" Investments held by entities meeting the definition of an investment entity to be reported at Fair Value rather than being consolidated at cost.

These Valuation Guidelines are focused on the consistent measurement of Fair Value. Other accounting concepts such as disclosure requirements or day-one gains/losses are beyond the scope of these Valuation Guidelines.

Unit of Account

Background
US and International financial reporting standards require the Fair Value of an asset to be measured consistently with the level of aggregation (Unit of Account) dictated by the accounting standard requiring or permitting its measurement at Fair Value (for example, ASC Topic 946, *Investment Companies,* in the United States or internationally IFRS 9 and 10, and International Accounting Standard (IAS) 27, 28, 39 and 40).[2] The Unit of Account is a level of aggregation concept that was developed for financial reporting purposes (that is, it addresses the way in which assets and liabilities are to be aggregated or disaggregated in the financial statements).

Because financial reporting is meant to portray economic phenomena, the Unit of Account attempts to describe the specific way that an Investment is owned, including the legal rights and obligations of ownership and its relationship to other ownership rights in a complex

[1] Fair Value is defined by US and International accounting standards as: "the price that would be received to sell an asset or paid to transfer a liability in an Orderly Transaction between Market Participants at the Measurement Date." IFRS 13 paragraph 9, ASC Topic 820-10-15-5. These Valuation Guidelines focus on Fair Value measurement from a Private Equity Fund perspective which generally focuses on underlying portfolio Investments, e.g. assets, and therefore for ease of drafting do not focus on the "or paid to transfer a liability" portion of the accounting definition.
[2] The international accounting guidance for private equity Investments is contained in IFRS 9, *Financial Instruments,* IFRS 10, *Consolidated Financial Statements,* IAS 27, *Consolidated and Separate Financial Statements,* IAS 28, *Investments in Associates*, and IAS 40, *Investment Property*. IFRS 9 will replace IAS 39 *Financial Instruments: Recognition and Measurement*.

capital structure. However, actual transactions may not and do not actually have to take place at the Unit of Account level specified by accounting standards.

ASC Topic 820 and IFRS 13
Fair Value measurement guidance articulated in both ASC Topic 820 and IFRS 13 states: "An entity shall measure the Fair Value of an asset or liability using the assumptions that Market Participants would use when pricing the asset or liability, assuming that Market Participants act in their economic best interest."[3] Neither ASC Topic 820 nor IFRS 13 specify the Unit of Account for assets or liabilities, but rely on other accounting standards to do so.

US GAAP – ASC Topic 946
In US GAAP, ASC Topic 946 specifies that an investment company must measure its investments in debt and equity securities at Fair Value. An entity then refers to ASC Topic 820 for Fair Value measurement guidance. In the absence of more specific Unit of Account guidance from ASC Topic 946, entities measure the Fair Value of their debt and equity securities consistently with how Market Participants would act in their economic best interest.

Alternative interpretations of Unit of Account under IFRS
Market Participants generally view the Investment or entire Interest to be the Unit of Account with which they would transact. IFRS 10 states that the Fair Value of controlled investments held by investment entities should be measured at fair value through profit or loss in accordance with IFRS 9. IAS 27 and IAS 28 also permit certain entities to measure their Investments at Fair Value through profit or loss in accordance with IFRS 9. IFRS 9 then refers to IFRS 13 for specific Fair Value measurement guidance. IFRS 9 has been interpreted by some to require the Unit of Account of a financial instrument to be assessed as a single or individual share. Although a single share Unit of Account interpretation applies to actively traded securities (see Section I paragraph 3.6 of these Valuation Guidelines), there are different interpretations of the Unit of Account for non-actively traded securities:

- One interpretation is that because IFRS 10 and IAS 28 refer to measuring Fair Value in accordance with IFRS 9, the Unit of Account is determined by IFRS 9 and is a single share. However, actual transactions for non-actively traded securities rarely take place on a single share basis.
- Another interpretation is that the Unit of Account is determined by IFRS 10, IAS 27 and IAS 28 as the "Investment", which is not necessarily a single share. This interpretation more fully matches how Market Participants transact.

The IASB is considering amendments to IFRS to clarify these interpretations. Based on deliberations to date, it appears that the IASB concurs with industry practice that the Unit of Account would be the entire interest if that is the basis upon which Market Participants would transact. While it is important that a Fund's auditors agree with management's conclusion on the Unit of Account, management must take responsibility for the accounting conclusions reached, including the appropriate Unit of Account. If there are any further discussions or decisions by the IASB or the FASB on this issue, these Valuation Guidelines will be updated accordingly.

[3] IFRS 13 paragraph 22; ASC Topic 820 paragraph 820-10-35-9.

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Consistency with how Market Participants transact
Because private equity transactions typically do not happen for individual shares, these Valuation Guidelines do not address how to value a single share of a non-actively traded security. In the absence of Unit of Account guidance to the contrary, these Valuation Guidelines have been prepared with the premise that the Fair Value measurement should be consistent with how Market Participants would transact in their economic best interest.

Examples where the investment is in multiple securities / tranches
As the Unit of Account concept must be judgementally applied, in the absence of specific guidance, we offer the following examples to help clarify how such judgements may be reached:

- Some private equity managers invest in multiple securities or tranches of the same portfolio company. Unit of Account would be expected to be determined on the same basis that Market Participants (willing buyers and sellers) would enter into an Orderly Transaction. If Market Participants would be expected to purchase all positions in the same underlying portfolio company simultaneously, then Fair Value would be measured for the aggregate investment in the portfolio company. If individual tranches of securities would be purchased by Market Participants individually, then the Unit of Account and the basis for determining Fair Value would be the individual tranche.
- If a Fund only holds a debt instrument within a portfolio company's capital structure, the Unit of Account would be the individual debt instrument and the Fair Value of the debt instrument would be measured using the perspective of a Market Participant and would include cash flow (coupon payments), risk, and time to expected principal repayment.
- If a Fund holds both debt and equity Investments in the same portfolio company and Market Participants would transact separately, purchasing a debt position independently from an equity position, then Unit of Account and Fair Value would be measured separately for the debt and equity positions.
- If a potential Market Participant buyer would or could purchase individual shares of an interest in a private company, then the Unit of Account may be a single share. However, generally in the Private Equity industry, Market Participants purchase a meaningful ownership interest in a private company, by acquiring more than single private shares.

Value of the entire Enterprise generally the appropriate starting point
Generally it is appropriate to use the value of an entire Enterprise (business) as a starting point for measuring Fair Value if Market Participants would use such an approach regardless of the accounting Unit of Account. This is because private equity investors often invest in-concert with one another and realise value only when the entire Enterprise is sold. Further, private equity returns are usually proportionate to the equity position held. Therefore, the hypothetical sale of an Enterprise is a fundamental premise used by Market Participants to determine Fair Value. Common adjustments necessary to allocate Enterprise Value on a Unit of Account basis to measure Fair Value are discussed in these Valuation Guidelines. In situations where a market participant would not use enterprise value as a starting point, for example if a non-control position is owned and the sale of such a position would not be realized through the sale of the enterprise, the sale of the individual interest, without the sale of the enterprise would be considered. (See further discussion at Section III 5.10)

The above discussion of Unit of Account is for informational purposes and represents the IPEV Board's interpretation of relevant accounting standards in the context of how Market

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Participants transact in the private equity industry. While it is important that a Fund's auditors agree with management's conclusion on the Unit of Account, management must take responsibility for the accounting conclusions reached, including the appropriate Unit of Account.

Valuation Standards

Global Valuation Standards continue to evolve. The IPEV Board has entered into an understanding with the International Valuation Standards Council (IVSC) with the objective of promoting consistency between the IPEV Board's Valuation Guidelines and the IVSC International Valuation Standards (IVSs) and to enable these Valuation Guidelines to be positioned as providing sector specific application guidance of the principles in IVS. A valuation of private equity investments prepared in accordance with the IVSs and following the Valuation Guidelines will be consistent with the requirements of applicable financial reporting standards and will also maximise Investor's trust and confidence. Further information about the IVSC, the IVSs and the IVSC Code of Ethical Principles for Professional Valuers is available at http://www.ivsc.org/.

Section I: Valuation Guidelines

1. The Concept of Fair Value

1.1. Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants at the Measurement Date.

1.2. A Fair Value measurement assumes that a hypothetical transaction to sell an asset takes place in the Principal Market or in its absence, the Most Advantageous Market for the asset.

1.3. For actively traded (quoted) Investments, available market prices will be the exclusive basis for the measurement of Fair Value for identical instruments.

1.4. For Unquoted Investments, the measurement of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised or sold at the Measurement Date, appropriately allocated to the various interests, regardless of whether the Underlying Business is prepared for sale or whether its shareholders intend to sell in the near future.

1.5. Some Funds invest in multiple securities or tranches of the same portfolio company. If a Market Participant would be expected to transact all positions in the same underlying Investee Company simultaneously, for example separate investments made in series A, series B, and series C, then, Fair Value would be estimated for the aggregate Investments in the Investee Company. If a Market Participant would be expected to transact separately, for example purchasing series A, independent from series B and series C, or if debt Investments are purchased independent of equity, then Fair Value would be more appropriately determined for each individual financial instrument.

1.6. Fair Value should be estimated using consistent valuation techniques from Measurement Date to Measurement Date unless there is a change in market conditions or Investment specific factors which would modify how a Market Participant would determine value. The use of consistent valuation techniques for investments with similar characteristics, industries and/or geographies would also be expected.

2. Principles of Valuation

2.1. The Fair Value of each Investment should be assessed at each Measurement Date.

2.2. In estimating Fair Value for an Investment, the Valuer should apply a technique or techniques that is/are appropriate in light of the nature, facts and circumstances of the Investment and should use reasonable current market data and inputs combined with Market Participant assumptions.

2.3. Fair Value is estimated using the perspective of Market Participants and market conditions at the Measurement Date irrespective of which valuation techniques are used.

2.4. Generally, for Private Equity, Market Participants determine the price they will pay for individual financial instruments using Enterprise Value estimated from a hypothetical sale of the Investee Company, as follows:

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(i) Determine the Enterprise Value of the Investee Company using the valuation techniques;

(ii) Adjust the Enterprise Value for factors that a Market Participant would take into account such as surplus assets or excess liabilities and other contingencies and relevant factors, to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount the value of any financial instruments ranking ahead of the highest ranking instrument of the Fund in a sale of the Enterprise scenario (e.g. the amount that would be paid[4]) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value between the company's relevant financial instruments according to their ranking;

(v) Allocate the amounts derived according to the Fund's holding in each financial instrument, representing their Fair Value.

2.5. Because of the uncertainties inherent in estimating Fair Value for private equity Investments, care should be applied in exercising judgement and making the necessary estimates. However, the Valuer should be wary of applying excessive caution.

[4] Some Valuers may question whether the Fair Value of debt or the face value of debt should be deducted from Adjusted Enterprise Value when estimating the Fair Value of an equity instrument. A Market Participant perspective should be used incorporating individual facts and circumstances when establishing the value of debt to be deducted. The premise of Fair Value measurement is that the Investment is sold at the Measurement Date. Because the definition of Fair Value contains an exit price notion, it could be assumed that a change in control would take place upon the sale of the Investment at the Measurement Date. However, if debt would be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value that debt for the purpose of valuing the equity instrument. Approaches to establishing the value of debt to be deducted could include:

(a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control does not take place as of the Measurement Date) by incorporating into the Fair Value of equity the impact, if any, of non-market terms associated with the debt and the impact on value, if any, of the change in control provision at the ultimate exit date; or

(b) Assuming that a hypothetical change in control takes place on the Measurement Date, resulting in the value of debt deducted being equal to the face or par value of debt.

An additional question arises if debt includes a prepayment penalty. In such circumstances, consideration must be given to the price at which Market Participants would transact to maximize value. The prepayment penalty would be incorporated into the value of debt deducted based on the probability it would be paid. When using a Market Participant perspective, the value of debt deducted may or may not equal the face or par value of debt depending on the facts and circumstances. If debt is required to be repaid upon a change of control with a prepayment penalty, the probability of the prepayment penalty being assessed would be incorporated into the value of debt deducted. If debt is not required to be repaid upon a change of control, then the value of debt that would be deducted from Adjusted Enterprise Value would be impacted by favorable or unfavorable terms (such as interest rate) of the debt.

2.6. When the price of the initial investment in an Investee Company or instrument is deemed Fair Value (which is generally the case if the entry transaction is considered Orderly[5]), then the valuation techniques that are expected to be used to estimate Fair Value in the future should be evaluated using market inputs as of the date the investment was made. This process is known as Calibration. Calibration validates that the valuation techniques using contemporaneous market inputs will generate Fair Value at inception and therefore that the valuation techniques using updated market inputs as of each subsequent Measurement Date will generate Fair Value at each future Measurement Date.

2.7. Valuers should seek to understand any substantive differences that legitimately occur between the exit price and the previous Fair Value assessment. This concept is known as Backtesting. Backtesting seeks to articulate:

(i) What information was known or knowable as of the Measurement Date;
(ii) Assess how such information was considered in coming to the most recent Fair Value Estimates; and
(iii) Determine whether known or knowable information was properly considered in determining Fair Value given the actual exit price results.

3. Valuation Methods

3.1. General

3.1 (i) In determining the Fair Value of an Investment, the Valuer should use judgement. This includes consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the economic substance of the Investment, which may take precedence over the strict legal form.

3.1 (ii) Where the reporting currency of the Fund is different from the currency in which the Investment is denominated, translation into the reporting currency for reporting purposes should be done using the bid spot exchange rate prevailing at the Measurement Date.

3.2. Selecting the Appropriate Valuation Technique

3.2 (i) The Valuer should exercise their judgement to select the valuation technique or techniques most appropriate for a particular Investment.

3.2 (ii) The Valuer should use one or more of the following Valuation Techniques, taking into account Market Participant assumptions as to how Value would be determined:

- A. Market Approach
  - a. Price of Recent Investment (3.3)
  - b. Multiples (3.4)
  - c. Industry Valuation Benchmarks (3.5)
  - d. Available Market Prices (3.6)

[5] A Forced Transaction (e.g. a forced liquidation or distress sale) would not be considered Orderly.

- B. Income Approach
  - a. Discounted Cash Flows (3.7, 3.8)
- C. Replacement Cost Approach
  - a. Net Assets (3.9)

3.3. Price of Recent Investment

In applying the Price of Recent Investment valuation technique, the Valuer uses the initial cost of the Investment itself, excluding transaction costs[6], or, where there has been subsequent investment, the price at which a significant amount of new Investment into the company was made, to estimate the Enterprise Value, but only if deemed to represent Fair Value and only for a limited period following the date of the relevant transaction. During the limited period following the date of the relevant transaction, the Valuer should in all cases assess at each Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

3.4. Multiples

Depending on the stage of development of an Enterprise, its industry, and its geographic location, Market Participants may apply a multiple of Earnings, or of Revenue. In using the Multiples valuation technique to estimate the Fair Value of an Enterprise, the Valuer should:

(i) Apply a multiple that is <u>appropriate</u> and <u>reasonable</u> (given the size, risk profile and earnings growth prospects of the underlying company) to the <u>applicable indicator of value (Earnings, or Revenue)</u> of the company;

(ii) Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

3.5. Industry Valuation Benchmarks

The use of industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a sanity check of values produced using other techniques.

[6] Depending on the applicable accounting standards, Transaction Costs in some cases are required to be capitalized as part of the cost basis of an Investment. However, Transaction Costs are not considered a characteristic of an asset and therefore should not be included as a component of an asset's Fair Value.

3.6. Available Market Prices

3.6 (i) Instruments quoted on an Active Market should be valued at the price within the bid / ask spread that is most representative of Fair Value on the Measurement Date. The Valuer should consistently use the most representative point estimate in the bid /ask spread.

3.6 (ii) Blockage Factors that reflect size as a characteristic of the reporting entity's holding (specifically, a factor that adjusts the quoted price of an asset because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) should not be applied.

3.6 (iii) Discounts may be applied to prices quoted in an Active Market if there is some contractual, Governmental or other legally enforceable restriction attributable to the security, not the holder, resulting in diminished Liquidity of the instrument that would impact the price a Market Participant would pay for the securities at the Measurement Date.

3.7. Discounted Cash Flows or Earnings (of Underlying Business)

In using the Discounted Cash Flows or Earnings (of Underlying Business) valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) **Derive the Enterprise Value of the company, using reasonable assumptions and estimations of expected future cash flows (or expected future earnings) and the terminal value, and discounting to the present by applying the appropriate risk-adjusted rate that captures the risk inherent in the projections;**

(ii) **Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;**

(iii) **Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;**

(iv) **Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of Market Participants. Judgement is required in assessing a Market Participant perspective.**

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3.8. Discounted Cash Flows (from an Investment)

In using the Discounted Cash Flows (from an Investment) valuation technique to estimate the Fair Value of an Investment, the Valuer should derive the present value of the cash flows from the Investment using reasonable assumptions and estimations of expected future cash flows, the terminal value or maturity amount, date, and the appropriate risk-adjusted rate that captures the risk inherent to the Investment. This valuation technique would generally be applied to Debt Investments or Interests with characteristics similar to debt.

3.9. Net Assets

In using the Net Assets valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) **Derive an Enterprise Value for the company using the perspective of a Market Participant to value its assets and liabilities (adjusting, if appropriate, for non-operating assets, excess liabilities and contingent assets and liabilities);**

(ii) **Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value; and**

(iii) **Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.**

4. Valuing Fund Interests

4.1. General

In measuring the Fair Value of an interest in a Fund the Valuer may base their estimate on their attributable proportion of the reported Fund Net Asset Value (NAV) if NAV is derived from the Fair Value of underlying Investments and is as of the same Measurement Date as that used by the Valuer of the Fund interest, except as follows:

(i) **if the Fund interest is actively traded Fair Value would be the actively traded price;**

(ii) **if management has made the decision to sell a Fund interest or portion thereof and the interest will be sold for an amount other than NAV, Fair Value would be the expected sales price.**

4.2. Adjustments to Net Asset Value

If the Valuer has determined that the reported NAV is an appropriate starting point for determining Fair Value, it may be necessary to make adjustments based on the best available information at the Measurement Date. Although the Valuer may look to the Fund Manager for the mechanics of their Fair Value estimation procedures, the Valuer needs to have appropriate processes and related controls in place to enable the Valuer to assess and understand the valuations received from the Fund Manager. If NAV is not derived from the Fair Value of underlying Investments and / or is not as of the same Measurement Date as that used by the Valuer of the Fund interest, then the Valuer will need to assess whether such differences are significant, resulting in the need to adjust reported NAV.

4.3. Secondary Transactions

When a Valuer of an interest knows the relevant terms of a Secondary Transaction in that particular Fund and the transaction is orderly, the Valuer must consider the transaction price as one component of the information used to measure the Fair Value of a Fund interest.

Section II: Explanatory Comments - Measuring Fair Value

1. The Concept of Fair Value

1.1. Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants at the Measurement Date.

1.2. A Fair Value measurement assumes that a hypothetical transaction to sell an asset takes place in the Principal Market or in its absence, the Most Advantageous Market for the asset.

1.3. For actively traded (quoted) Investments, available market prices will be the exclusive basis for the measurement of Fair Value for identical instruments.

1.4. For Unquoted Investments, the measurement of Fair Value requires the Valuer to assume the Underlying Business or instrument is realised or sold at the Measurement Date, appropriately allocated to the various interests, regardless of whether the Underlying Business is prepared for sale or whether its shareholders intend to sell in the near future.

1.5. Some Funds invest in multiple securities or tranches of the same portfolio company. If a Market Participant would be expected to transact all positions in the same underlying Investee Company simultaneously, for example separate Investments made in series A, series B, and series C, then, Fair Value would be estimated for the aggregate Investments in the Investee Company. If a Market Participant would be expected to transact separately, for example purchasing series A, independent from series B and series C, or if debt Investments are purchased independent of equity, then Fair Value would be more appropriately determined for each individual financial instrument.

1.6. Fair Value should be estimated using consistent valuation techniques from Measurement Date to Measurement Date unless there is a change in market conditions or Investment specific factors which would modify how a Market Participant would determine value. The use of consistent valuation techniques for Investments with similar characteristics, industries and/or geographies would also be expected.

The objective of measuring Fair Value is to estimate the price at which an Orderly Transaction would take place between Market Participants at the Measurement Date.

Fair Value is the hypothetical exchange price taking into account current market conditions for buying and selling assets. Fair Value is not the amount that an entity would receive or pay in a Forced Transaction, involuntary liquidation or distressed sale.

Although transfers of shares in private businesses are often subject to restrictions, rights of pre-emption and other barriers, it should still be possible to estimate what amount a willing buyer would pay to take ownership of the Investment, subject to such restrictions.

The estimation of Fair Value assumes that the time period required to consummate a transaction hypothetically began at a point in time in advance of the Measurement Date such that the hypothetical exchange culminates on the Measurement Date. Therefore, Fair Value should reflect the actual amount that a seller would receive in an Orderly Transaction under current market conditions at the Measurement Date. An additional discount for Marketability (where Marketability is defined as the time required to effect a transaction) is not appropriate. Liquidity or illiquidity (meaning the frequency of transactions) is taken into account by Market Participants and should be a factor used in assessing Fair Value.

Fair Value measurements are determined consistent with the ownership structure of the Investment. That means that Fair Value is determined independently for each reporting entity.

Once a valuation technique has been selected, it should be applied consistently (from Measurement Date to Measurement Date); however a change in technique is appropriate if it results in a measurement that is more representative of Fair Value in the circumstances.

Examples of events that might appropriately lead to a change in valuation technique:

- The stage of development of the Enterprise changes (from pre revenue to revenue to earnings)
- New markets develop
- New information becomes available
- Information previously used is no longer available
- Valuation techniques improve
- Market conditions change.

Further, subject to utilizing market participant perspectives, Investments with similar characteristics, stages of development, geographies and/or industries would be expected to be valued using consistent valuation techniques.

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2. Principles of Valuation

2.1. The Fair Value of each Investment should be assessed at each Measurement Date.

In the absence of an Active Market for a financial instrument, the Valuer must estimate Fair Value utilising one or more of the valuation techniques.

2.2. In estimating Fair Value for an Investment, the Valuer should apply a technique or techniques that is/are appropriate in light of the nature, facts and circumstances of the Investment and should use reasonable current market data and inputs combined with Market Participant assumptions.

2.3. Fair Value is estimated using the perspective of Market Participants and market conditions at the Measurement Date irrespective of which valuation techniques are used.

In private equity, value is generally realised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes. The value of the business as a whole at the Measurement Date (Enterprise Value) will often provide a key insight into the value of Investment stakes in that business. [7]

If value is realised as described above, then Enterprise Value would be used by a Market Participant to determine the orderly price they would pay for an Investment. Alternatively, if a Market Participant would transact for individual instruments, such as individual shares, debt tranches, or a single series of equity, then Fair Value would be more appropriately assessed at the individual instrument level.

[7] Some have interpreted International accounting standards as requiring the Unit of Account to be a single share of a private company (see discussion of Accounting Standards and Unit of Account on pages 6 through 9 of these Valuation Guidelines). These Valuation Guidelines do not address a single share Unit of Account conclusion (other than for actively traded securities) as a Fair Value measurement for a single share of a private company generally does not occur in practice and therefore would not reflect Market Participant assumptions and would not provide a meaningful measurement of Fair Value.

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2.4. Generally, for Private Equity, Market Participants determine the price they will pay for individual equity instruments using Enterprise Value estimated from a hypothetical sale of the Investee Company, as follows:

(i) Determine the Enterprise Value of the Investee Company using the valuation techniques;

(ii) Adjust the Enterprise Value for factors that a Market Participant would take into account such as surplus assets or excess liabilities and other contingencies and relevant factors, to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount the value of any financial instruments ranking ahead of the highest ranking instrument of the Fund in a sale of the Enterprise scenario (e.g. the amount that would be paid[8]) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value between the company's relevant financial instruments according to their ranking;

(v) Allocate the amounts derived according to the Fund's holding in each financial instrument, representing their Fair Value.

[8] Some Valuers may question whether the Fair Value of debt or the face value of debt should be deducted from Adjusted Enterprise Value when estimating the Fair Value of an equity instrument. A Market Participant perspective should be used incorporating individual facts and circumstances when establishing the value of debt to be deducted. The premise of Fair Value measurement is that the Investment is sold at the Measurement Date. Because the definition of Fair Value contains an exit price notion, it could be assumed that a change in control would take place upon the sale of the Investment at the Measurement Date. However, if debt would be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value that debt for the purpose of valuing the equity instrument. Approaches to establishing the value of debt to be deducted could include:

(a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control does not take place as of the Measurement Date) by incorporating into the Fair Value of equity the impact, if any, of non-market terms associated with the debt and the impact on value, if any, of the change in control provision at the ultimate exit date; or

(b) Assuming that a hypothetical change in control takes place on the Measurement Date, resulting in the value of debt deducted being equal to the face or par value of debt.

An additional question arises if debt includes a prepayment penalty. In such circumstances, consideration must be given to the price at which Market Participants would transact to maximize value. The prepayment penalty would be incorporated into the value of debt deducted based on the probability it would be paid. When using a Market Participant perspective, the value of debt deducted may or may not equal the face or par value of debt depending on the facts and circumstances. If debt is required to be repaid upon a change of control with a prepayment penalty, the probability of the prepayment penalty being assessed would be incorporated into the value of debt deducted. If debt is not required to be repaid upon a change of control, then the value of debt that would be deducted from Adjusted Enterprise Value would be impacted by favorable or unfavorable terms (such as interest rate) of the debt.

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It is important to recognise the subjective nature of private equity Investment valuation. It is inherently based on forward-looking estimates and judgements about the Underlying Business itself: its market and the environment in which it operates; the state of the mergers and acquisitions market; stock market conditions and other factors and expectations that exist at the Measurement Date.

Due to the complex interaction of these factors and often the lack of directly comparable market transactions, care should be applied when using publicly available information regarding other entities in deriving a valuation. In order to measure the Fair Value of an Investment, the Valuer will have to exercise judgement and make necessary estimates to adjust the market data to reflect the potential impact of other factors such as geography, credit risk, foreign currency, rights attributable, equity prices and volatility.

As such, it must be recognised that, while valuations do provide useful interim indications of the progress of a particular Underlying Business or Investment, ultimately it is not until Realisation that true performance is firmly determined. A Valuer should be aware of reasons why Realisation proceeds are different from their estimates of Fair Value and consider such reasons in future Fair Value estimates.

Apportion the Attributable Enterprise Value appropriately

The apportionment should reflect the respective amounts accruing to the holder of each financial instrument and all other financial instruments (regardless of holder) in the event of a Realisation at the Measurement Date. As discussed further in section III 5.8, where there are ratchets or share options or other mechanisms (such as 'liquidation preferences', in the case of Investments in early-stage businesses) in place which are likely to be triggered in the event of a sale of the company at the given Enterprise Value at that date, these should be reflected in the apportionment.

The estimation of Fair Value should be undertaken on the assumption that options and warrants are exercised, where the Fair Value is in excess of the exercise price and accordingly it is a reasonable assumption that these will be exercised. The aggregate exercise price of these may result in surplus cash arising in the Underlying Business if the aggregate exercise price is significant.

Where significant positions in options and warrants are held by the Fund, these may need to be valued separately from the underlying Investments using an appropriate option based pricing model.

Differential allocation of proceeds may have an impact on the value of an Investment. If liquidation preferences exist, these need to be reviewed to assess whether they are expected to give rise to a benefit to the Fund, or a benefit to a third party to the detriment of the Fund.

When subtracting outstanding debt from Enterprise Value to measure the Fair Value of Equity Instruments, judgement should be exercised to ensure that the Fair Value of debt represents a Market Participant perspective. For example, if debt must be repaid upon the sale of the Underlying Business, which is often the case in a private equity transaction, then a Market Participant transacting in their economic best interest, may deem the Fair Value of debt to equal the Par Value of debt (or the amount to be repaid) for purposes of determining the Fair Value of equity. If debt would not be repaid when the Enterprise is sold, then the Fair Value of debt would not necessarily equal the Par Value of debt.

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If debt must be repaid upon a change of control, then a question arises about how a Market Participant would be expected to value debt for purposes of valuing an equity instrument:

(a) Taking into account the timing and likelihood of a future actual change in control (that is, assuming that a change in control has not yet taken place as of the Measurement Date, but incorporating into the Fair Value of the debt the existence of the change in control provision); or

(b) using a term of zero on the basis that a hypothetical change in control has taken place (that is, assuming that the change in control takes place on the Measurement Date, resulting in the Fair Value of debt being equal to the face or par value of debt)

As previously stated, when using a Market Participant perspective, the Fair Value of debt may equal the face or par value of debt depending on the facts and circumstances. If debt is not required to be repaid upon a change of control, then the Fair Value of equity would be impacted by favorable or unfavorable terms (such as interest rate) of the debt, or in other words, the Fair Value of debt reflecting the favorable/unfavorable elements would be subtracted from Adjusted Enterprise Value.

It should be noted, however, that if debt is a standalone Investment, a Market Participant would take into account risk, coupon, time to expected repayment, and other market conditions in determining the Fair Value of the debt instrument, which may **not** be equivalent to Par Value.

2.5. Because of the uncertainties inherent in estimating Fair Value for private equity Investments, care should be applied in exercising judgement and making the necessary estimates. However, the Valuer should be wary of applying excessive caution.

Private Equity Funds often undertake an Investment with a view to build, develop and/or to effect substantial changes in the Underlying Business, whether it is to its strategy, operations, management, or financial condition. Sometimes these situations involve rescue refinancing or a turnaround of the business in question. While it might be difficult in these situations to measure Fair Value, it should in most cases be possible to estimate the amount a Market Participant would pay for the Investment in question at a point in time.

There may be situations where:

- the range of reasonable Fair Value estimates is significant;
- the probabilities of the various estimates within the range cannot be reasonably assessed;
- the probability and financial impact of achieving a key milestone cannot be reasonably predicted; and
- there has been no recent investment into the business.

While these situations prove difficult, the Valuer must still come to a conclusion as to their best estimate of the hypothetical exchange price between willing Market Participants.

Estimating the increase or decrease in Fair Value in such cases may involve reference to broad indicators of value change (such as relevant stock market indices). After considering

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these broad indicators, in some situations, the Valuer might reasonably conclude that the Fair Value at the previous Measurement Date remains the best estimate of Fair Value.

Where a change in Fair Value is perceived to have occurred, the Valuer should amend the carrying value of the Investment to reflect the new Fair Value estimate.

2.6. When the price of the initial investment in an Investee Company or instrument is deemed Fair Value (which is generally the case if the entry transaction is considered Orderly[9]), then the valuation techniques that are expected to be used to estimate Fair Value in the future should be evaluated using market inputs as of the date the investment was made. This process is known as Calibration. Calibration validates that the valuation techniques using contemporaneous market inputs will generate Fair Value at inception and therefore that the valuation techniques using updated market inputs as of each subsequent Measurement Date will generate Fair Value at each such date.

Fair Value should reflect reasonable estimates and assumptions for all significant factors that parties to an arm's length transaction would be expected to consider, including those which have an impact upon the expected cash flows from the Investment and upon the degree of risk associated with those cash flows.

In assessing the reasonableness of assumptions and estimates, the Valuer should:

- note that the objective is to replicate those assumptions that the parties in an arm's-length transaction would make at the Measurement Date;
- take account of events taking place subsequent to the Measurement Date where they provide additional evidence of conditions that existed at the Measurement Date that were known or knowable by Market Participants;
- take account of then current market conditions at each Measurement Date; and
- to the extent the initial entry price is deemed Fair Value, test (or calibrate) valuation techniques expected to be used at subsequent valuation dates, using input data at inception to ensure that the valuation techniques result in an initial Fair Value estimate equal to the entry price (**Note**: at subsequent Measurement Dates the calibrated valuation techniques are used with then current market inputs reflecting then current market conditions.).

Calibration is a powerful tool which can assist in capturing the impacts of control and Liquidity, among other inputs, on a Fair Value measurement. For illustrative purposes, assume an Investment is purchased at Fair Value at an implied 10x EBITDA multiple. At the time of purchase, comparable companies are trading at 12x EBITDA. When compared to the comparable companies, the 10x entry multiple incorporates Liquidity, control and other differences between the Investment and comparable companies. At future Measurement Dates, judgement would be applied to determine how to move the acquisition multiple of 10x in relation to changes in the multiple of comparable companies.

For example, if the comparable companies moved from 12x to 15x, the Valuer may conclude that the two turns of EBITDA difference at entry (10x vs 12x) should be maintained, resulting

[9] A Forced Transaction (e.g. a forced liquidation or distress sale) would not be considered Orderly.

in a Fair Value estimate derived by applying a13x multiple to the subject company's updated EBITDA. Similar judgements would be made using inputs for other valuation techniques. The Valuer would not automatically use the entry difference (2x) at future valuation dates, but would determine how much a Market Participant would be willing to pay for the Investment using the calibrated entry inputs as a point of reference.

Similar calibration concepts can be used with an income valuation approach. The discount rate implied at acquisition can be deconstructed into its component parts based on the weighted average cost of capital, which will, in particular, provide a basis for a company specific risk premium, also known as alpha. The components of the weighted average cost of capital would then be updated at future Measurement Dates based on then current market conditions (with adjustments to the alpha based on company specific facts and circumstances) and applied to most likely cash flows at that point in time.

Backtesting

Backtesting is the process of comparing an actual liquidity event (sale, IPO, etc.) to the most recently determined Fair Value estimate. When the valuation implied by an actual realization or liquidity event is compared to Fair Value estimates at the most recent Measurement Dates, the Valuer is provided with additional information to help assess the rigor of the Fair Value estimation process. This does not mean that the exit price should equal the previous Fair Value measurement, but should be used as an input to continuously improve the rigor of the Fair Value estimates.

2.7. Valuers should seek to understand the substantive differences that legitimately occur between the exit price and the previous Fair Value assessment. This concept is known as Backtesting. Backtesting seeks to articulate:

(i) What information was known or knowable as of the Measurement Date;
(ii) Assess how such information was considered in coming to the most recent Fair Value Estimates; and
(iii) Determine whether known or knowable information was properly considered in determining Fair Value given the actual exit price results.

Backtesting is not used to identify theoretical mistakes, if any, in the valuation process, but rather to encourage the Valuer to assess changes in information, market conditions, Market Participants, etc. that may have occurred between the Measurement Date and the exit date.

Backtesting can provide meaningful insights that could be applied when developing future Fair Value estimates. Over time, Backtesting provides the Valuer with a tool to assess whether there are inherent biases (e.g., overly conservative assumptions) built into the valuation process and thereby identify areas for potential improvement.

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3. Valuation Methods

3.1. General

A number of valuation methods or techniques that may be considered for use in measuring the Fair Value of Unquoted Investments are described in sections 3.3 to 3.9 (excluding 3.6) below. These valuation techniques should incorporate case-specific factors affecting Fair Value. For example, if the Underlying Business is holding surplus cash or other assets, the value of the business should reflect that fact to the extent a Market Participant would attribute value to such items.

Techniques for valuing Actively Traded Investments are described in section 3.6 below.

Because, in the private equity arena, value is generally realised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes, the value of the business as a whole at the Measurement Date will often provide a key insight into the value of Investment stakes in that business. For this reason, a number of the techniques described below involve estimating the Enterprise Value as an initial step. If a Market Participant would be expected to maximize value through the sale of the entire business, the estimation of the Fair Value of individual financial instruments would include an assessment of the allocation of the Enterprise Value to the value of individual financial instruments.

There will be some situations where the Fair Value will derive mainly from the expected cash flows and risk of the relevant financial instruments rather than from the Enterprise Value. The valuation technique used in such circumstances should reflect relevant exit expectations.

There may also be some situations in which determining the Enterprise Value under the assumption that the Enterprise would be sold at the Measurement Date, may not be appropriate. For example, if a minority stake is being valued and the other owners' interests are not aligned, it may not be appropriate to assume a sale of the Enterprise and allocation of value as described below. In such circumstances alternative valuation techniques would be used as more fully discussed in Section III.5.10.

3.1 (i) In determining the Fair Value of an Investment, the Valuer should use judgement. This includes consideration of those specific terms of the Investment which may impact its Fair Value. In this regard, the Valuer should consider the economic substance of the Investment, which may take precedence over the strict legal form.

Underlying Businesses may operate using multiple currencies. Investments may be denominated in currencies other than the Funds reporting currency. Movements in rates of exchange may impact the value of the Fund's Investments and these should be taken into account using a Market Participant perspective.

3.1 (ii) Where the reporting currency of the Fund is different from the currency in which the Investment is denominated, translation into the reporting currency for reporting purposes should be done using the bid spot exchange rate prevailing at the Measurement Date.

3.2. Selecting the Appropriate Valuation Technique

3.2 (i) The Valuer should exercise their judgement to select the valuation technique or techniques most appropriate for a particular Investment.

3.2 (ii) The Valuer should use one or more of the following Valuation Techniques, taking into account Market Participant assumptions as to how Value would be determined:

A. Market Approach
  - **a. Price of Recent Investment (3.3)**
  - **b. Multiples (3.4)**
  - **c. Industry Valuation Benchmarks (3.5)**
  - **d. Available Market Prices (3.6)**

B. Income Approach
  - **a. Discounted Cash Flows (3.7, 3.8)**

C. Replacement Cost Approach
  - **a. Net Assets (3.9)**

The key criterion in selecting a valuation technique is that it should be appropriate in light of the nature, facts and circumstances of the Investment and in the expected view of Market Participants. The Valuer may consider utilising further techniques to check the Fair Value derived, as appropriate.

When selecting the appropriate valuation technique each Investment should be considered individually.

An appropriate valuation technique will incorporate available information about all factors that are likely to materially affect the Fair Value of the Investment.

The Valuer will select the valuation technique that is the most appropriate and consequently make valuation adjustments on the basis of their informed and experienced judgement. This will include consideration of factors such as:

- the relative applicability of the techniques used given the nature of the industry and current market conditions;
- the quality, and reliability of the data used in each valuation technique;
- the comparability of Enterprise or transaction data;
- the stage of development of the Enterprise;
- the ability of the Enterprise to generate maintainable profits or positive cashflow;
- any additional considerations unique to the Enterprise; and
- the results of testing (calibrating) techniques and inputs to replicate the entry price of the Investment. (**Note**: at subsequent Measurement Dates the calibrated valuation techniques are used with updated inputs reflecting then current market conditions. See also Section II 2.6)

In assessing whether a technique is appropriate, the Valuer should maximise the use of techniques that draw heavily on observable market-based measures of risk and return. Fair Value estimates based entirely on observable market data are deemed less subjective than those based on Valuer assumptions. In some cases observable market data may require adjustment by the Valuer to properly reflect the facts and circumstances of the Investment being valued. Such adjustments should not be automatically regarded as reducing the reliability of the Fair Value estimation.

While accounting standards do not specify a hierarchy of valuation techniques, the use of multiple techniques is encouraged by some. In particular, IFRS 13 (and ASC Topic 820) states that "in some cases a single valuation technique will be appropriate (e.g. when valuing an asset or a liability using quoted prices in an Active Market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate. If multiple valuation techniques are used to measure Fair Value, the results (i.e. respective indications of Fair Value) shall be evaluated considering the reasonableness of the range of values indicated by those results. A Fair Value measurement is the point within that range that is most representative of Fair Value in the circumstances."[10]

Where the Valuer considers that several techniques are appropriate to value a specific Investment, the Valuer may consider the outcome of these different valuation techniques so that the results of one particular valuation technique may be used as a cross-check of values or to corroborate or otherwise be used in conjunction with one or more other techniques in order to measure the Fair Value of the Investment.

Techniques should be applied consistently from period to period, except where a change would result in better estimates of Fair Value.

The basis for any changes in valuation techniques should be clearly understood. It is expected that there would not be frequent changes in valuation techniques over the course of the life of an Investment.

The table below identifies a number of the most widely used techniques

Valuation Technique	Approach
Price of Recent Investment	Market Approach
Multiples	Market Approach
Industry Valuation Benchmarks	Market Approach
Available Market Prices	Market Approach
Discounted Cash Flows or Earnings (of Underlying Business)	Income Approach
Discounted Cash Flows (from an Investment)	Income Approach
Net assets	Replacement Cost Approach

[10] IFRS 13 paragraph 63; Congruent with ASC Topic 820.

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3.3. Price of Recent Investment

Where the Investment being valued was itself made recently, its cost may provide a good indication of Fair Value. Where there has been any recent Investment in the Investee Company, the price of that Investment will provide a basis of the valuation.

Validity of the Price of Recent Investment erodes over time
The validity of a valuation obtained in this way is inevitably eroded over time, since the price at which an Investment was made reflects the effects of conditions that existed on the date that the transaction took place. In a dynamic environment, changes in market conditions, the passage of time itself and other factors will act to diminish the appropriateness of this valuation technique as a means of estimating value at subsequent dates.

The Price of a Recent Investment valuation technique is likely to be appropriate for all private equity Investments, but only for a limited period after the date of the relevant transaction. Because of the relatively high frequency with which funding rounds are often undertaken for seed and start-up situations, or in respect of businesses engaged in technological or scientific innovation and discovery, this method will often be appropriate for valuing Investments in such circumstances. Generally, Fair Value would be indicated by the Post Money Valuation.

The length of period for which it would remain appropriate to use this valuation technique will depend on the specific circumstances of the Investment and is subject to the judgement of the Valuer.

In stable market conditions with little change in the entity or external market environment, the length of period for which this valuation technique is likely to be appropriate will be longer than during a period of rapid change.

Background to the transaction also needs to be taken into account
In addition, where the price at which a third party has invested is being considered as the basis of valuation, the background to the transaction must be taken in to account. In particular, the following factors may indicate that the price was not wholly representative of the Fair Value at the time:

- different rights attach to the new and existing Investments;
- disproportionate dilution of existing investors arising from a new investor(s);
- a new investor motivated by strategic considerations; or
- the transaction may be considered to be a forced sale or 'rescue package'.

Price of Recent Investment is not a default
Notwithstanding the foregoing, at each Measurement Date, Fair Value must be estimated. Using the Price of a Recent Investment is not a default that precludes re-estimating Fair Value at each Measurement Date.

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3.3. In applying the Price of Recent Investment valuation technique, the Valuer uses the initial cost of the Investment itself, excluding transaction costs[11], or, where there has been subsequent Investment, the price at which a significant amount of new Investment into the company was made, to estimate the Enterprise Value, but only if deemed to represent Fair Value and only for a limited period following the date of the relevant transaction. During the limited period following the date of the relevant transaction, the Valuer should in all cases assess at each Measurement Date whether changes or events subsequent to the relevant transaction would imply a change in the Investment's Fair Value.

Price of Recent Investment Commonly used for seed, start-up and early stage Investments
The Price of Recent Investment valuation technique is commonly used in a seed, start-up or an early-stage situation, where there are no current and no short-term future earnings or positive cash flows. For these Enterprises, typically, it is difficult to gauge the probability and financial impact of the success or failure of development or research activities and to make reliable cash flow forecasts.

Consequently, the most appropriate approach to measure Fair Value may be a valuation technique that is based on market data, that being the Price of a Recent Investment. Other valuation techniques, if used by Market Participants, may also be applicable.

Benchmark / milestone analysis to determine if Fair Value has changed
If the Valuer concludes that the Price of Recent Investment, unadjusted (except for transaction costs—see footnote 11), is no longer relevant, and there are no comparable companies or transactions from which to infer value, it may be appropriate to apply an enhanced assessment based on an industry analysis, sector analysis, scenario analysis (See Section III 5.11) and/or milestone analysis.

In such circumstances, industry-specific benchmarks/milestones, which are customarily and routinely used in the specific industries of the Investee Company, can be used in estimating Fair Value where appropriate. In applying the milestone approach, the Valuer attempts to ascertain whether there has been a change in the milestone and/or benchmark which would indicate that the Fair Value of the Investment has changed. Missing a benchmark/milestone may provide indication of a decrease in value while exceeding a benchmark/milestone may provide evidence of an increase in value depending on the facts and circumstances.

Common milestones / benchmarks
For an Investment in early or development stages, commonly a set of agreed milestones would be established at the time of making the investment decision. These will vary across types of investment, specific companies and industries, but are likely to include:

Financial measures:

- revenue growth;

[11] Depending on the applicable accounting standards, Transaction Costs in some cases are required to be capitalized as part of the cost basis of an Investment. However, Transaction Costs are not considered a characteristic of an asset and therefore should not be included as a component of an asset's Fair Value.

- profitability expectations;
- cash burn rate;
- covenant compliance.

Technical measures:

- phases of development;
- testing cycles;
- patent approvals;
- regulatory approvals.

Marketing and sales measures:

- customer surveys;
- testing phases;
- market introduction;
- market share.

In addition, the key market drivers of the Investee Company, as well as the overall economic environment, are relevant to the assessment.

Typical indicators of a change in Fair Value
In applying the milestone analysis approach, the Valuer attempts to assess whether there is an indication of change in Fair Value based on a consideration of the milestones. This assessment might include considering whether:

- there has been any significant change in the results of the Investee Company compared to budget plan or milestone;
- there have been any changes in expectation that technical milestones will be achieved;
- there has been any significant change in the market for the Investee Company or its products or potential products;
- there has been any significant change in the global economy or the economic environment in which the Investee Company operates;
- there has been any significant change in the observable performance of comparable companies, or in the valuations implied by the overall market;
- any internal matters such as fraud, commercial disputes, litigation, changes in management or strategy

Adjustment to Fair Value in such circumstances
If the Valuer concludes that there is an indication that the Fair Value has changed, they must estimate the amount of any adjustment from the last Price of Recent Investment. By its very nature such adjustment will be subjective. This estimation is likely to be based on objective data from the company, and the experience of the investment professionals and other investors.

However, the necessity and magnitude of the adjustments are relatively subjective and require a large amount of judgement on the part of the Valuer. Where deterioration in value has

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occurred, the Valuer should reduce the carrying value of the Investment reported at the previous Measurement Date to reflect the estimated decrease.

If there is evidence of value creation, such as those listed above, the Valuer may consider increasing the carrying value of the Investment. Caution must be applied so that positive developments are only valued when they contribute to an increase in value of the Underlying Business when viewed by a Market Participant. When considering these more subtle indicators of value enhancement, in the absence of additional financing rounds or profit generation, the Valuer should consider what value a Market Participant would place on these indicators, taking into account the potential outcome and the costs and risks to achieving that outcome.

DCF technique may be useful as a cross-check
In the absence of significant revenues, profits or positive cash flows, other methods such as the earnings multiple are generally inappropriate. The DCF technique may be utilised as a cross-check, however the disadvantages inherent in this technique, arising from the high levels of subjective judgement, may render the method inappropriate without corroborating support.

3.4. Multiples

This valuation technique involves the application of an appropriate multiple to a performance measure such as Earnings or Revenue, of the business being valued in order to derive a value for the business.

This valuation technique is likely to be appropriate for an Investment in an established business with an identifiable stream of continuing earnings or revenue that is considered to be maintainable.

This section sets out guidance for preparing valuations of businesses on the basis of positive earnings. In addition, for businesses that are still in the development stage and prior to positive earnings being generated, multiples of actual or projected revenue may be used as a basis of valuation.

3.4. Depending on the stage of development of an Enterprise, its industry, and its geographic location, Market Participants may apply a multiple of Earnings or Revenue. In using the Multiples valuation technique to estimate the Fair Value of an Enterprise, the Valuer should:

(i) Apply a multiple that is appropriate and reasonable (given the size, risk profile and earnings growth prospects of the underlying company) to the applicable indicator of value (Earnings, or Revenue) of the company;

(ii) Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

Guidance on the interpretation of underlined terms is given below.

Appropriate multiple

By definition, multiples have as their numerator a value, such as price, Enterprise Value, etc., and as their denominator an earnings or revenue figure. The denominator can be the earnings or revenue figure for any specified period of time and multiples are often defined as 'historical', 'current' or 'forecast' to indicate the earnings or revenue used. It is important that the multiple used correlates to the period and concept of earnings or revenue of the company being valued.

Use of Earnings multiples
A number of earnings multiples or ratios are commonly used, including price/earnings (P/E), Enterprise Value/earnings before interest and tax (EV/EBIT) and depreciation and amortisation (EV/EBITDA). The particular multiple used should be appropriate for the business being valued and should conform to Market Participant Assumptions.

In general, because of the role of financial structuring in private equity, multiples should be used to derive an Enterprise Value for the Underlying Business. Where EBITDA multiples are available, these are commonly used.

When EBITDA multiples are not available, P/E multiples may be used since these are commonly reported. For a P/E multiple to be comparable, the two entities should have similar financing structures and levels of borrowing.

Therefore, where a P/E multiple is used, it should generally be applied to an EBIT figure which has been adjusted for the impact of finance costs relating to operations, working capital needs and tax impacts. These adjustments are designed to eliminate the effect on earnings related to the acquisition finance on the Enterprise Value since this is subsequently adjusted.

Use of a Revenue multiple
For Enterprises that have sustainable earnings, it would be more appropriate to utilize an earnings multiple, however for Enterprises that have established operations but have not yet obtained sustainable profitability, a multiple of revenue may be appropriate to determine Fair Value. A revenue multiple is commonly based on an assumption as to the 'normalised' level of earnings that can be generated from that revenue. This valuation technique may be applicable to companies with negative earnings, if the losses are considered to be temporary and one can identify a level of 'normalised' maintainable earnings. This may involve the use of adjusted historic revenue, using a forecast level of revenue or applying a 'sustainable' profit margin to current or forecast revenues.

The most appropriate revenues to use in this valuation technique would be those likely to be used by a prospective Market Participant purchaser of the business.

Reasonable multiple

Acquisition multiples vs quoted company trading multiples
The Valuer would usually derive a multiple by reference to current market-based multiples, reflected in the market valuations of quoted companies or the price at which companies have changed ownership. The multiple derived from the acquisition price is calibrated with the multiple of comparable companies expected to be used in on-going valuation estimates. Differences between the acquisition multiple and the comparable companies multiples are monitored and adjusted, as appropriate, over time, given differences between the Investee Company and the comparable companies.

For example, assume the acquisition price of an Investment was deemed Fair Value (e.g. an Orderly Transaction price) and represented an EBITDA multiple of 8 when comparable company EBITDA multiples were 10. In future periods, when estimating Fair Value judgement is required as to whether or not the 20% discount to comparable company multiples should be maintained or should change at each subsequent Measurement Date.

This market-based approach presumes that the comparable companies are correctly valued by the market. While there is an argument that the market capitalisation of a quoted company reflects not the value of the company but merely the price at which 'small parcels' of shares are exchanged, the presumption in these Valuation Guidelines is that market based multiples are indicative of the value of the company as a whole.

Identifying similarities and differences
Where market-based multiples are used, the aim is to identify companies that are similar, in terms of risk attributes and earnings growth prospects, to the company being valued. This is more likely to be the case where the companies are similar in terms of business activities, markets served, size, geography and applicable tax rate.

The impact of gearing (leverage) and tax on P/E ratios
In using P/E multiples, the Valuer should note that the P/E ratios of comparable companies will be affected by the level of financial gearing (leverage) and applicable tax rate of those companies.

EBITDA multiples and depreciation / amortisation
In using EV/EBITDA multiples, the Valuer should note that such multiples, by definition, remove the impact on value of depreciation of fixed assets and amortisation of goodwill and

other intangibles. If such multiples are used without sufficient care, the Valuer may fail to recognise that business decisions to spend heavily on fixed assets or to grow by acquisition rather than organically do have real costs associated with them which should be reflected in the value attributed to the business in question.

Adjusting for points of difference
It is important that the earnings multiple of each comparable company is adjusted for points of difference between the comparable company and the company being valued. These points of difference should be considered and assessed by reference to the two key variables of risk and earnings growth prospects which underpin the earnings multiple. In assessing the risk profile of the company being valued, the Valuer should recognise that risk arises from a range of aspects, including the nature of the company's operations, the markets in which it operates and its competitive position in those markets, the quality of its management and employees and, importantly in the case of private equity, its capital structure and the ability of the Fund holding the Investment to effect change in the company.

The impact of lack of Liquidity
When considering adjustments to reported multiples, the Valuer should also consider the impact of the differences between the Liquidity of the shares being valued and those on a quoted exchange. There is a risk associated with a lack of Liquidity. The Valuer should consider the extent to which a prospective acquirer of those shares would take into account the additional risks associated with holding an unquoted share.

In an unquoted company the risk arising from the lack of Liquidity is clearly greater for a shareholder who is unable to control or influence a Realisation process than for a shareholder who owns sufficient shares to drive a Realisation at will. It may reasonably be expected that a prospective Market Participant purchaser would assess that there is a higher risk associated with holding a minority position than for a control position.

Calibration
Value attributed to a lack of Liquidity may be difficult to assess. Calibration provides a technique to objectively assess value attributed to a lack of Liquidity. The multiple at the date of acquisition should be calibrated against the market comparable multiples. Differences, if any, should be understood and similar differences may be expected or need to be understood at subsequent valuation dates.

Other reasons for adjustment
Other reasons why the comparable company multiples may need to be adjusted may include the following:

- the size and diversity of the entities and, therefore, the ability to withstand adverse economic conditions;
- the rate of growth of the earnings;
- the reliance on a small number of key employees;
- the diversity of the product ranges;
- the diversity and quality of the customer base;
- the level of borrowing;
- for any other reason the quality of earnings may differ; and

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- the risks arising from the lack of Liquidity of the shares.

Fair Value measurements should not include a premium or discount that is inconsistent with the instrument (Unit of Account) being valued. Blockage Factors are not allowed by accounting standards. However, investors in private companies generally consider their overall interest and the extent to which they act in concert with other investors. Judgement must be applied to individual facts and circumstances to assess the amount a Market Participant would pay in the context of the potential adjustments to multiples noted above.

Comparable recent transactions
Recent transactions involving the sale of similar companies are sometimes used as a frame of reference in seeking to derive a reasonable multiple. It is sometimes argued, since such transactions involve the transfer of whole companies whereas quoted multiples relate to the price for 'small parcels' of shares, that recent transactions provide a more relevant source of multiples. However, the appropriateness of the use of recent transaction data is often undermined by the following:

- the lack of forward looking financial data and other information to allow points of difference to be identified and adjusted for;
- the generally lower reliability and transparency of reported earnings figures of private companies;
- the amount of time that has passed since the transaction was negotiated/consummated;
- the impact of reputational issues, such as ESG (environmental, social and governance) and other factors; and
- the lack of reliable pricing information for the transaction itself.

It is a matter of judgement for the Valuer as to whether, in deriving a reasonable multiple, they refer to a single comparable company or a number of companies or the earnings multiple of a quoted stock market sector or sub-sector. It may be acceptable, in particular circumstances, for the Valuer to conclude that the use of quoted sector or sub-sector multiples or an average of multiples from a 'basket' of comparable companies may be appropriate.

Maintainable earnings / Maintainable revenue

In applying a multiple to maintainable earnings, it is important that the Valuer is satisfied that the earnings figure can be relied upon. While this might tend to favour the use of audited historical figures rather than unaudited or forecast figures, it should be recognised that value is by definition a forward-looking concept, and quoted markets more often think of value in terms of 'current' and 'forecast' multiples, rather than 'historical' ones. In addition, there is the argument that the valuation should, in a dynamic environment, reflect the most recent available information. There is therefore a trade-off between the reliability and relevance of the earnings figures available to the Valuer.

Similar to the discussion above, in applying a multiple to maintainable revenue, it is important that the Valuer is satisfied that the revenue figure can be relied upon. While this might tend to favour the use of audited historical figures rather than unaudited or forecast figures, it should be recognised that value is by definition a forward-looking concept, and quoted markets more often think of value in terms of 'current' and 'forecast' multiples, rather than 'historical' ones.

In addition, there is the argument that the valuation should, in a dynamic environment, reflect the most recent available information. There is therefore a trade-off between the reliability and relevance of the revenue figures available to the Valuer.

On balance, while it remains a matter of judgement for the Valuer, a Market Participant perspective should be used either focused on historical earnings or focused on future earnings based on the availability and reliability of forward looking projections and multiples or historical results and multiples.

Whichever period's earnings are used, the Valuer should satisfy himself that they represent a reasonable estimate of maintainable earnings, which implies the need to adjust for exceptional or non-recurring items, the impact of discontinued activities and acquisitions and forecast material changes in earnings. Such adjustments, if appropriate, should also be reflected in the multiple derived from comparable companies.

3.5. Industry Valuation Benchmarks

3.5. The use of industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a sanity check of values produced using other techniques.

A number of industries have industry-specific valuation benchmarks, such as 'price per bed' (for nursing-home operators) and 'price per subscriber' (for cable television companies). Other industries, including certain financial services and information technology sectors and some services sectors where long-term contracts are a key feature, use multiples of revenues as a valuation benchmark.

These industry norms are often based on the assumption that investors are willing to pay for turnover (revenue) or market share, and that the normal profitability of businesses in the industry does not vary much.

3.6. Quoted Investments

Private Equity Funds may be holding Quoted instruments, for which there is an available market price.

3.6 (i) Instruments quoted on an Active Market should be valued at the price within the bid / ask spread that is most representative of Fair Value on the Measurement Date. The Valuer should consistently use the most representative point estimate in the bid /ask spread.

For certain Quoted Investments there is only one market price quoted, representing, for example, the value at which the most recent trade in the instrument was transacted.

For other Quoted Investments there are two market prices at any one time: the lower 'bid' price quoted by a market maker, which he will pay an investor for a holding (i.e. the investor's disposal price), and the higher 'ask' price, which an investor can expect to pay to

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acquire a holding. However, as an alternative to the bid price (where not required by regulation), is the mid-market price (i.e. the average of the bid and ask prices), where this is considered the most representative point estimate in the bid/ask spread.

As previously noted, Fair Value measurements should not include a premium or discount that is inconsistent with the instrument (Unit of Account) being valued. Blockage Factors are not allowed by accounting standards.

3.6 (ii) Blockage Factors that reflect size as a characteristic of the reporting entity's holding (specifically, a factor that adjusts the quoted price of an asset because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity) should not be applied.

If a market is deemed **not** to be active, the Valuer may consider the use of quoted prices supplemented by additional valuation techniques to measure Fair Value, as appropriate.

3.6 (iii) Discounts may be applied to prices quoted in an Active Market if there is some contractual, Governmental or other legally enforceable restriction attributable to the security, not the holder, resulting in diminished Liquidity of the instrument that would impact the price a Market Participant would pay at the Measurement Date.

An example of a contractual restriction deemed attributable to the security could be an underwriter's lock-up as any buyer of the securities would be expected to abide by the same contractual lock-up provisions. An example of a restriction which would be deemed an attribute of the holder could be limitations on sale imposed by holding a Board of Directors seat. As the holder of the security is not mandated to hold a board seat, it is an attribute of the holder rather than an attribute of the security.

When applicable, to determine the level of discount to apply, the Valuer should consider the impact on the price that a buyer would pay when comparing the Investment in question with an identical but unrestricted holding.

A Valuer may consider using an option pricing model to value the impact of this restriction on Realisation. However, in practice for restrictions which only cover a limited number of reporting periods, this is simplified to a simple mathematical discount to the quoted price.

The discount applied should appropriately reflect the time value of money and the enhanced risk arising from the reduced Liquidity. The discount used is a matter of judgement influenced by expected volatility which should reduce to zero at the end of the restriction period.

3.7. Discounted Cash Flows or Earnings (of Underlying Business)

This valuation technique involves deriving the value of a business by calculating the present value of expected future cash flows (or the present value of expected future earnings, as a surrogate for expected future cash flows). The cash flows and 'terminal value' are those of the Underlying Business, not those from the Investment itself.

The Discounted Cash Flows (DCF) technique is flexible in the sense that it can be applied to any stream of cash flows (or earnings). In the context of private equity valuation, this flexibility enables the valuation technique to be applied in situations that other techniques may be incapable of addressing. While this valuation technique may be applied to businesses going through a period of great change, such as a rescue refinancing, turnaround, strategic repositioning, loss making or is in its start-up phase, there is a significant risk in utilising this valuation technique.

The disadvantages of the DCF valuation technique centre around its requirement for detailed cash flow forecasts and the need to estimate the 'terminal value' and an appropriate risk-adjusted discount rate. All of these inputs require substantial subjective judgements to be made, and the derived present value amount is often sensitive to small changes in these inputs.

There is no hierarchy of valuation techniques required by accounting standards. However, the use of multiple valuation techniques is encouraged. Therefore, while many industry participants believe that DCF based valuations are open to a high level of subjectivity in selecting inputs for this technique when valuing equity Investments for the private equity industry, Income based valuation techniques may be helpful in corroborating Fair Value estimates determined using market based techniques.

3.7. In using the Discounted Cash Flows or Earnings (of Underlying Business) valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive the Enterprise Value of the company, using reasonable assumptions and estimations of expected future cash flows (or expected future earnings) and the terminal value, and discounting to the present by applying the appropriate risk-adjusted rate that captures the risk inherent in the projections;

(ii) Adjust the Enterprise Value for surplus or non-operating assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of Market Participants. Judgement is required in assessing a Market Participant perspective.

3.8. Discounted Cash Flows (from an Investment)

This valuation technique applies the DCF concept and technique to the expected cash flows from the Investment itself.

This valuation technique, because of its flexibility, is capable of being applied to all private

equity Investment situations. It is particularly suitable for valuing non-equity Investments in instruments such as debt or mezzanine debt, since the value of such instruments derives mainly from instrument-specific cash flows and risks rather than from the value of the Underlying Business as a whole.

However, because of its inherent reliance on substantial subjective judgements, and because of the general availability of market based techniques, the Valuer should be cautious of using this valuation technique as the only basis of estimating Fair Value for Investments which include an equity element.

Risk and the rates of return necessary to compensate for different risk levels are central commercial variables in the making of all private equity Investments. Accordingly there exists a frame of reference against which to develop discount rate assumptions.

Terminal value estimation

However the need to make detailed cash flow forecasts over the Investment life (except in circumstances where Realisation is imminent) may reduce the reliability and crucially for equity Investments, there remains a need to estimate the 'terminal value'.

Where the Investment comprises equity or a combination of equity and other financial instruments, the terminal value would usually be derived from the anticipated value of the Underlying Business at Realisation. This will usually necessitate making assumptions about future business performance and developments and stock market and other valuation ratios at the assumed Realisation date. In the case of equity Investments, small changes in these assumptions can materially impact the valuation. In the case of non-equity instruments, the terminal value will usually be a pre-defined amount, which greatly enhances the reliability of the valuation.

In circumstances where a Realisation is not foreseeable, the terminal value may be based upon assumptions of the perpetuity cash flows accruing to the holder of the Investment. These circumstances (which are expected to be rare in private equity) may arise where the Fund has little ability to influence the timing of a Realisation and/or those shareholders that can influence the timing do not seek a Realisation.

Realisation imminent and pricing agreed

Where Realisation of an Investment or a flotation of the Underlying Business is imminent and the pricing of the relevant transaction has been substantially agreed, the Discounted Cash Flows (from the Investment) valuation technique (or, as a surrogate, the use of a simple discount to the expected Realisation proceeds or flotation value) is likely to be the most appropriate valuation technique.

3.8. In using the Discounted Cash Flows (from an Investment) valuation technique to estimate the Fair Value of an Investment, the Valuer should derive the present value of the cash flows from the Investment using reasonable assumptions and estimations of expected future cash flows, the terminal value or maturity amount, date, and the appropriate risk-adjusted rate that captures the risk inherent to the Investment. This valuation technique would generally be applied to Investments with characteristics similar to debt.

The implied discount rate at initial investment is adjusted over time for changes in market conditions. In selecting a discount rate, it is important to consider not only the various inputs typically used to estimate the cost of capital, but also the differences between the Underlying Business and the selected comparable companies used in estimating the discount rate, which might indicate that a higher or lower cost of capital is appropriate. Calibration provides an indication of the way that Market Participants would value the investment as of the transaction date given the differences between the Underlying Business and the selected comparable companies. The initial implied yield and assumptions can then be adjusted to take into account changes in the Underlying Business and the market between the transaction date and each subsequent Measurement Date.

3.9. Net Assets

This valuation technique involves deriving the value of a business by reference to the value of its net assets.

This valuation technique is likely to be appropriate for a business whose value derives mainly from the underlying Fair Value of its assets rather than its earnings, such as property holding companies and investment businesses (such as Fund-of-Funds as more fully discussed in 4. Valuing Fund Interests).

This valuation technique may also be appropriate for a business that is not making an adequate return on assets and for which a greater value can be realised by liquidating the business and selling its assets. In the context of private equity, it may therefore be appropriate, in certain circumstances, for valuing Investments in loss-making companies and companies making only marginal levels of profits.

3.9. In using the Net Assets valuation technique to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive an Enterprise Value for the company using the perspective of a Market Participant to value its assets and liabilities (adjusting, if appropriate, for non-operating assets, excess liabilities and contingent assets and liabilities);

(ii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund's Investment to derive the Attributable Enterprise Value; and

(iii) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments using the perspective of potential Market Participants. Judgement is required in assessing a Market Participant perspective.

4. Valuing Fund Interests

4.1. General

4.1. In measuring the Fair Value of an interest in a Fund the Valuer may base their estimate on their attributable proportion of the reported Fund Net Asset Value (NAV) if NAV is derived from the Fair Value of underlying Investments and is as of the same Measurement Date as that used by the Valuer of the Fund interest, except as follows:

(i) if the Fund interest is actively traded Fair Value would be the actively traded price;

(ii) if management has made the decision to sell a Fund interest or portion thereof and the interest will be sold for an amount other than NAV, Fair Value would be the expected sales price.

Fund-of-Funds and investors in Private Equity Funds must value their Interest in an underlying Fund at regular intervals to support their financial reporting. Historically, the Net Asset Value ('NAV') based on the underlying Fair Value of Investments held by a Fund, as reported by the Manager, has been used as the basis for estimating the Fair Value of an interest in an underlying Fund.[12] (Note: As stated in Guideline 4.1 (i), if the Fund interest is actively traded, Fair Value would be determined using the actively traded price).

Fair Value for a Fund interest is, at its most basic level, equivalent to the summation of the estimated value of underlying Investments as if realised on the Measurement Date. The proceeds from such hypothetical Realisations would flow through to the investor in an amount equal to NAV. Therefore, NAV, when derived as the Fair Value of underlying Investments and adjusted for incentive payments, etc., provides the best indication of the cash flows an investor would receive at the Measurement Date, and thereby a clear indication of the value of the Fund interest. This concept makes particular sense for closed-end Fund investors who realise cash returns on their Investment when Realisation events occur through the sale of the underlying portfolio companies.

As an investor in a Fund, reliance on a reported NAV provided by the investee Fund manager can only be used by the investor, to determine the Fair Value of the Fund Interest, to the extent that the investor has evidence that the reported NAV is appropriately derived from the Fair Value of underlying Investments as part of a robust process. Typically, evidence as to a Manager's Fair Value approach, estimation procedures and consistency of application is gathered via initial due diligence, on-going monitoring, and review of financial reporting and governance of the investee Fund by the investor entity.

[12] FASB ASC Topic 820 (820-10-15-4 & 820-10-35-59 to 62) allows the use of NAV to measure Fair Value if certain conditions are met: the Investment is in a Fund (as defined by ASC Topic 946); and underlying Investments are reported at Fair Value as of the Measurement Date. IFRS is silent on the use of NAV and provides no further guidance on how to measure the Fair Value of a Fund interest. Generally under IFRS, NAV is used as a starting point with the Valuer assessing that reported net assets are valued compliant with Fair Value principles.

Therefore, NAV, when derived from the Fair Value of underlying Fund Investments rigorously determined in accordance with the principles of Fair Value and these Valuation Guidelines, provides the best estimate upon which to base the Fair Value of an Interest in a Fund.

4.2. Adjustments to Net Asset Value

4.2. If the Valuer has determined that the reported NAV is an appropriate starting point for determining Fair Value, it may be necessary to make adjustments based on the best available information at the Measurement Date. Although the Valuer may look to the Fund Manager for the mechanics of their Fair Value estimation procedures, the Valuer needs to have appropriate processes and related controls in place to enable the Valuer to assess and understand the valuations received from the Fund Manager. If NAV is not derived from the Fair Value of underlying Investments and / or is not as of the same Measurement Date as that used by the Valuer of the Fund interest, then the Valuer will need to assess whether such differences are significant, resulting in the need to adjust reported NAV.

Factors which might result in an adjustment to the reported NAV would include the following:

- significant time elapsing between the Measurement Date of the Fund NAV and the Valuer entity's Measurement Date. This would be further exacerbated by:
  - the Fund making subsequent Investments or achieving realizations;
  - the Valuer becoming aware of subsequent changes in the Fair Value of underlying investee companies;
  - subsequent market changes or other economic conditions changing to impact the value of the Fund's portfolio;
- information from an orderly Secondary Transaction if sufficient and transparent;
- the appropriate recognition of potential performance fees or carried interest in the Fund NAV;
- waived management fees included in NAV;
- impact of claw back provisions;
- any features of the Fund agreement that may affect distributions but which are not captured in the NAV;
- materially different valuations by GPs for common companies and identical securities; and
- any other facts and circumstances which might impact underlying Fund value.

NAV should be adjusted such that it is equivalent to the amount of cash that would be received by the holder of the interest in the Fund if all underlying Investee Companies were realised as at the Measurement Date.

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4.3. Secondary Transactions

4.3. When a Valuer of an interest knows the relevant terms of a Secondary Transaction in that particular Fund and the transaction is orderly, the Valuer must consider the transaction price as one component of the information used to measure the Fair Value of a Fund interest.

Limited Secondary Transactions exist for Private Equity Funds. External market transactions for a Fund are typically infrequent, opaque and information is extremely limited. Secondary prices are negotiated, may be influenced by factors beyond Fair Value and based on assumptions and return expectations that are often unique to the counter parties. In addition, information relevant to specific transactions may not be deemed orderly and any pricing data available may no longer be current.
In the event that the investor in the Private Equity Fund has decided to sell their interest in that Fund, then data known from orderly Secondary Transaction prices is likely to be better evidence of Fair Value.

Any use of a Secondary Transaction price requires considerable judgement. If orderly Secondary Transaction prices are available, but are not deemed active, then such prices should be augmented with other valuation inputs, generally NAV.

4.4. Discounted Cash Flows

In situations where a Valuer decides not to use or cannot use NAV as a starting point for determining Fair Value and orderly Secondary Transaction information is not available, the primary valuation technique available to estimate Fair Value for a Fund interest would be to perform a discounted cash flow analysis of all future cash flows for the Fund. Given the subjectivity involved, it is not expected that the DCF alternative would be used often in practice.

Section III: Application Guidance

Introduction

Section II sets out the Valuation Guidelines and principles which represent best practice for the valuation of private equity and venture capital Investments. This section, Section III, sets out further practical guidance to the application of those principles and techniques to specific cases.

5. Specific Considerations

5.1. Insider Funding Rounds

The price at which a funding round takes place may be a clear indicator of Fair Value at that date. When using the Price of Recent Investment valuation technique, the Valuer should consider whether there are specific circumstances surrounding that round of Investment which may reduce the reliability of the price as an indicator of Fair Value.

Where there is a round of financing that involves only existing investors of the Underlying Business in the same proportion to their existing Investments (insider round), the commercial need for the transaction to be undertaken at Fair Value may be diminished. The Valuer needs to assess whether the transaction was appropriately negotiated and reflected the Enterprise Value at that date.

Nevertheless, a financing with existing investors that is priced at a valuation that is lower than the valuation reported at the previous Reporting Date (insider down round) may indicate a decrease in value and should therefore be taken into consideration.

Insider down rounds may take various forms, including a corporate reorganisation, i.e. a significant change in the common equity base of a company such as converting all outstanding preferred shares into common equity, combining outstanding preferred shares into a smaller number of shares (share consolidation) or even cancelling all outstanding shares before a capital increase.

5.2. Distressed Market

Markets from which transaction data may be extracted may be viewed by Valuers to be ‘distressed markets’. A distressed market does not mean that all transactions within that market may be deemed to be distressed and invalid for use as comparative purposes, however an individual transaction may be deemed not orderly. In these situations significant judgement is needed when determining whether individual transactions are considered orderly and thereby are indicative of Fair Value.

When considering whether a transaction may be deemed to be distressed or forced (e.g. not orderly), the Valuer may include such matters as the following indicators in their consideration:

- a legal requirement to transact, for example a regulatory mandate;

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- a necessity to dispose of an asset immediately and there is insufficient time to market the asset to be sold;
- the existence of a single potential buyer as a result of the legal or time restrictions imposed;
- the seller is in or near bankruptcy or receivership (i.e. the seller is distressed);
- there was not adequate exposure to the market to allow for usual and customary marketing activities; and
- the transaction is considered an outlier by Market Participants when considering other similar transactions of the same or similar asset.

Determining whether a transaction is not orderly or merely reflects current distressed market conditions requires judgement.

5.3. Higher Ranking Instruments

Many acquisition structures include third party debt which ranks higher than the interests of the Fund, which is deducted from Adjusted Enterprise Value to estimate the Attributable Enterprise Value.

For certain transactions, this debt is actively traded and may be acquired by the Investee Company or the Fund in the market at a price which is at a discount to the par value.

In calculating the Attributable Enterprise Value, the Valuer should deduct from the Enterprise Value the amount which is expected to be repaid in settlement of this debt at the Measurement Date. Typically this is the par value since the debt is generally repayable at the time of disposal of the Investee Company and the Enterprise Value has been estimated on the basis of disposal at the Measurement Date as this is how Market Participants in the Private Equity industry view the realization process.

When debt must be repaid upon the sale of the Underlying Business, then a Market Participant may deem the Fair Value of debt to equal the Par Value of debt (or the amount to be repaid) for purposes of determining the Fair Value of equity. It should be noted however, that if debt is a standalone Investment, a Market Participant would take into account risk, coupon, time to expected repayment, and other market conditions in determining the Fair Value of the debt instrument, which would generally **not** be equivalent to Par Value (see 5.5 below).

Where the debt is trading at a discount to par, this lower amount would not normally be deducted from the Enterprise Value until the Investee Company or the Fund has acquired that debt in the market at that value and intends to cancel the debt rather than seek repayment at par.

5.4. Bridge Financing

Funds, or related vehicles, may grant loans to an Underlying Business pending a new round of equity financing (Bridge financing). This may be provided in anticipation of an initial Investment by the Fund, or ahead of a proposed follow-on Investment.

In the case of an initial Investment, where the Fund holds no other Investments in the Underlying Business, the Bridge loan should be valued in isolation. In these situations and if it is expected that the financing will occur in due course and that the Bridge loan is merely ensuring that funds are made available early, cost may be the best indicator of Fair Value, unless market or company specific conditions exist which would indicate that Fair Value differs from cost.

If it is anticipated that the company may have difficulty arranging the financing, and that its viability is in doubt, the Valuer should reassess Fair Value.

If the bridge finance is provided to an existing Investee Company in anticipation of a follow on Investment, the bridge finance should be included, together with the original Investment, as a part of the overall package of Investment being valued to the extent a Market Participant would be expected to combine the overall Investment.

5.5. Mezzanine Loans

Mezzanine loans are one of the commonly used sources of debt finance for Investments. Typically these will rank below the senior debt, but above shareholder loans or equity, bear an interest rate appropriate to the level of risk being assumed by the loan provider and may have additional value enhancing aspects, such as warrants.

Often these are provided by a party other than the equity provider and as such may be the only instrument held by the Fund in the Underlying Business. In these situations, the mezzanine loan should be valued on a standalone basis. The price at which the mezzanine loan was issued is a reliable indicator of Fair Value at that date.

The Valuer should consider whether any indications of deterioration in the value of the Underlying Business exist, which suggest that the loan will not be fully recovered. The Valuer should also consider whether any indications of changes in required yield exist, which suggest that the value of the loan has changed.

There are generally limited market opportunities for the holders of mezzanine loans to trade. There are agencies which regularly quote prices on these types of loans; however transactions cannot always be undertaken at the indicative prices offered. Prices reported of transactions should be considered by the Valuer as to whether these are a reasonable indication of Fair Value. The use of such prices is permitted to determine Fair Value if the Valuer has determined how a quotation or a price provided by a third-party source was determined and to what extent it is contemporaneous and actionable. The Valuer should understand what the source of the information was, the inputs and assumptions used and whether a quote is binding or not.
Since the cash flows associated with a mezzanine loan may be predicted with a reasonable amount of certainty, typically these are valued on the basis of a DCF calculation.

Warrants attached to mezzanine loans should be considered separately from the loan. The Valuer should select a valuation technique appropriate to valuing the Underlying Business and apply the percentage ownership that the exercised warrants will confer to that valuation.

In the event that the warrant position is significant, the Valuer may consider utilising one of the sophisticated option and warrant pricing models.

If the mezzanine loan is one of a number of Investments held by a Fund in the Underlying Business, then the mezzanine loan and any attached warrants should be included as a part of the overall package of Investment being valued, to the extent that a Market Participant would

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combine the Investments. Depending on the facts and circumstances of the Investments held by a Fund, the Fair Value of a mezzanine loan may be equal to the par value of the loan if it must be repaid upon a change of control.

5.6. Rolled up Loan Interest

Many financial instruments commonly used in private equity Investments accumulate interest which is only realised on redemption of the instrument (e.g. deep discount debentures or Payment-in-Kind Notes).

In valuing these instruments, the Valuer should assess the expected present value of the amount to be recovered from these instruments. The consideration of recoverable amount will also include the existence of any reasonably anticipated enhancements such as interest rate step increases.

In a typical financing package, these are inseparable from the underlying equity Investment and will be realised as part of a sale transaction.

The difference between the estimated recoverable amount (if in excess of the original cost) should be spread over the anticipated life of the note so as to give a constant rate of return on the instrument.

5.7. Indicative Offers

Indicative offers received recently from a third party for the Underlying Business may provide a good indication of Fair Value. This will apply to offers for a part or the whole Underlying Business as well as other situations such as price indications for debt or equity refinancing.

However, before using the offer as evidence of Fair Value, the Valuer should consider the motivation of the party in making the offer. Indicative offers may be made deliberately high for such reasons as: to open negotiations, gain access to the company or made subject to stringent conditions or future events.

Similarly they may be deliberately low if the offeror believes that the vendor may be in a forced sale position, or to take an opportunity to increase their equity stake at the expense of other less liquid stakeholders.

In addition, indicative offers may be made on the basis of insufficient detailed information to be properly valid.

These motivations should be considered by the Valuer; however it is unlikely that a firm conclusion can be drawn.

Accordingly, indicative offers may provide useful additional support for a valuation estimated by one of the valuation techniques, but are generally insufficiently robust to be used in isolation.

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5.8. Impacts from Structuring

Frequently the structuring of a private equity Investment is complex with groups of stakeholders holding different rights which either enhance or diminish the value of their interests, depending on the success or disappointments of the Underlying Business.

Valuations must consider the impact of future changes in the structure of the Investment which may materially impact the Fair Value. These potential impacts may take several different legal forms and may be initiated at the Fund's option, automatically on certain events taking place, or at the option of another party.

Common clauses include, but are not limited to:

- stock options and warrants;
- anti-dilution clauses;
- ratchet clauses;
- convertible debt instruments;
- liquidation preferences;
- guaranteed IRR;
- commitments to take up follow-on capital Investments.

These rights should be reviewed on a regular basis to assess whether these are likely to be exercised and the extent of any impact on value of the Fund's Investment. At each Measurement Date, the Valuer should determine whether these rights are likely to be exercised.

In assessing whether rights are likely to be taken up by stakeholders, the Valuer may limit their consideration to a comparison of the value received by the exerciser against the cost of exercising. If the exerciser will receive an enhancement in value by exercising, the Valuer should assume that they will do so.

The estimation of Fair Value should be undertaken on the basis that all rights that are currently exercisable and are likely to be exercised (such as options), or those that occur automatically on certain events taking place (such as liquidation preferences on Realisation, or ratchets based on value), have taken place.

Consideration should also be given to whether the exercise price will result in surplus cash arising in the Investee Company.

Notwithstanding the above, when considering the impact of liquidation preferences, the Valuer should include in their assessment the likelihood of the Fund receiving their full contractual right under the preference. In practice, full value for the preference may not be achieved, particularly when this would result in other investors who are integral to the sale process (such as a continuing management team) receiving a significantly reduced value for their Investment.

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5.9. Contractual Rights

Increasingly, additional consideration dependent upon future events is used as a strategy for exiting an Investment. Upon the sale of an Underlying Business some consideration is received, with additional consideration potentially being deferred and received in the future. The contractual right to future consideration can be very beneficial, especially for deals encircled with uncertainty; where significant potential value of a business lies in the outcome of future events. The contractual right to future consideration is often described as "contingent consideration."

Negotiating a contract for future consideration allows sellers to close a deal with the ability to realize a price they think is fair, taking into account future performance they deem both valuable and likely, but that has not yet been achieved. For buyers, the ability to contractually delay paying for value before it fully crystallizes protects their Investment.

Because the interpretation of accounting standards differs and the treatment of so-called "gain contingencies" is not uniform, the Fair Value of contractual rights (gain contingencies) may not have been recorded in a Fund's financial statements or related notes. However, in the context of a private equity or venture capital Investment, the sale of an Investment that includes potential future consideration is both contractual and qualifies as a financial instrument. Said differently, a contractual right exists. The right itself is not contingent; the future consideration is variable depending on future events and outcomes. In many ways this is no different than the ownership in an underlying Investee Company; an ownership right exists; the future cash flows that will result from that ownership right are dependent (contingent) upon future events. The same concept applies to warrants or options. The ultimate value is contingent upon future events. To avoid confusion, and misapplication of accounting principles, it is more appropriate to describe "contingent consideration" in its legal form, that being a "contractual right" to future consideration.

Due to the unique aspects of these types of rights, it is likely that an income approach (discounted cash flow) will be the best tool to estimate Fair Value using cash flows which have been appropriately probability weighted for expected outcomes. The expected cash flows are then discounted using an appropriately chosen discount rate. Most likely cash flows, in their simplest form, are determined by assessing the probability and amount of payment at various points in time. Some Market Participants may use other valuation approaches to determine the value of such future cash flows.

Cash flow assumptions should include the estimation of the likelihood and timing of various possible outcomes for achievement of the specified contingency and/or consider scenario-based projections relevant to the specified contingencies. The key starting point is to decompose the factors that would lead to a contingency being met (or not being met). The Valuer must identify sources of data to be used to support assumptions. It is often possible to keep the analysis relatively simple while still incorporating the material complexities of the contractual right, especially if the probability of success is low or the amount of the future consideration is small. As noted above, even though the interpretation of the proper accounting treatment of contractual rights differs (recognition as an asset in the financial statements vs. disclosure in notes to financial statements), Investors generally are in need of a Valuer's estimate of the Fair Value of such contractual rights or contingent gains.

5.10. Non-Control Investments

As noted in Guideline 2.4, generally Enterprise Value of the portfolio company is the starting point for determining Fair Value. This is because investors either have control or have invested together with other investors (and collectively have control) such that value at exit is maximized by the sale of the Enterprise.[13]

In certain limited circumstances, the unit of valuation may not be the overall enterprise. This may be the case where a non-controlling or minority interest is purchased and the controlling shareholders interests are not aligned with the non-controlling or minority shareholders. In such limited situations, value may not be maximized through the sale of the Enterprise, and/or the controlling shareholder may have no intent or need to sell the Enterprise.

In such situations, the Market Participant contemplated in the Fair Value determination is the hypothetical buyer for the minority interest, *not* a hypothetical buyer for the entire Enterprise. If the minority interest would be sold to a Market Participant without the Enterprise being sold, then the valuation technique(s) used to determine Fair Value would mirror those of potential Market Participant buyers of the position. In some circumstances a market approach may be applicable, though in other cases an income approach may be appropriate.

If an income approach (discounted cash flow) is used alone or in combination with a market approach, it would require estimation of future economic benefits and the application of an appropriate *discount rate* to equate them to a single present value. The future economic benefits to be discounted are generally a stream of periodic cash flows attributable to the asset being valued, but they could also take other forms under specific circumstances—for example, a lump sum payment at a particular time in the future with or without interim cash flows as would be the case where there is a contracted put option in place for the sale of the investment.. Fair Value would represent the amount a Market Participant would pay in an Orderly Transaction for the non-controlling minority interest.

5.11. Mathematical Models / Scenario Analysis

Unlike derivatives and debt markets, mathematical option pricing models have not seen wide usage in the private equity marketplace. Such models are rarely used by Market Participants to determine the transaction price for an Investment. However, for certain early stage Investments, option pricing models (OPM) or probability-weighted expected return models (PWERM) are deemed by some to provide a reliable indication of Fair Value where a limited number of discrete outcomes can be expected.

To the extent a Market Participant would determine value of early stage (pre revenue, pre earnings) Enterprises using mathematical models or a scenario analysis, it would be appropriate to consider such valuation techniques in determining Fair Value. For example, Enterprise Value could be estimated by assigning probabilities to value increasing (future up round), value remaining the same (flat round), value decreasing (down round), and value eroding (zero return), taking into account anticipated dilution, if any, and then discounting the

[13] For purposes of these Guidelines, control should not be interpreted in the context of accounting consolidation rules. It is the premise of these Guidelines that all Investments made by Investment Entities and Investment Companies are reported at Fair Value. Control in these guidelines is used for purposes of determining which entity or entities have the ability to cause the portfolio company or Investment to be sold at the Measurement Date.

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future funding event to the Measurement Date using an appropriate weighted average cost of capital. The Enterprise Value could then be allocated, again using estimated probabilities, to individual securities using a liquidation or exit approach meaningful for each scenario. It should be noted that selecting inputs for such techniques would be highly subjective.

5.12. Sum of the Parts

Fair Value is determined using Market Participant assumptions. For certain Investments, Fair Value is determined by aggregating the individual Fair Values of portions of the business. This may be the case in situations where an Underlying Business has distinct parts where Market Participants would apply different metrics to value each portion. In such circumstances, it may be appropriate to determine the Fair Value of each part and then aggregate the values to determine the overall Fair Value.

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Definitions

The following definitions shall apply in these Valuation Guidelines.

Active Market

A market in which transactions for an asset take place with sufficient frequency and volume to provide pricing information on an on-going basis.

Actively Traded Investment

A financial instrument traded in an Active Market. The necessary level of trading required to meet these criteria is a matter of judgement.

Adjusted Enterprise Value

The Adjusted Enterprise Value is the Enterprise Value adjusted for factors that a Market Participant would take into account, including but not limited to surplus assets, excess liabilities, contingencies and other relevant factors.

Attributable Enterprise Value

The Attributable Enterprise Value is the Adjusted Enterprise Value attributable to the financial instruments held by the Fund and other financial instruments in the entity that rank alongside or beneath the highest ranking instrument of the Fund.

Backtesting

The process of using the observed value of an Investment as implied by a sale, liquidity event (e.g., an IPO) or other material change in facts with respect to the Investment, related Investments, or the Enterprise, to assess the Fair Value estimated at an earlier Measurement Date (or Measurement Dates).

Blockage Factor

An adjustment that adds a discount or premia to the quoted price of a security because the normal daily trading volume, on the exchange where the security trades, is not sufficient to absorb the quantity held by the Fund. Blockage Factors are not permitted under US GAAP or IFRS.

Distressed or Forced Transaction

A forced liquidation or distress sale (i.e., a forced transaction) is not an Orderly Transaction and is not determinative of Fair Value. An entity applies judgement in determining whether a particular transaction is distressed or forced.

Enterprise

A commercial company or business financed through debt and equity capital provided by debt holders and owners.

Enterprise Value

The Enterprise Value is the total value of the financial instruments representing ownership interests (equity) in a business entity plus the value of its debt or debt-related liabilities, minus any cash or cash equivalents available to meet those liabilities.

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Fair Value

Fair Value is the price that would be received to sell an asset in an Orderly Transaction between Market Participants given current market conditions at the Measurement Date.

Fund or Private Equity Fund

The Fund or Private Equity Fund is the generic term used in these Valuation Guidelines to refer to any designated pool of investment capital targeted at all stages of private equity investment from start-up to large buyout, including those held by corporate entities, limited partnerships and other investment vehicles.

Fund-of-Funds

Fund-of-Funds is the generic term used in these Valuation Guidelines to refer to any designated pool of investment capital targeted at investment in underlying Private Equity Funds.

Investee Company

The term Investee Company refers to a single Enterprise or group of Enterprises in which a Fund is directly invested.

Investment

An Investment refers to the individual financial instruments held by the Fund in an Investee Company.

Liquidity

A measure of the ease with which an asset may be converted into cash. A highly liquid asset can be easily converted into cash; an illiquid asset may be difficult to convert into cash. Liquidity represents the relative ease and promptness with which an instrument may be sold when desired.

Market Participants

Buyers and sellers in the Principal (or Most Advantageous) Market for the asset that have the following characteristics:

a. They are independent of each other,
b. They are knowledgeable,
c. They are able to transact,
d. They are willing to transact, that is, they are motivated but not forced or otherwise compelled to do so.

Marketability

The time required to effect a transaction or sell an Investment. Accounting standards dictate that the Marketability period begins sufficiently in advance of the Measurement Date such that the hypothetical transaction determining Fair Value occurs on the Measurement Date. Therefore, accounting standards do not allow a discount for Marketability when determining Fair Value.

Measurement Date

The date for which the valuation is being prepared, which often equates to the reporting date.

Most Advantageous Market
The market that maximizes the amount that would be received to sell an asset after taking into account transaction costs and transportation costs.

Net Asset Value ('NAV')
NAV of a Fund is the amount estimated as being attributable to the investors in that Fund on the basis of the Fair Value of the underlying Investee Companies and other assets and liabilities.

Orderly Transaction
An Orderly Transaction is a transaction that assumes exposure to the market for a period prior to the Measurement Date to allow for marketing activities that are usual and customary for transactions involving such assets; it is not a Forced Transaction.

Post Money Valuation
The value of a company after an investment has been made. The implied Post Money Valuation is calculated as the monetary amount of an investment divided by the equity stake gained in an investment.

Principal Market
The market with the greatest volume and level of activity for the potential sale of an asset.

Quoted Investment
A Quoted Investment is any financial instrument for which quoted prices reflecting normal market transactions are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency.

Realisation
Realisation is the sale, redemption or repayment of an Investment, in whole or in part; or the insolvency of an Investee Company, where no significant return to the Fund is envisaged.

Secondary Transaction
A Secondary Transaction refers to a transaction which takes place when a holder of an unquoted or illiquid interest in a Fund trades their interest to another party.

Unquoted Investment
An Unquoted Investment is any financial instrument other than a Quoted Investment.

Underlying Business
The Underlying Business is the operating entities in which the Fund has invested, either directly or through a number of dedicated holding companies.

Unit of Account
An accounting term which identifies the level at which an asset is aggregated or disaggregated for Fair Value recognition purposes. Unit of Account is dictated by individual accounting standards which are subject to interpretation. Because Fair Value accounting standards seek to reflect the economic behaviour and the perspective of Market Participants these Valuation Guidelines generally use a Market Participant view in assessing the level of aggregation or

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disaggregation. For example where accounting guidance is open to interpretation, if a Market Participant would purchase an interest in a private company, not focusing on individual shares; the Unit of Account would be the overall interest purchased. However, if accounting standards clearly define Unit of Account, such guidance should be followed.

Valuer
The Valuer is the person with direct responsibility for valuing one or more of the Investments of the Fund or Fund-of-Funds.

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Endorsing Associations

Refer to www.privateequityvaluation.com

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