



THE VOICE OF  
PRIVATE CAPITAL  
VENTURE CAPITAL  
PRIVATE EQUITY  
INFRASTRUCTURE  
LONG TERM INVESTORS

Edition November 2015

# PROFESSIONAL STANDARDS

HANDBOOK

## Acknowledgements

Invest Europe would like to thank the members of the Invest Europe Professional Standards Committee for their valuable input during the development of the 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](http://www.investeurope.eu).

For more information on our Professional Standards, please contact us at [professionalstandards@investeurope.eu](mailto:professionalstandards@investeurope.eu) and we will respond to your enquiry promptly.

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# INTRODUCTION TO THE HANDBOOK

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## **The Promotion of Professional Standards**

Invest Europe promotes the highest ethical and professional standards within the private equity, venture capital and infrastructure industry<sup>1</sup>.

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.

<sup>1</sup> 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 Code of Conduct for Placement Agents, 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

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.

### 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

At the time of writing, the national legislation and further European (EU) regulation implementing the Alternative Investment Fund Managers Directive (AIFMD) is still taking form. There is also much new regulation outside the European Economic Area, which is expected to have considerable impact on the private equity industry worldwide.

This Handbook is not intended to be a guide or act as a detailed operational manual for compliance with the AIFMD, or other laws and regulations (e.g. FATCA, etc.).

The AIFMD has been or will be implemented into law in more than thirty countries representing many variations within legislative and administrative tradition, and in any event is not applicable to those Invest Europe members who are outside the scope of its authorisation requirements. Further, the organisational set-ups of private equity funds and their managers are too diverse for the Handbook to cover all statutory and international laws and regulation that might be applicable to a specific circumstance.

However, the Handbook does seek to clarify how existing standards are best articulated within an AIFMD and regulatory framework and highlights where its impact is viewed as particularly important. 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

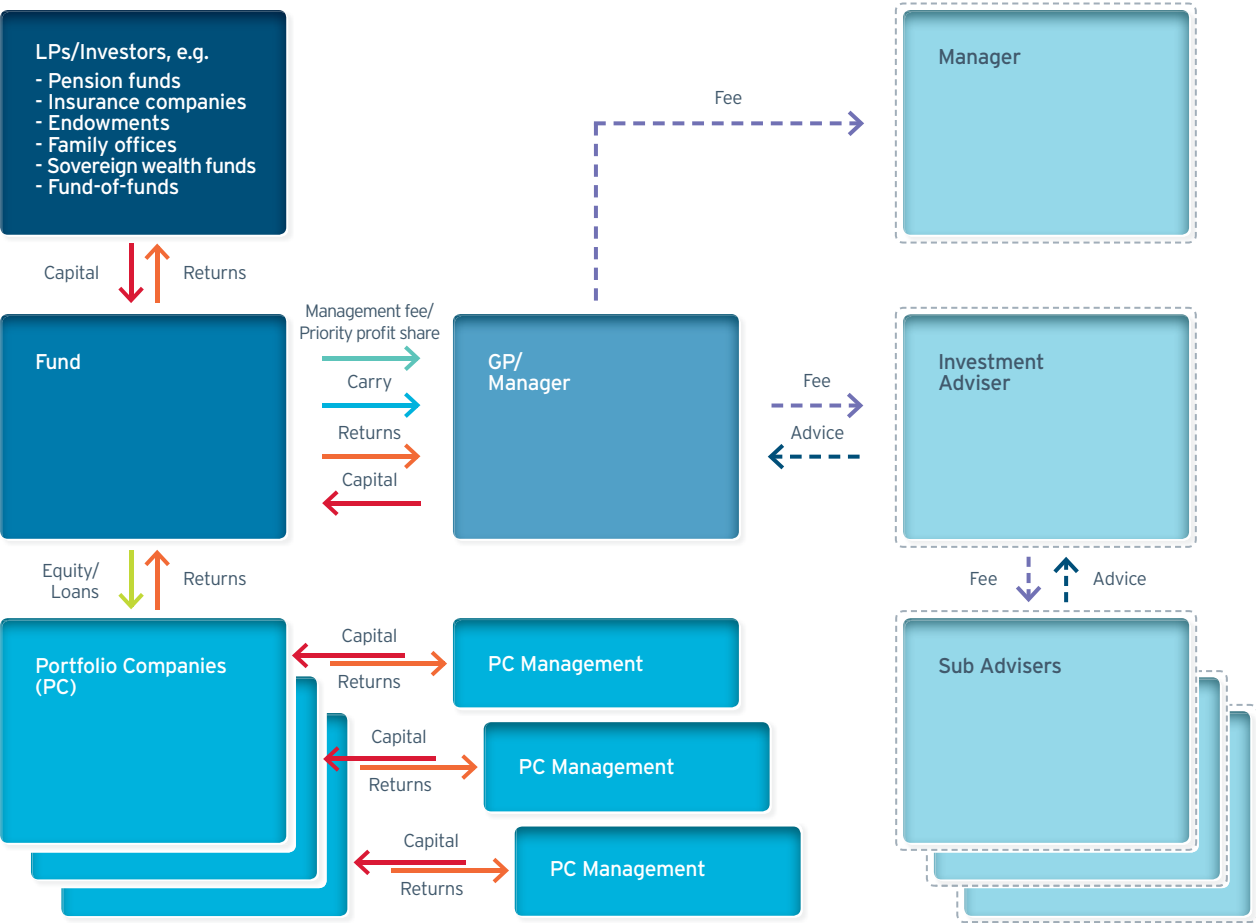
The Handbook is a dynamic document. The Invest Europe Professional Standards Committee has responsibility for maintaining the Handbook. The Professional Standards Committee welcomes your feedback and suggestions for editing. Please direct any comments to [professionalstandards@investeurope.eu](mailto:professionalstandards@investeurope.eu).

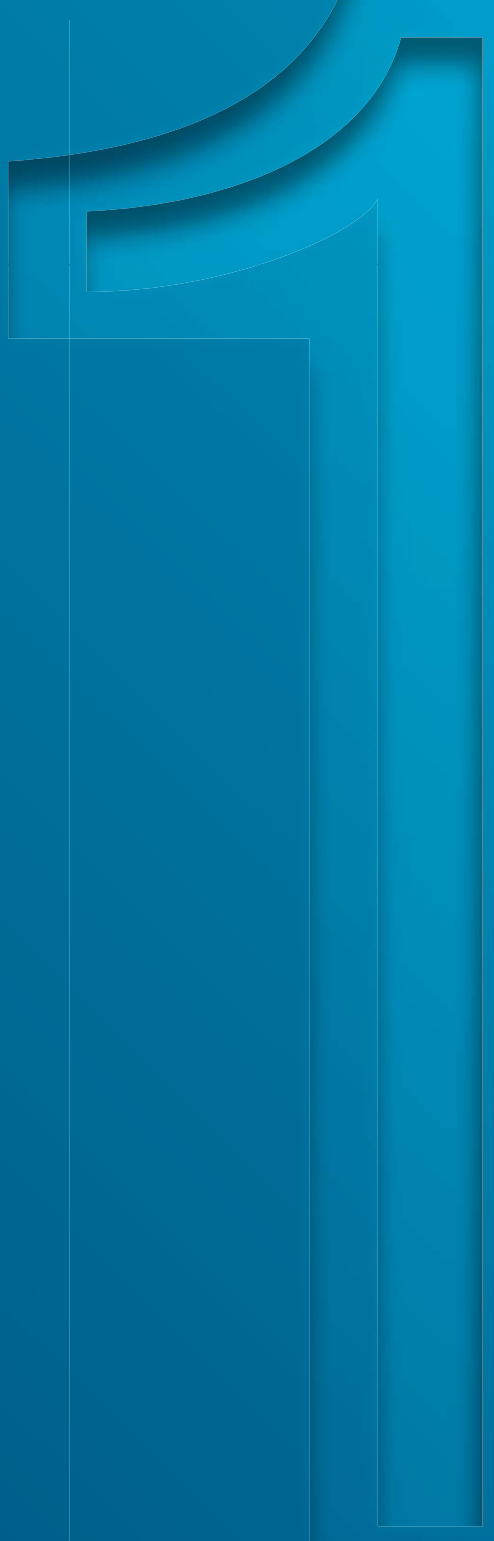
The Handbook will be formally reviewed annually. It has most recently been reviewed in 2014/2015 by the Invest Europe Professional Standards Committee, including member consultation. Invest Europe may also issue updates to the Handbook to reflect industry developments.

This version was published in November 2015.

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.







## SECTION 1

# CODE OF CONDUCT

# CODE OF CONDUCT

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1.

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**Act with  
integrity**

2.

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**Keep your  
promises**

3.

---

**Disclose conflicts  
of interest**

4.

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**Act in  
fairness**

5.

---

**Maintain  
confidentiality**

6.

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**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 and honesty. 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 manipulative 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. 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<sup>2</sup>, 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.

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<sup>3</sup>, 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.**

<sup>2</sup> 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.

<sup>3</sup> 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 for the wider benefit 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. Creating competitive advantages by violation of applicable laws and regulation for personal gain or higher fund returns is therefore considered harmful to the industry as a whole.





## 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<sup>4</sup> wherever possible.

The illustrations are not intended to be exhaustive or prescriptive. While the questions are intended 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, differ in the various jurisdictions. Additionally, the differing investment objectives of different funds may also mean that some examples may not be appropriate to all funds.

Since the last update of this Handbook, we have seen the first harmonised pan-European legislation and regulation in the form of the Alternative Investment Fund Managers Directive (AIFMD) come into effect. However, the 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 remain below the threshold for compliance and 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<sup>5</sup> 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.

<sup>4</sup> 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.

<sup>5</sup> 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

- 3.1.1. Early-stage planning
- 3.1.2. Fundraising and regulation
- 3.1.3. Structuring

## 3.2 Fundraising

- 3.2.1. The fundraising process: planning, responsibilities and costs
- 3.2.2. Target LPs
- 3.2.3. Know Your Investor
- 3.2.4. Structure of the offer: Terms of investment
- 3.2.5. Fundraising documents
- 3.2.6. Terms in the fund documents
- 3.2.7. Presentations to LPs
- 3.2.8. Responsible investment
- 3.2.9. Track records
- 3.2.10. Forecasts
- 3.2.11. Time period for fundraising

## 3.3 Investing

- 3.3.1. Due diligence
- 3.3.2. Approach to responsible investment
- 3.3.3. Investment decision
- 3.3.4. Structuring investments
- 3.3.5. Responsibilities to other shareholders in the same or other classes of shares and to bondholders
- 3.3.6. Investment Agreement
- 3.3.7. GP's consent to portfolio company actions and board appointments
- 3.3.8. The portfolio company's corporate strategy
- 3.3.9. Co-operation with co-investors and syndicate partners
- 3.3.10. Co-investment and parallel investment by the GP and its executives
- 3.3.11. Co-investment and parallel investments by LPs and other third parties
- 3.3.12. Divestment planning

## 3.4 Management of an investment

- 3.4.1. Investment monitoring
- 3.4.2. Environmental factors
- 3.4.3. Social factors
- 3.4.4. Governance factors
- 3.4.5. Board structure
- 3.4.6. Board membership
- 3.4.7. Exercise of GP consents
- 3.4.8. Exercise of influence on responsible investment factors
- 3.4.9. Responsibilities in relation to other stakeholders
- 3.4.10. Follow-on investments
- 3.4.11. Underperforming investments
- 3.4.12. Factors particular to investing in distressed assets

## 3.5 Disposal of an investment

- 3.5.1. Implementation of divestment planning
- 3.5.2. Responsibility for divestment decision-making
- 3.5.3. Warranties and indemnities
- 3.5.4. Cash vs. shares/earn-outs on realisation
- 3.5.5. Sale of a portfolio company between funds managed by the same GP
- 3.5.6. Managing quoted investments

## 3.6 Distributions

- 3.6.1. Distribution provisions
- 3.6.2. Timing of distributions

## 3.7 LP relations

- 3.7.1. Reporting obligations to LPs
- 3.7.2. Transparency to LPs
- 3.7.3. LP relations generally
- 3.7.4. LP conflicts of interest
- 3.7.5. LP Advisory Committee
- 3.7.6. Key Person provisions

## 3.8 Secondaries

- 3.8.1. LP secondary transactions
- 3.8.2. Secondary direct transactions

## 3.9 Extension and winding up of a fund

- 3.9.1. Fund extension
- 3.9.2. Liquidation
- 3.9.3. Fund documents

## 3.10 Management of multiple funds

- 3.10.1. Conflicts of interest
- 3.10.2. Establishment of new funds

## 3.11 GP's internal organisation

- 3.11.1. Corporate governance in the GP context
- 3.11.2. Management is responsible for establishing the control environment
- 3.11.3. Management is responsible for control activities
- 3.11.4. Management is responsible for establishing procedures for risk assessment and management
- 3.11.5. Human resources
- 3.11.6. Incentivisation
- 3.11.7. Financial resources
- 3.11.8. Segregation of fund assets
- 3.11.9. Procedures and organisation
- 3.11.10. Internal reviews and control
- 3.11.11. Management is responsible for the organisation's information and information systems and for communications within and outside the organisation
- 3.11.12. External communication
- 3.11.13. Market transparency - Invest Europe Research and Data
- 3.11.14. External assistance
- 3.11.15. Considerations relating to monitoring of governance - GP governance

# 3.1 FUND FORMATION: INITIAL PLANNING

In the Handbook, the fundraising team is referred to as the group of professionals specifically involved in the fundraising process for the GP. The fundraising team may be assisted by outside professionals, including legal advisers, placement agents 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.

## 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 agent 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 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.

## 3.2 FUNDRAISING

Along with the advent of pan-European regulation, the marketing of funds within the EEA may depend on the jurisdiction of the fund vehicle, as well as the location 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, 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, and so 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 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.

To provide evidence of its compliance with relevant regulations, 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.

### 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 agent, 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 agent 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). If this is not the case, 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 any applicable local law) 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, and this will often be required 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 issues 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.

## 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. 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<sup>6</sup>.

#### 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.

<sup>6</sup> See: <http://www.investeurope.eu/about-us/professional-standards/other-industry-standards/>

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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 responsible investment 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.

### 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;
- 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.

#### 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.



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### 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

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<sup>7</sup>;
- the consideration of ESG risks and opportunities<sup>8</sup>.

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?**

- (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.
- 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.

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### (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.



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 that 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.

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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.

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 within 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.

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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.

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.



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### 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 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 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.

### 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 MANAGEMENT OF AN INVESTMENT

### 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 within the portfolio company<sup>9</sup>. 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.

#### 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.

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.

<sup>9</sup> For more information, please see the Invest Europe Responsible Investment Bibliography.



### 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.

### 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.

## 3.4 MANAGEMENT OF AN INVESTMENT

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.

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.

## 3.5 DISPOSAL OF AN INVESTMENT

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.

## 3.6 DISTRIBUTIONS

### 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<sup>10</sup> management which are relevant to the listed securities markets in which the GP operates.

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.

<sup>10</sup> <http://www.investeurope.eu/about-us/professional-standards/responsible-investment-bibliography/>



## 3.6 DISTRIBUTIONS

### 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).

### 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.



### 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.

## 3.7 LP RELATIONS

### 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.

## 3.8 SECONDARIES

### 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.

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.

## 3.8 SECONDARIES

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

# 3.10 MANAGEMENT OF MULTIPLE FUNDS

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.

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.



## 3.10 MANAGEMENT OF MULTIPLE FUNDS

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".

## 3.11 GP'S INTERNAL ORGANISATION

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.



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/depository 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.

## 3.11 GP'S INTERNAL ORGANISATION

### 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 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.

### 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.

### 3.11.5. 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 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 arrangements requiring its employees 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 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.

### 3.11.6. 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 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 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.

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

### 3.11.7. 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 may have been prescribed. The AIFMD for example currently provides that own funds (as well as cash or liquid assets) 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.

### 3.11.8. 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 authorised by the AIFMD will require a depositary to carry out three core duties under Article 21 of the AIFMD, specifically, 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 the appointment of a depositary.

## 3.11 GP'S INTERNAL ORGANISATION

### 3.11.9. 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;

- 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, such as FATCA and AIFMD.

### 3.11.10. 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.

### 3.11.11. 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.

3.11.12. 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.

## 3.11 GP'S INTERNAL ORGANISATION

### 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.

### 3.11.13. 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.

### 3.11.14. 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.



### 3.11.15. 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.

## 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

The Alternative Investment Fund Managers Directive (AIFMD) entered into force on 22 July 2011 following its publication in the Official Journal of the European Union on 1 July 2011. The Directive had to be transposed by EU Member States into statutory laws by 22 July 2013, the date that the AIFMD took effect in national law across the EU. And since 22 July 2014 – which marked the end of a one-year transition period – managers falling within the scope of the Directive are obliged to be authorised by their national competent authorities. The AIFMD is a piece of EU legislation aimed at increasing investor protection and reducing systemic risk by establishing a harmonised EU framework for regulating alternative investment funds ("AIFs") and their managers ("AIFMs").

## 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<sup>11</sup>. It is a phrase commonly used alongside responsible investment.

## 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.

<sup>11</sup> For examples of the types of ESG factor that can impact a portfolio, please refer to: [http://www.unpri.org/viewer/?file=wp-content/uploads/PRI\\_IntegratingESGinprivateequity\\_digital.pdf](http://www.unpri.org/viewer/?file=wp-content/uploads/PRI_IntegratingESGinprivateequity_digital.pdf)

## 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) 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 agent

A person or entity acting as an agent for the fundraising team in raising investment funds. Placement agents should comply with Invest Europe's separate Code of Conduct for Placement Agents (see page 63).

### 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.



## SECTION 4

# CODE OF CONDUCT FOR PLACEMENT AGENTS

# PLACEMENT AGENTS SUPPLEMENTARY CODE OF CONDUCT

## 1. Preamble

This Supplementary Code is additional to the EVCA Code of Conduct (the “Code”). It is to be read and implemented in conjunction with the Code by all member firms the business of which encompasses acting as a placement agent.

This Code has been produced by EVCA in acknowledgement of the importance of the role of the placement agent in successful capital raising for private equity and venture capital firms. It seeks to reflect the bona fides and professional rigour which member firm placement agents undertake at present and are expected to continue to bring to their work in support of their clients in the industry.

The role of the placement agent has developed significantly over the past ten years and is seen as an important and positive component within the industry. EVCA resolved to introduce the Supplementary Code (a) to reflect the established institutionalisation of the placement agency business model; (b) to highlight the importance of such role in private equity fundraising; (c) to maintain and publish benchmarks in the practices of placement agents 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 agents 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 impose requirements as to transparency and accountability of dealings.

EVCA recommends all applicable member firms append the Supplementary Code to their terms of engagement for client care letters at the initiation of any new instruction.

EVCA will continue to monitor the Supplementary Code. Compliance with it is a prerequisite to membership of EVCA by any member firm engaging in placement agent activity. The sanction for non-adoption or for proven breach of the Supplementary Code or proven misconduct by a member is expulsion of that member from EVCA.

## 2. Rules

### 1. Regulation and Authorisation

- 1.1 A Firm conducting placement agent activity must be in the habitual, systematised business of acting as a placement agent.
- 1.2 Where local laws require it, a Firm must be registered and/or authorised with, and regulated by, as applicable, appropriate regulatory bodies in each jurisdiction in which it undertakes regulated activities.
- 1.3 A Firm’s representatives who are not acting in a strictly administrative or ministerial capacity should possess the licences or certifications required by legal, governmental, regulatory or self regulatory organisations to which the placement agent or its representatives are subject, 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 oversight processes.

### 2. Conduct of Business

- 2.1 A Firm is expected to maintain high standards of probity, integrity and professionalism in the conduct of its business.
- 2.2 A Firm should perform reasonable due diligence in respect of a Client commensurate with the scope of its engagement.
- 2.3 A Firm should maintain professional relationships with a meaningful number of investors which seek to invest in private equity, and typically should be retained to raise capital from all or a significant sub-set of such investors.
- 2.4 A Firm should enter into a written contract with a Client (i) specifying the scope of services the Firm will perform and the fee arrangement, and (ii) confirming the Firm will adopt and adhere to the Code and this Supplementary Code.

2.5 A Firm should not make or offer to make any payment or other consideration with a view to inducing a third party to enter into contractual negotiations with a Client.

2.6 A Firm should keep records of the performance of its duties for a minimum period of five years (longer in accordance with applicable law), available for inspection by the relevant Client.

### 3. Expertise and competence

3.1 Staff shall be appropriately qualified, authorised and supervised commensurate with the capacity in which they are employed, the jurisdictions in which they operate and their seniority.

### 4. Disclosure

- 4.1 A Firm should disclose, upon the request of a prospective or existing investor, the fee arrangement the Firm has agreed to with a prospective or existing Client or its manager in respect of such investor’s investment in such Client or its funds. 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. A Firm should not make or offer to make any payment with a view to inducing a third party to enter into contractual negotiations or contact with a prospective or existing Client.
- 4.2 Any political or quasi-political donation made by any placement agent firm, any affiliate or representative of the firm or any employee (or immediate family member of any employee) shall be disclosed to prospective and existing Clients, to prospective and existing investors of such Clients, to regulatory bodies and to decision-making bodies connected to that recipient firm or individual upon request.



- 4.3 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 for at least three years.
- 4.4 Any sub-placement agent retained by a Firm must (i) be disclosed to a prospective or existing Client and its investors, and (ii) must undertake to ensure its compliance with the Code and this Supplementary Code.
- 4.5 The Firm shall take reasonable steps to procure that any sub-placement agent retained by a prospective or existing Client or its applicable manager must (i) be disclosed to the Firm; (ii) to the Client's prospective and existing investors; and (iii) must undertake to ensure its compliance with the Code and Supplementary Code, failing either of which stipulations, the Firm must cease to act on its instruction for the Client.
- 4.6 A Firm's role, and the role of any sub-placement agent, should be disclosed within marketing materials issued by the Client or otherwise in connection with the Client's fundraising.

### 3. Explanatory notes to the Code

#### Definitions:

Client: an EVCA Member firm which engages a placement agent in an advisory and/or fundraising capacity

Firm: an EVCA Member firm carrying on business as a placement agent.

#### Note to Rule 1

*In respect of the applicable regulatory requirements for placement agents operating in Europe for example, in the United Kingdom this would be the pursuant to the Financial Services Authority and in non-EU countries, for example, the US, this would be the Securities and Exchange Commission ("SEC") and the US Financial Industry Regulatory Authority, Inc. ("FINRA").*

#### Note to Rule 2

*In respect of staff qualifications, for placement agents operating within Europe, for example, in the United Kingdom, staff performing controlled functions are to be approved persons under the Financial Services and Markets Act 2000 and in non-EU countries, for example, in the US this would be the Series 7 and 63 licences for its representatives, and the Series 24 for those individuals acting in a supervisory capacity. Firms are expected to maintain and monitor appropriate training, competence and professional development of all staff. Firms are expected to be in compliance with the relevant training and competence regime stipulated by applicable regulators in their country of domicile.*

#### Note to Rule 4.1 and Rule 4.6

*Where a Client views the terms of engagement of the Firm as commercially sensitive, the Client may require confidentiality undertakings from investors to whom the information is disclosed.*

#### Note to Rule 4.2

*Certain institutions prefer that no political donations are made whatsoever. The expression quasi-political is to be broadly construed to include campaign contributions, lobbying organisations, trades unions and individuals and to encompass donations to individuals, corporate bodies and other associations.*



## 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.

Chair: Jonathan Martin, *KPMG in the UK*

Members: Godfrey Davies, *previously CDC Group plc (now retired)*

Neil Harding, *3i plc*

Ryan McNelley, *Duff & Phelps*

Tushar Pabari, *Headway Capital Partners LLP*

Timo Strunkmann-Meister, *Capital Dynamics*

Daniel Tallqvist, *EQT Holdings AB*

Glyn Thomas, *Augentius*

Annette Wilson, *Silverfleet Capital*

### Disclaimer

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# 1. INTRODUCTION

Reporting guidelines in the private equity sector have developed continuously since Invest Europe (formerly, the European Private Equity and Venture Capital Association (EVCA)) issued its first Reporting Guidelines in 2000. The onset of the global economic downturn, the increase in focus on Responsible Investment practices and the advent of pan-European regulation in the form of the Alternative Investment Fund Managers Directive (AIFMD) have all heightened the need to ensure that General Partners (GPs) continue to present their investors with best practice financial and non-financial information.

As with all other aspects of their relationships, private equity<sup>12</sup> firms and their investors negotiate the disclosures to be made regarding each fund on a bilateral basis. It is not Invest Europe's intention to restrict such disclosure in any way, nor to limit the excellent information flow that already occurs between GPs and LPs in the industry. Rather, these Guidelines have been developed to facilitate negotiations between GPs and LPs and provide core reporting elements for all funds that will enhance LPs' ability to make comparisons between different funds. The Guidelines are not designed to prescribe and create standardised templates for reporting. Rather these Guidelines should aid GPs to create and tailor their own style of reporting. To that end, a number of examples have been added in Section 7.

In that spirit, Invest Europe is pleased to note that its Reporting Guidelines have been widely used across the private equity industry and have benefited from regular member consultations in order to ensure that they remain valid for the current environment.

This version, published in October 2015, incorporates the key tenets of best practice GP reporting to their investors and has been updated to take account of the changing landscape following the implementation of the AIFMD across the EU over the past two years.

These Guidelines will replace all former versions released by Invest Europe and IPEV. For GPs wishing to claim compliance with these Guidelines, adoption is required for the quarter/half-year ending 31 December 2016.

The Guidelines are designed primarily for mid-market and large buyout houses. It is the intention of Invest Europe to publish further guidelines for specific fund managers (e.g. venture capital, fund-of-funds, etc.) in due course. In the meantime, managers of such funds may state compliance with these Guidelines provided that all relevant disclosures are provided.

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

These Guidelines are primarily designed to provide **best practice investor reporting** across an annual cycle, it being recognised that quarterly and half-yearly reporting may seek to cover only certain parts of these Guidelines. 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.

<sup>12</sup> For the purposes of these Guidelines, "private equity" and "industry" are used as generic terms to refer to and to encompass venture capital, infrastructure and private equity.

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## 2. PRINCIPLES OF REPORTING

### 2.1. General Considerations

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 General Partner ("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 Limited Partners ("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.

### 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 of the quarter end and annual accounts to be issued no later than 90 days of 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 company (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 equity 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*
<b>Fund Information</b>	
1 Fund Overview	Annually with changes 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
<b>Investment Portfolio Information</b>	
1 Portfolio Summary	Quarterly
2 Portfolio Company Detail	Annually and preferably six-monthly with updates quarterly
<b>Investor Information</b>	
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.

# 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;
- 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/Manager/Adviser;
- Open or closed-ended fund structure;
- Maximum investment size;
- Other investment restrictions;
- Re-investment policy/recycling of investments;
- Maximum fund level leverage as detailed in fund formation documents (including details of bridging and other credit facilities);
- 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;
- Bankers;
- Investment adviser/Manager;
- Tax and regulatory;
- Regulator of manager;
- Country of registration;
- Depositary;
- Independent valuer;
- Independent risk manager.

#### Additional possible disclosures

- 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 the 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 fundings;
- 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 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 adviser;
- 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;
- Explanation of any significant non-compliance with the Invest Europe Investor Reporting Guidelines.

### Additional possible disclosures

- A fund progression 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
- Key findings in adviser/administrator's compliance/control report if they could significantly impact the fund;
- Details of significant changes in the economic and market environment;
- Commentary on deal flow and pipeline where relevant;
- 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 of fund progress charts.*

### 3.3. Fund Performance Status

#### Purpose

The Fund Performance Status section in the investor report 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;
- Net IRR, 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;
- Note of any borrowing of the fund, including debt, bridge loans, guarantees, charges, warranties, indemnities or other contingent liabilities;
- Guarantees made by the fund to or on behalf of portfolio companies, and their impact on fund fair value, if any.

*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 report comprehensive financial statements that meet local regulatory requirements annually only. However, for investor reports abridged financial information should be as follows. This abridged financial information need not be in GAAP format/layout.

#### Requirements

Reports to investors should normally include a set of 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, etc.).

#### Additional possible disclosures

Ideally, the 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 and since inception.

### *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) need to be offset against the management fees either in full or in part. If this is applicable then the disclosure of management fees should be done showing 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 of 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 treatments 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 may include expenses such as audit, tax, legal, fund formation costs and aborted deal costs. (This may appear 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 could also be analysed by portfolio company.

*Example 7.4 provides an illustration of a GP Fees, Carried interest and Fund Operating Expenses disclosure.*

## 3.6. 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 capital 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 original cost (including follow-ons)
  - 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 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 investment currency may also be reported.

*Example 7.5 provides an illustration of the Portfolio Summary.*

### 4.2. Portfolio Company Detail

#### Purpose

The Portfolio Company Detail information is designed to give LPs detailed information in both a quantitative and qualitative format on each of the current portfolio companies and the fund's investment in them. The volume of information may vary depending on the size of the investment relative to the whole fund, but typically each individual portfolio company 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 company information;
- Fund's investment;
- Trading and financial overview;
- Valuation.

Typically such Portfolio Company 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 company information

### Requirements

- Legal and/or trading names of portfolio company, 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 and marketplace;
- Stage of initial investment (e.g. seed, venture, growth, buyout, etc.), for multi-strategy funds;
- Where relevant, the fund's role in the investment (lead, co-lead, etc.) at the time of the first investment;
- Company's reporting (functional) currency.

### Additional possible disclosures

- Information on the deal team members responsible for making and monitoring the investment;
- Current stage (with reference to Invest Europe definition of stages);
- Number of employees.

## 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 (show only fully diluted if vested) 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;
- 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 fund 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 for the current year, if permissible and not in conflict with regulatory requirements;
- A narrative assessment of the company's recent performance, including comparison to previous expectations, either budget, prior period or original investment thesis;
- Disclosure of any significant extraordinary items including legal and regulatory compliance matters;
- Description of environmental, social or governance risks and opportunities specifically affecting the portfolio company and measures taken by the GP to manage them. This may include specific ESG KPIs relevant to the sector the portfolio company 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 reputation risk items and any ESG incident follow-up and resolution<sup>13</sup>;
- Commentary on key developments in the business including:
  - Key personnel changes
  - Strategy changes
  - Acquisitions and disposals
  - Achievements, certifications, approvals, key events

<sup>13</sup> For further detail please refer to Part 2 of the ESG Disclosure Framework for Private Equity, March 2013

## 5. INVESTOR INFORMATION

- Commentary on portfolio company debt, where significant/relevant, and covenant breaches;
- Exit plans, where applicable and permissible, 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.

### **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 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. 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 company, 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);
- Value creation in portfolio company since investment (increase to EBITDA, multiples or debt payback);
- Breakdown of fair value allocation across equity and debt instruments.

### **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;
- 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; alternatively, show unrealised carried interest assuming that all investments are realised at their reported fair value at the reporting date.

*Example 7.6 provides an illustration of Individual Capital Account statements. Sole investor specific information is increasingly required by investors; however, in cases where investors do not have confidentiality concerns over sharing their capital account information with others in the fund, the example in 7.7 is an illustration of an alternative whole fund 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.

*Example 7.8 provides an illustration of the 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 exercise discretion where commercial sensitivity is required, particularly if the drawdown is being undertaken prior to the closing of the investment.

Distribution notices should be accompanied by a covering note listing the company or companies divested, and giving relevant details such as the exit route, any escrows and the fund's gross multiple and IRR. 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.

### 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 callable distributions;
- Cumulative capital distributed at the investor and fund level, analysed, where possible, between callable and non-callable;
- 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.

## 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. 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.

## 6.5. 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 private equity strategy. This is a subjective area and accordingly Invest Europe does not require reporting of PME measures.

## 6.6. Principles of calculating returns

### a. Commitments made by a private equity fund to a portfolio company

The cash outflows should be taken to be the amount actually invested in a portfolio company at a given point in time, i.e. on a gross return basis. A private equity fund may commit itself to making a series of investments in a portfolio company 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 private equity 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 private equity 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 private equity 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 which are floated 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; 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, etc.).

*Example 7.9 provides a worked example illustrating the principles of calculating returns 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

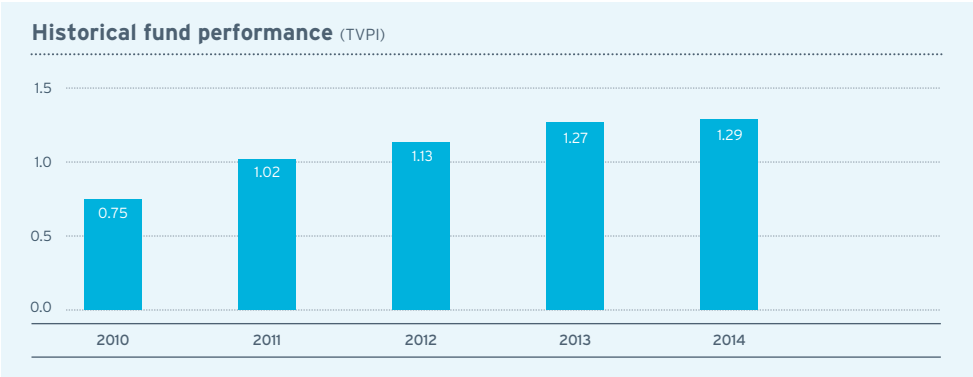
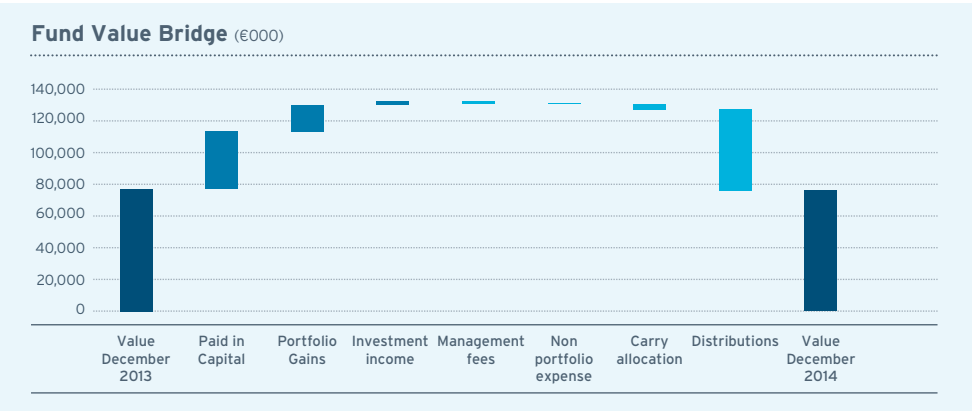
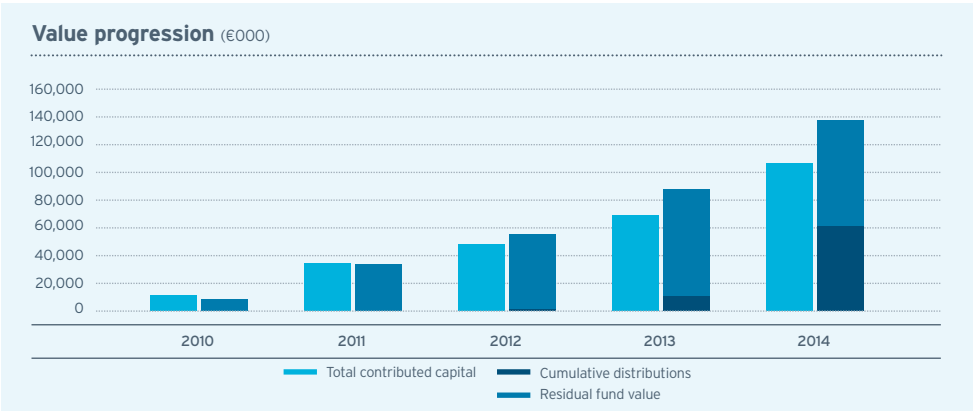
General	
Fund full name	Invest Europe Fund
First closing date	10 January 2010
Final closing date	31 May 2010
Vintage year	2010
First investment date	25 October 2010
Term	10 years to 31 December 2019
Investment period	5 years to 31 December 2014
Extensions	Up to three one year extensions, the first two 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 Europe Fund A LP Invest Europe Fund B LP
Outline of structure	1 General Partner, 10 Limited Partners
Manager	Invest Europe Manager Limited
Adviser	Invest Europe Adviser
General Partner	Invest Europe GP Limited 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 leverage	20%
Accounting principles	IFRS
Valuation policy	International Private Equity and Venture Capital ('IPEV') Valuation Guidelines
ESG restrictions	No alcohol or weaponry
ESG policy	See LP portal on <a href="http://www.InvestEuropeFund.com">www.InvestEuropeFund.com</a>
ESG reporting	See LP portal on <a href="http://www.InvestEuropeFund.com">www.InvestEuropeFund.com</a>

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
AIFMD	
Manager's regulator	Financial Conduct Authority
Depository	AIFMD Depository Limited
Country of registration	UK
Independent valuer	Valuations LLP
Independent risk manager	AIFMD Risk Manager Limited
Service providers	
Auditor	Auditor LLP
Administrator	Administrator Limited
Lawyer	Invest Europe Lawyer LLP
Banking facilities	A. N. Other Bank plc
Tax & Regulatory	Tax & Regulatory Advisers LLP
LP Advisory Committee (additional possible disclosures)	
Members of LP Advisory	A LP
Committee (if not against legal or LPA restrictions)	B LP
	C LP
	D LP

This report is in compliance with Invest Europe Guidelines



7.2. Fund Performance Charts



### 7.3. Fund Performance Status

	2014	2014	2013	2013
	€000	% Committed Capital	€000	% 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	€60,736	61%	€9,592	10%
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		€80,182	
Total cash, borrowings, other assets and liabilities	€2,000		€1,000	
Total net asset value (NAV)	€83,702		€81,182	
Gross IRR	21.8%		20.4%	
Gross multiple to cost	1.50		1.30	
Net IRR	13.4%		12.2%	
Distributions to Paid In Capital (DPI)	0.57		0.15	
Residual Value to Paid In Capital (RVPI)	0.72		1.12	
Total Value to Paid In Capital (TVPI)	1.29		1.27	
Funded Commitment to Committed Capital	0.71		0.67	
Paid in Capital to Committed Capital (PICC)	106.3%		70.0%	

### 7.4. GP Fees, Carried interest and Fund operating expenses

	Q4 2014	Year to 31 Dec 2014	Inception to 31 Dec 2014
	€000	€000	€000
<b>Management fees</b>			
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
<b>Transaction and other fees</b>			
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	-	-	-
<b>Carried interest</b>			
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	1,909	3,459	7,621
Accrued Carried interest balance at start of period	5,713	4,163	-
Accrued Carried interest balance at the end of the period	7,621	7,621	7,621
* Amount held in escrow	-	-	-
<b>Fund operating expenses</b>			
Audit fees	6	25	58
Tax	7	21	479
Legal	137	189	998
Fund formation costs	-	-	1,000
Aborted deal costs	-	-	260
Other expenses	-	5	47
Fund operating costs	150	240	2,842

## 7.5. Portfolio Summary

Investment name Date of first investment Date of exit Holding period (yrs) Exit method Geography Industry Current fully-diluted %age ownership							Cash Flows				Current Portfolio		Returns					
							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-10	Apr-13	3.2	Trade sale	France	Healthcare		3,157	5,421	732	6,153			6,153	2,996	1.9x	34%	
Investment B	Feb-10	Aug-14	4.5	Secondary	Germany	Manufacturing		5,100	8,311	857	9,168			9,168	4,068	1.8x	14%	
Investment C	Mar-11	Sep-14	3.5	Trade sale	UK	Consumer retail		2,580	4,650	229	4,879			4,879	2,299	1.9x	22%	
Investment D	May-11	Nov-14	5.5	Trade sale	Spain	Manufacturing		6,434	3,800	211	4,011			4,011	(2,423)	0.6x	n/a	
Investment E	Aug-11	Dec-14	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	20%		
Current Investment Portfolio																		
Investment G	May-13		4.7		France	Manufacturing	86%	5,703	0	70	70	5,703	7,863	7,933	2,230	1.4x	32%	
Investment H	Nov-13		3.2		Germany	Business services	75%	14,344	530	74	604	13,814	18,650	19,254	4,910	1.3x	36%	
Investment I*	May-12		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	28%	
Investment J**	May-14		0.7		Sweden	Hotel & casino	95%	17,500	0	521	521	17,500	25,317	25,838	8,338	1.5x	79%	
Investment K	Sep-14		0.3		UK	Manufacturing	68%	9,214	0	70	70	9,214	8,527	8,597	(617)	0.9x	n/a	
Investment L	Nov-14		0.2		Germany	Consumer retail	84%	7,856	0	25	25	7,856	7,856	7,881	25	1.0x	2%	
							67,446	13,153	1,920	15,073	60,501	81,702	96,775	29,329	1.4x	26%		
Totals							96,331	55,161	7,575	62,736	60,501	81,702	144,438	48,107	1.5x	22%		

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.

## 7.6. Individual Capital Account

### Investor Statement for <Investor name> for the quarter ending 31 December 2014

#### Invest Europe Fund

1. Commitment	Inception to 31 Dec 2014			Q4 2014
	Fund	Vehicle	<Investor Name>	<Investor Name>
	€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 2014	29,499	22,124	2,950	2,950
Ownership % of Fund		75%	10%	

2. Capital account	Quarter to 31 Dec 2014		Year to 31 Dec 2014		Inception to 31 Dec 2014	
	Fund*	<Investor Name>	Fund*	<Investor Name>	Fund*	<Investor Name>
Current Investment Portfolio	€000	€000	€000	€000	€000	€000
Capital Account at Fair Value opening balance	90,800	9,080	81,182	8,118		
Paid in Capital from Investors	8,306	831	36,370	3,637	106,331	10,633
Distributions to Investors	(24,947)	(2,495)	(51,144)	(5,114)	(60,736)	(6,074)
Realised portfolio gains/(losses)	5,578	558	17,067	1,707	19,331	1,933
Unrealised portfolio gains/(losses)	3,624	362	(377)	(38)	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**		(191)		(346)		(762)
Capital Account at Fair Value as of 31 December 2014	83,702	8,179	83,702	8,024	83,702	6,657

3. Investment Schedule	Investments at Cost		Investments at Fair Value***	
	Fund*	<Investor Name>	Fund*	<Investor Name>
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				(762)
Share of funds other net assets			2,000	161
Capital Account at Fair Value as of 31 December 2014			83,702	6,657

\* 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 was determined in accordance with the International Private Equity and Venture Capital Valuation Guidelines.

\*\*\*\* An investor was excluded from this investment, with equalisation on the following investment.

## 7.7. Capital Account

### Statement for all LPs - Capital account since inception to 31 December 2014 in €000

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	Recallable Distributions	Unfunded Commitment available for Drawdown
		€000	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000	€000
Investor No. 1	25%	25,000	26,583	(15,184)	4,833	5,554	1,905	(2,188)	(313)	(1,905)	19,284	8,958	7,375
Investor No. 2	20%	20,000	21,266	(12,147)	3,866	4,443	1,524	(1,750)	(250)	(1,524)	15,427	7,166	5,900
Investor No. 3	8%	8,000	8,506	(4,859)	1,546	1,777	609	(700)	(100)	(610)	6,171	2,866	2,360
Investor No. 4	10%	10,000	10,633	(6,074)	1,933	1,208	719	(875)	(125)	(762)	6,657	3,583	2,950
Investor No. 5	6%	6,000	6,380	(3,644)	1,160	1,333	457	(525)	(75)	(457)	4,628	2,150	1,770
Investor No. 6	7%	7,000	7,443	(4,252)	1,353	1,555	533	(613)	(88)	(533)	5,400	2,508	2,065
Investor No. 7	9%	9,000	9,570	(5,466)	1,740	1,999	686	(788)	(113)	(686)	6,942	3,225	2,655
Investor No. 8	5%	5,000	5,317	(3,037)	967	1,111	381	(438)	(63)	(381)	3,857	1,792	1,475
Investor No. 9	5%	5,000	5,317	(3,037)	967	1,111	381	(438)	(63)	(381)	3,857	1,792	1,475
Investor No. 10	4%	4,000	4,253	(2,429)	773	889	305	(350)	(50)	(305)	3,085	1,433	1,180
General partner	1%	1,000	1,063	(607)	193	222	76	(88)	(13)	(76)	771	358	295
Investors	100%	100,000	106,331	(60,736)	19,331	21,201	7,575	(8,750)	(1,250)	(7,621)	76,081	35,830	29,499
Carried interest partner										7,621	7,621		
Total	100%	100,000	106,331	(60,736)	19,331	21,201	7,575	(8,750)	(1,250)	-	83,702	35,830	29,499

## 7.8. Fund Cash Flow Schedule and Net IRR Calculation

### Commitments to Fund €100,000,000

Date of cash flow	Paid in Capital from investors	Distribution to investors	Residual Value (RV)	Cash flows and RV
	€000	€000	€000	€000
02 January 2010	(1,450)			(1,450)
09 January 2010	(3,157)			(3,157)
03 February 2010	(5,100)			(5,100)
01 April 2010	(450)			(450)
01 July 2010	(450)			(450)
01 October 2010	(450)			(450)
02 January 2011	(450)			(450)
08 March 2011	(2,580)			(2,580)
01 April 2011	(450)			(450)
09 May 2011	(6,434)			(6,434)
01 July 2011	(450)			(450)
10 August 2011	(11,614)			(11,614)
01 October 2011	(450)			(450)
02 January 2012	(450)			(450)
01 April 2012	(450)	732		282
12 May 2012	(12,829)			(12,829)
01 July 2012	(450)	160		(290)
01 October 2012	(15,450)			(15,450)
12 December 2012	15,000			15,000
02 January 2013	(450)			(450)
22 April 2013	(450)	5,421		4,971
04 May 2013	(5,703)			(5,703)
01 July 2013	(450)	55		(395)
25 September 2013		1,086		1,086
01 October 2013	(450)			(450)
11 November 2013	(14,344)			(14,344)
13 November 2013		887		887
13 December 2013		2,004		2,004

Date of cash flow	Paid in Capital from investors	Distribution to investors	Residual Value (RV)	Cash flows and RV
	€000	€000	€000	€000
02 January 2014	(450)			(450)
01 April 2014	(450)			(450)
24 May 2014	(17,500)			(17,500)
24 June 2014		536		536
01 July 2014	(450)			(450)
25 August 2014		21,934		21,934
26 September 2014	(9,214)	3,650		(5,564)
01 October 2014	(450)	645		195
17 November 2014	(7,856)	3,800		(4,056)
22 December 2014		19,826		19,826
31 December 2014			76,081	76,081
	(106,331)	60,736	76,081	30,486
Net IRR				13.4%
Multiples				
Distributions to Paid in Capital (DPI)				0.57
Residual Value to Paid in Capital (RVPI)				0.72
Total Value to Paid in Capital (TVPI)				1.29



## 7.9. Example Calculation of Fund Multiples

### 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	
<b>Type of Cash Flow</b>				
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:	24,906			24,906
Distributions of portfolio proceeds to date which are considered recallable/recyclable:	35,830		35,830	35,830
Total	(45,595)	(106,331)	29,499	60,736
		A	B	C
“Residual Value”	76,081 D			
		<b>Calcs</b>		
Distributions to Paid in Capital (DPI)	0.57	C/A		
Residual Value to Paid in Capital (RVPI)	0.72	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

### 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.

### 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.

### 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.

### Investor/Limited Partner/LP

Person or entity holding an investment interest (as distinct from a management interest) in a private equity fund.

### 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.

### 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.

**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.

**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.



## SECTION 6

# IPEV VALUATION GUIDELINES

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At the time of going to print, the International Private Equity and Venture Capital (IPEV) Valuation Guidelines were under review. For more information on the review process please go to: <http://www.privateequityvaluation.com/consultation/4590940575>.

The final revised Valuation Guidelines are due to be published in early 2016. Until then, the current edition of the IPEV Valuation Guidelines, which dates from December 2012, remains in force. When published, the new IPEV Valuation Guidelines will also become the standard for Invest Europe and form an integral part of the Invest Europe Professional Standards Handbook.

Invest Europe is a founding association of IPEV, and is represented on its board. The mission of the IPEV board is to provide high quality, uniform, globally acceptable, best practice guidance for private equity and venture capital valuation purposes. The Invest Europe representative ensures that the interests of the European industry are reflected in the work of IPEV.

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