The LEGAL 500 series

DEBEVOISE & PLIMPTON LLP

Private equity roundtable

Discussing global regulatory issues affecting the industry

PRIVATY EQUITY ROUNDTABLE

26 November 2013

Location: The Connaught Hotel, Carlos Place, Mayfair, London

Co Chairs:

- **Alexander Boyes, The Legal 500**
- **Sally Gibson, Debevoise & Plimpton LLP**
- **Tim Hames, BVCA**
- **David Innes, Debevoise & Plimpton LLP**
- **Geoff Kittredge, Debevoise & Plimpton LLP**
- **John Ponyicsanyi, Debevoise & Plimpton LLP**

Guests:

- **Geoffrey Bailhache, Blackstone**
- **Julie Bradshaw, Doughty Hanson**
- **Christine Chen, Cinven**
- **Peter Gibbs, Permira**
- **Anna Marx, Morgan Stanley**
- **Wendy Meharg, AnaCap**
- **Jim Stoner, 3i**

ALEXANDER BOYES: Thank you all for coming this morning. We are here to discuss some of the key regulatory issues that the private equity industry is being faced with at the moment. The objective of the discussion is to get a broad range of perspectives on some of these regulatory issues from both the in house counsel side as well as the law firms' perspective.

In terms of the scope of the discussion, we will be touching on key US and UK regulatory issues affecting the market at the moment, including SEC registration and exam issues, the implications of the JOBS Act and the potential changes to private placement rules arising from there. We are also planning to touch on AIFMD and the issues arising from the implementation of that directive across Europe. With regard to the format of the discussion, it is just a matter of trying to get a conversation flowing between everyone, so it is not a Q&A session so much as just feeling free to pitch in with your views as and when you feel it is necessary.

To start things off, would it be possible if we just went around the room and if you could introduce yourselves, talk about your role at the firm and briefly highlight the key regulatory issues that you feel have been fairly significant or that have made a fairly large impact in the industry at the moment?

JULIE BRADSHAW: I am Julie Bradshaw from Doughty Hanson, which is a European based asset manager that has been operating for 25 years in Europe. We have a PE team of support staff of 28 investment professionals and 7 other team members as well as administrative support staff. From a regulatory point of view, we have been very focused on AIFMD over the last 6 to 12 months. One of our founders, unfortunately, died unexpectedly last year and that led to us looking at restructuring the firm and because we had to do that we were very focused, from an early date, on what we should be doing to be ready for the AIFMD coming into place. Therefore, we were one of the first firms to be authorised under AIFMD. We were looking to do a fundraising and we wanted to make sure that we could have the benefit of the passport to continue our fundraising. We put our application in for approval I think in June this year and we were authorised on 22 July, so

Christine Chen - Cinven

I had to grapple with what was required, rewriting policies and now I am grappling with what the other European regulators still want of us even though we have the passport, which is interesting.

We also have to deal with US issues where we work with Debevoise in terms of our SEC filings. We are an exempt reporting advisor.

What we are looking to now is what the impact will be of regulation on the deals we do as well. One of the interesting things, of course, is all the provisions that are coming in with respect to asset stripping and that sort of thing, which my deal team are much more interested in than anything else to do with the regulatory side.

PETER GIBBS: I am Peter Gibbs. I am a Principal at Permira and have responsibility for legal issues relating to the funds we are raising. One regulatory issue that we have been spending some time thinking about is AIFM. We have been looking at how to market Permira funds into Europe, and also considering requirements in other places.

TIM HAMES: Hello. My name is Tim Hames, I am Director General of the BVCA. I am not a lawyer, sorry about that, but I spend my life dealing with the political management of regulatory issues, so I feel I am an honorary lawyer.

WENDY MEHARG: I am Wendy Meharg from AnaCap, which is a private equity fund based in Europe focusing purely on investments in financial services across Europe. We have a debt fund as well, which also focuses on investments in distressed debt across Europe. Similarly, we have been grappling largely with marketing under AIFMD and we are also structured offshore, so marketing across Europe and the changes to the various private placement regimes is something that has figured fairly highly on our radar. Equally, we have been looking increasingly at SEC related issues. We are an exempt registrant at the moment, but are looking at whether that is the status that we are going to continue with or if that is going to change. Since we invest only in financial services, most of our portfolio companies are also highly regulated – banks and insurance companies – and so that puts an extra layer of regulation on top of the fund level regulatory issues that we deal with. Therefore, quite a lot of my job ends up being around how we can deal with the interplay between what is required of us in any particular jurisdiction under local banking regulation, for instance, versus what is required of us from a reporting perspective in the US or, indeed, in Europe. Those things do not always fit together very well, so that takes

up quite a lot of my time at the moment.

ANNA MARX: I am Anna Marx from Morgan Stanley. I cover a range of private equity asset classes in the private fund side, so we have real estate, infrastructure, mid market private equity. I also cover part of the fund of funds businesses, again looking at private equity fund of funds, real estate and some hedge fund of funds. Morgan Stanley has a very varied platform. We have offshore funds, onshore Europe, most of the larger global funds tend to be structured offshore (Delaware, Cayman), so I would echo what other people have said about grappling with AIFMD. However, we have to overlay onto that the fact that Morgan Stanley is a financial holding company and so is subject to the Bank Holding Company Act, which has an impact on our fund structuring. Obviously we have to take into account the Volcker Rule in terms of fund structuring, but also the Bank Holding Company Act has a huge impact on our deal structuring and how we think about deals and what we can do with them.

I would also say what I am noticing in the context of fundraising that investors or potential investors are presenting regulatory hurdles that were not necessarily so obvious to me. For example, Solvency II is an issue that might prevent them investing in the way that we had expected. Even though Solvency II is not going to be implemented until 2015 or 2016, people are already starting to think about those issues on the investing side, so I think that is interesting.

Tim Hames - BVCA

CHRISTINE CHEN: I am Christine Chen from Cinven. Like Wendy and Peter, our funds are structured offshore with offshore managers. We had completed our last fundraising before AIFMD came in and then we realised that we did have to worry about marketing because of things like syndications, which we are doing more of, as is the industry generally. We are also looking to the future in terms of FUND 6 and do you go with the passport or not, so we have dealt with a lot of that and the fallout from AIMFD, the remuneration directive, CRD IV, whether that is going to affect us. That is largely what we have been doing.

GEOFFREY BAILHACHE: I am Geoff Bailhache from Blackstone. We have some onshore and some offshore funds, which do credit as well as private equity and real estate, so dealing with the AIFMD has hit us from all sides. I certainly agree that a lot of the focus has been on the marketing side of things, to enable funds to maintain access to capital during the transitional period. The industry is still trying to get as much clarity as it can from a regulators

Wendy Maharg - AnaCap

who don't have control over timing. On the marketing side, therefore, apart from anything, the lack of clarity that there is around timing is one of the key issues that we face. We are focusing on all the same issues as you in terms of CRD IV and AIFMD. EMIR is one of the other obvious regulations which has taken quite a lot of time to work through and make sure everyone has a clear understanding of what is required and how it should operate.

JIM STONER: I am Jim Stoner. I am a lawyer looking after the infrastructure business at 3i, which also has a private equity business and a debt management business. In the infrastructure business we have a listed fund, which is offshore, we have a fund in India, which we manage from the UK and we have just completed the acquisition of Barclays' infrastructure funds management business. They come with another regulated entity, so that now sits alongside our main manager, and a few funds as well, which are all onshore. Therefore, we have a nice mix of structures in the infrastructure business. Some of the issues people have talked about already, AIFMD in particular. We are not fundraising at the moment. We have done a lot of AIFMD analysis for the listed fund and worked out what our position is and analysed that marketing issues are going to be key, but I am lucky in that we have an excellent central compliance function. Therefore, as soon as it becomes really tricky and I am out of my depth, which is pretty quickly, then it goes across to those guys and they deal with, for 3i, the US aspects, which luckily we do not really encounter in infrastructure.

ALEXANDER BOYES: One of the key issues has been AIFMD and the issues surrounding marketing and

implementation. Before we touch on that, I wonder if perhaps we could discuss the US piece and how that may feed into the European piece as well and some of the things that can be learned from how the SEC registration and examination process has been approached in the US. John, would you like to speak to that point?

JOHN PONYICSANYI: Sure, thanks. I am John Ponyicsanyi and I am a senior associate in the DC office of Debevoise. I have a litigation background and have been specialising in government investigations and SEC enforcement work. For the past year and a half I have been working with Rob Kaplan, who is a partner in our office and had previously been with the SEC where he was the co chief of the asset management unit, which is the unit within the division of enforcement that brings enforcement cases against asset managers. While he was in that role he worked with the examination teams and helped them develop their modules for what they do and the boxes they check off and the areas they focus on when they are conducting examinations and even he has been a little bit surprised at the interaction now with enforcement and the examination team. That has been a development that our clients, even those who have been through an examination have found to be a noticeable difference this time around. That is, there may be enforcement attorneys who are present at the examinations or who are working alongside the examiners. The issue from the government perspective is the quality of the referrals that come to enforcement from the examinations. It is a question of did you get the right documents that the enforcement team wants, did they look at the right issues, did they ask the right questions and so all along the way it has given it a stronger enforcement flavour to the examinations, which has been a change for our clients. For me, from a litigation background, an enforcement background, we are so used to outside counsel being present in the room or reviewing documents before they go over to the government. This is a different expectation from the examination team. They expect a registrant to be open with their books, they can talk to who they want, they can ask the questions they want to ask, usually outside counsel is not there, inside counsel might not even be there. Therefore, much of it is preparing the people who are going to be speaking with the government or going through the documents before they are turned over and working in advance as much as possible, if that is doable.

We have helped clients all along the way. We have helped some who have not yet received their examination letter, we have helped some who have received it and are just starting the process, we have helped others who are in the middle of the exam and something has gone wrong or they need some help or they reach out to Rob for advice on a particular issue. Therefore, what I thought I would do today is talk a little bit about the examinations and the scope and what issues they are focused on and then dig into some of the key issues that the SEC seems to be focused on at this time. In particular, there are a few issues that keep recurring and it appears that something is not sitting right with the SEC. They have asked a lot of questions around these issues and we may see some enforcement activity down the road. I do not want to speak too much about client matters that are currently ongoing, but you can almost sense where an enforcement action is likely to come in certain areas, because the SEC is troubled by different things and appears

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John Ponyicsanyi - Debevoise & Plimpton LLP

to be looking for the right set of facts to bring a case to clarify some issues or to –

JULIE BRADSHAW: Is that something that should be of concern to us outside the US as well as in the US? That is what I keep hearing, but I was not sure as yet as to whether any actions have been commenced for asset managers who are primarily based in Europe as opposed to primarily based in the US.

GEOFF KITTREDGE: I believe that with respect to exempt reporting advisors, which includes some around the table but not all, the SEC has reserved the right to examine if they choose to, but has also at the same time said there is no current intention to conduct examinations of exempt reporting advisors. However, I have also heard that if an exempt reporting advisor comes to the attention of the SEC in some way for some particular reason then they might choose to examine them. The examinations, though, for the registered investment advisors should be expected of all newly registered investment advisors over some period of one, two or three years.

JULIE BRADSHAW: Is that the case whatever the location? If you are a registered advisor, no matter where you are located you will be open to examination?

GEOFF KITTREDGE: You will be examined, is my understanding. Is that right?

DAVID INNES: John, you were talking about the percentage of people who have already been seen.

JOHN PONYICSANYI: Yes. Right now, the current target is to examine 4,000 investment advisors. They are releasing a report soon and what we have heard unofficially is that they may have examined something like 1,000 so far. The number I have heard is 1,300 approximately are advisors who have never been examined or who are new registrants, so this would be their first examination. The goal is to get through all 4,000 in a three to four year period, so those who have not received a letter yet can likely expect one.

WENDY MEHARG: I had heard that the SEC had two teams in London recently for exactly these purposes, for registrants who had not been examined previously, so they are definitely focusing outside the US as well.

JOHN PONYICSANYI: They have 450 examiners; that is attorneys, accountants, examiners and industry experts: they have been hiring from hedge funds and private equity firms to advise the exam team on

specific issues and direct them toward particular things. Some of the exam is a learning process for the SEC. Sometimes it is an issue where it is a new type of investment or something that they are concerned about or want to know more about and so they will ask a lot of questions in a particular area, but it is to gain knowledge for the Commission. Maybe in particular areas where they are expecting to come out with guidance soon they might be asking questions and we will have clients who are concerned, because it seems as though they are really drilling into something that the client had not seen as a problem in the past. We suspect sometimes that it is just a way of gaining knowledge. Other times they focus on particular issues where they have received a tip from someone or they have some other reason – maybe there is a transaction they have heard about where they are drilling into something particular. In general, though, they begin in a basic way, asking for the same set of documents from most advisors. As the exam goes on, sometimes it might be weeks or, for large advisors, we have seen fieldwork that has been two to three months where the examiners are going through materials and then usually there are issues that come out of that, of course, that they look into further.

GEOFF KITTREDGE: What are some of the hot buttons that they are focusing on?

Geoff Kittredge - Debevoise & Plimpton LLP

JOHN PONYICSANYI: The stated issues are I guess what you would expect with allocation, valuation, conflicts, custody. In particular, some issues they have focused on are broken deal expenses, how those are allocated and other kinds of shared expenses, side by side investors, when employees or directors or senior advisors are allowed to invest alongside the funds, whether they are also sharing in the expenses.

We have seen them focus a lot on the senior advisors: whether the scope of their role is defined and whether that is fully disclosed; whether the types of compensation they receive has been disclosed; whether it has been disclosed that they may be compensated even if the fund has a negative overall performance. Those are all things that the Commission has been looking at.

Secondees is another issue that they have focused on: whether the expenses for those are being properly allocated. Co invest has been another area they have looked at. In particular, the amount of the co invest that is available after the funds have had their share. They have come at this question from a variety of different ways, not just whether the funds have received what they need but whether they had a long enough time to diligence the deal and whether that was fair. Whether it is fully disclosed

to the funds what is done with the money after the funds have had their share, the surplus or the remainder and whether the opportunities that come out of that have been allocated fairly. The SEC appears to be taking the view that those are opportunities that may belong to the funds' investors even after the funds have had their share, so this is an issue that is worth watching. I think it will be something the SEC tries to get their arms around, whether there is anything there that can be done to tighten up either the disclosures or the practice itself.

GEOFF KITTREDGE: I generally advise to retain full flexibility on the application of co-investment and disclose that fact. Are you saying that there might be guidelines about the allocation of co investment opportunity that they are considering coming out with or just focusing on whether or not you have disclosed the fact that co investment can be allocated at the discretion of the manager?

JOHN PONYICSANYI: Whenever there is an area like that where there is discretion of the manager, the SEC is interested in probing –

GEOFF KITTREDGE: How it exercises that discretion.

JOHN PONYICSANYI: Right and seeing whether it is a disclosure issue or if there is some kind of behind the scenes unfairness that is going on is something that they appear to be interested in, particularly with respect to co invest.

PETER GIBBS: Can you elaborate?

JOHN PONYICSANYI: I could probably share a little bit more if we were not in a public forum. My view of it is a little bit limited by what I have seen in particular client matters.

PETER GIBBS: Do you think there is going to be a read across of these kinds of issues from the SEC to other regulators?

SALLY GIBSON: I think so. Some of the issues the FCA is looking at around conflicts of interest, for example, seem to correspond quite closely with what the SEC's views are around conflicts of interest policies, so I suspect that there will be sharing of information learnt between the regulators as a consequence of the examinations.

JULIE BRADSHAW: I think you are right, Peter, on your point about the focus being on conflicts. That is the next thing that the FCA seems very focused on addressing, paticularly the allocation of co invest. Also, what you were saying, which is interesting, is that group co invest is also an issue. Hitherto for investors it has been an accepted part and a requirement of most of the fundraising that there is the group co invest. However, I am not sure their interest has ever gone beyond looking at exactly what the terms of that are and how the expenses are allocated between the GP co invest and the fund itself.

JOHN PONYICSANYI: Another issue we have seen a lot of focus on is the termination fees and the acceleration of monitoring fees upon termination. That is an issue that the SEC asks a lot of questions about and is almost looking for examples of different ways that this has been used in practice. At the end of the examination process they come out with a deficiency letter, which has a range of things described in it. Not all of them are referrals to enforcement and, in fact, the referrals might not appear in the deficiency letter, although we have seen the deficiency letters getting longer and including evidence or documents attached as appendices and that kind of thing, so they do appear to be aiming them at enforcement. One of the issues that has come up is the different ways in which the monitoring fees are accelerated after termination. In particular, the staff look at whether that has been disclosed. Even when it has – in most cases this is contracted up front and the client has a good argument that these are sophisticated investors who are aware of these – the staff still seem to be looking at maybe the type or the amount was not fully disclosed or that the fund was not fully aware of how much the fees would end

up being. In some cases, the SEC appears to be asking for tens of millions of Dollars to be returned that have been part of these accelerated fees.

JIM STONER: Returned to the funds or is there some element of fine or penalty as well?

JOHN PONYICSANYI: What we have seen is returned to the funds.

JIM STONER: Could I ask what is probably a stupid question? The deficiency letter, which is private correspondence between the SEC and a particular fund, is there any way those can end up in public? I do not know enough about the US rules behind that.

Julie Bradshaw - Doughty Hanson

JOHN PONYICSANYI: I have not seen that happen.

JIM STONER: Good.

JOHN PONYICSANYI: Yes. It is a private letter. It is usually preceded by a call in which the staff will lay out the things that it expects to put into the deficiency letter. Typically, the staff begin by saying, 'Although not everything we tell you on the call will be in your deficiency letter, there will be nothing in the deficiency letter that we do not tell you about now'. That gives the client a chance to submit additional documents or explain a certain situation or something. We had one client who was going through this and they preceded it with that and gave the list of the deficiencies they intended to cite and it was a very good list. The deficiency letter is routine for these things. It is almost impossible to go through it and not have them cite something or other with the compliance policies or the code of conduct. We were congratulating her on that and then she called and said that they called her back and said, 'Oh, and there was just one other thing'. We have not heard of that happening before, but it was an issue that now that they have the scrutiny of all of the other divisions of the SEC and they are all working together, it may have come from one of the others that said, 'We have been looking at this place for this reason' or 'did you ask them about this?'

GEOFF KITTREDGE: One thing I would be a little bit mindful of, I suppose, is overly broad requests from investors coming to your fund to receive notification of a material breach of regulation or something like that. I do see these side letter requests that just say, 'Rep that there has been no material breach of regulation, agree to notify us of any material breach'. I had never really thought of a deficiency letter from the SEC of an investment advisor's examination as being a breach of regulation; it is simply part of the process of complying, but I would be careful not to agree to side letter covenants that could be read to

mean that you have to hand over a copy of a deficiency letter or notify them about it. These letters get issued regularly and then advisors respond and comply, no big deal. Notifying investors is not a public disclosure but it is a little less private than the way they are normally treated.

JOHN PONYICSANYI: That is something that our clients have been concerned about. Most of the time for the minor deficiencies it is very easy to agree to make the changes they want; a lot of times it is clarifying language. Much of the time the practices are fine and it is the policies that need to catch up to the practices and the SEC recognises that and says, 'Although we have found no instances where this was occurring we would like you to state in particular'. That kind of a deficiency is not problematic or troublesome, except that the clients will say, 'We are going to turn this over to our biggest investor' or 'we are concerned that they will ask for a copy of it' or 'we have an agreement where we may need to' and so they will work to keep certain deficiencies out, even though it was not something that was particularly troublesome from the SEC's perspective.

GEOFF KITTREDGE: Going back to Peter's question about whether the co investment issue is more about the aggregate amount or who gets it, are you saying that the SEC might say, 'Your practice of allocating co investment opportunity to this investor or that investor is fine, but show us your policy on how you do that', because not everyone has one of those, a policy on allocation of co investment to various investors?

JOHN PONYICSANYI: We have worked with people who have had a policy and who followed their policy and the SEC will recognise that they followed the policy and still have issues that they want to raise with the co investment. For example, whether it is from a fairness perspective, whether there is some kind of breach of fiduciary duty to investors, even if you are following the policy and even if you follow all of the agreements that would cover co invest.

'I would be careful not to agree to side letter covenants that could be read to mean that you have to hand over a copy of a deficiency letter or notify them about it.'

ANNA MARX: Are they querying the policy and its validity or the efficacy of the policy or they do not like that particular co investment, do you think?

JOHN PONYICSANYI: I think they do not like the idea of the co investment and the way that they will come at it is to look at the policy to see if there is a gap there. Maybe they can open a window between the policy and what the understanding was or how it worked in practice.

JULIE BRADSHAW: It does sound as though they are moving to say, 'We do not want you to do co investment' if they are approaching it that way. You started by saying there needs to be guidelines as to how it is done. To limit it totally seems a bit ridiculous given, in most cases, as I understand, people do not have a written policy. We have a policy that everyone is offered the opportunity at the start and it is disclosed at the start, and so they get the chance to decide whether they want to participate or not. Everybody knows they get the chance, everybody knows what the terms are. To then reach a position where even though an agreement has been reached with investors a regulator can then still come, as a matter of policy, and say 'We still do not like it' is difficult.

JOHN PONYICSANYI: This could be a case where they are just forming their ideas on this and they are probing the issue to see if they agree with the way this is occurring in the industry. Ultimately, they may conclude that it is not an issue and it is fine, but it is something that we have seen them really probe into.

Valuation, especially, of course, hard to value assets; the interesting thing there is that they have really focused on the documentation around it. One of the things that has surprised us is even when there has been an independent valuation they will ask, 'What did you do to check their work and what did you do to oversee that and did you just accept what they said or did you ask to look at any documents that they relied on? How did they get their certifications? Did you play any role in monitoring that process?' We have not seen anyone cited in a major way around that, but they find smaller things: 'You did not document this as well as you might have' or 'We would like to see more of this written down. You are using a portal for the process and we would like to see the summary documents.' That is the kind of issue that they have talked about. The concern seems to be, particularly for assets that are held in a place like China and if you are using a local valuation service, that the investment manager may have some kind of obligation to follow up on what they have done and ensure that they have done what they said they did and that that was sufficient, and that all of this has been documented and recorded by the advisor.

GEOFF KITTREDGE: Is that what an FCA exam is like? They do not come and stay for weeks, do they?

JULIE BRADSHAW: No. We had an ARROW visit before my time, and it sounded as though it was a more co-operative process and more iterative. However, going forward, there has been a suggestion that there will be a change in the nature of FCA investigations that will take place and that we should be expecting more thematic investigations, which will be used in the same way as the SEC is doing as part of getting to know about the industry, to educate themselves. The concern, as always, is if you get people in to do an examination they are always going to find something to justify having been there and to complain about.

WENDY MEHARG: We have certainly seen something similar with the FCA recently. As I say, most of our businesses are financial services and they are regulated, so we have to go through change of control procedures and although we have submitted multiple change of control applications to the FCA during my time, we have recently had far more questions back from them. Information that they have seen multiple times, they have raised questions that they have never raised before. None of them were questions that we could not quite happily answer, but certainly the process took longer and we had questions that we had not received previously despite the fact that it was a similar application.

SALLY GIBSON: As a general matter, the FCA is trying to move away from tick-the-box type reviews in order to achieve a real understanding of the business it is regulating.

JIM STONER: I heard from our director of compliance about one of the shifts when we were putting in our change of control notification to justify this Barclays team. That was a new process to me and so I asked him, 'Do you want to keep your contact informed?' and he said that was one of the changes. We used to have a 3i person there who understood the whole business, which is various different business lines and in some parts it is quite complicated, and we do not anymore; there is just a team to look after it. Maybe they will have very good industry knowledge, but when they come in to do the examination they may have less detailed knowledge about the fund.

SALLY GIBSON: From a practical perspective, that makes things a bit difficult when you are putting in an FCA application. In the past, and this was the position for the external lawyer as well, you thought we will just call the contact person and explain the point, work out what needs to be done and come to a consensus as to how to approach things. I think some of that flexibility has probably been lost.

JIM STONER: Yes.

ALEXANDER BOYES: In terms of pre emptive measures that can be taken to avoid some of these issues, it sounds like it is very much on a case-by-case basis. Are there any particular tips or suggestions that you can sidestep some of these issues?

JOHN PONYICSANYI: One thing that we have found that has been interesting is sometimes people have brought us in to ask questions that are likely to be asked by the examiner, because when the exam staff come in they will be talking to the business people or the people who are on committees. One of the things we have found in talking through a lot of these issues is that the SEC tends to view an organisational chart as a blueprint that is absolutely

followed and in most companies and organisations it is not as clean as it looks on the organisational chart. Things like authority and where the discretion lies and who has the ability to make the final decisions and all of that, they will be talking to the people about. When we have talked to the people in advance, in extreme examples they might not be sure if they are on a committee or not or whether they just visit it every week; or everyone else in the organisation will say, 'That does not happen because so and so is on the risk committee and he will veto it if that comes up'. Then you talk to that person and they say, 'I do not have that authority and I do not think I should have that authority'. The time to work that out is in advance before the exam team is asking that kind of question and the people on the ground are exposed because they are not sure whether they should try to claim more for themselves than they feel they possess; or it is just time to update the policies and the committee charters and things like that to make it clear how certain issues would be resolved if they were escalated.

GEOFF KITTREDGE: Can you agree with the SEC examiners that the general counsel is going to sit in on these interviews or meetings? Can they say no?

JOHN PONYICSANYI: The tone issue is one of the most difficult things to deal with. The general expectation of the exam staff is that you would not have lawyers being in the room. They do understand that with the most senior management or when they meet with founders or things like that that the general counsel is likely to be there. Usually, we have seen instances where someone from either legal or compliance will be in the room, but it is not always the case that that happens or that the exam staff will accept it. They do not like any restrictions on what you turn over. Other than privilege, every document is fair for them. In working out the tone, therefore, one of the issues to be cognisant of is the way they view having a strong presence from legal in the room. Sometimes, even though you might like to have your in house counsel there at all the meetings, that may not be the right tone; it might not sit well with the examination team. It is certainly not an instance where you would be objecting to questions or that kind of role.

DAVID INNES: What is the seniority and background of most of the examiners who come in?

JOHN PONYICSANYI: It is a mix. Some of them are very experienced. One of the things that we are often counselling our clients, especially when we have senior people and founders, is that they need to expect that a lot of these people will be very young; many of them may not have much experience at all; they may not understand the business as well as you might like. There is a tendency sometimes to want to explain things or to argue or point things out and that is another thing that obviously does not sit very well with the examination team. However, I do think that they have made a lot of effort to bring in industry experts and to have a team that is a mix of people who are very knowledgeable and people who are new to the process. I guess, now that they have gone through this many exams, they are probably quickly gaining experience, so they are building up their expertise that way.

GEOFFREY BAILHACHE: Our experience with the FCA was that the team that visited us was very educated on our business and even despite the fact that you no longer have a direct supervisor who is dedicated to your business, there are ways you can try to help them in advance of the meetings. The most obvious way is giving them time to read documents, rather than dumping huge quantities of documents on them at the last minute. In addition, we found presenting things in a user-friendly way rather than just sending them 7,000 pages of compliance documents is helpful.

JOHN PONYICSANYI: That is very true. We have helped clients with that kind of thing as well and some of them have offered to give a

Geoffrey Bailhache - Blackstone

one or two day presentation where they talk about different topics or different areas of the business and we will help them put together slide presentations or the talking points. It is a way to get the exam started on even ground as far as the knowledge of the advisor or the particular industry is concerned and to walk through the things that the advisor has done in those areas.

That brings up another point on a way to prepare. If you have had an annual audit or some kind of work done in order to identify compliance weaknesses, that is almost likely to be the place that the exam team will start. Therefore, make sure those issues have been resolved and have all the documentation available for how they were resolved and in a format that is easily retrieved. You talked about not wanting to give them 7,000 pages of something. The portal issue is one that we have encountered, where the advisor will say, 'We do not have a memo or anything to hand to you, but all this is tracked on our portal'. The exam team will say, 'Great. Please provide password access to your valuation portal' or something like that and that might not be the most efficient way or maybe that is not something you particularly want them to be logging into and going through. If there is a better way to maintain that information that will be easier for them and more efficient, it might be the best practice.

GEOFF KITTREDGE: Here in London I have some clients who use independent compliance consulting firms to conduct internal audits of their policies and procedures so that they are up to snuff. Do firms do that in preparation or in anticipation of an SEC examination? In effect, retain some sort of outside firm to conduct a mock exam.

JOHN PONYICSANYI: They do. In fact, US advisors are required to complete an annual process like that. All of those results are fair game for the exam team. We have helped some do a mock exam that is more focused on the type of exam that the SEC will do. I am not sure if the other consultants who typically do the annual audits have also started tracking the SEC exam as well, but it is something to think about because it is very useful. For example, a main difference would be rather than reviewing the policies you would go and talk to the people who are carrying out the policies. That might be a difference that would be worth doing on top of the annual review of the policies and procedures.

ALEXANDER BOYES: It might be worth moving on now to the JOBS Act and particularly to the rules on private placements and private offerings. The impression I have is that the JOBS Act essentially permits general solicitation and advertising of these offerings. Is that something that you feel might be of benefit to fundraising?

GEOFF KITTREDGE: I think there is less to say on the JOBS Act than on exams. From my perspective, I was pretty excited about the JOBS Act last year or whenever it was announced, because I thought that general solicitations would be allowed in Reg D offerings, that is private placement safe harbour offerings in the US. The foot faults that occur from time to time when business people talk about their fundraising in the press when they should not have, causing tortuous analysis for us on issuing legal opinions and deciding whether or not cooling off periods are necessary and so forth I hoped would all go away. After all, it should not really matter anyway: institutional investors and private equity funds do not make investment decisions based on whether or not somebody said something in the press and so I was quite excited about all that. I am much less excited about it than I was, because it is not really working that way as it turns out. The relaxation of the prohibition on general solicitation has so many hurdles and conditions associated with it that for private equity fund sponsors it is just not that useful.

First of all, you have to fill out a form and say you are going to conduct a general solicitation and file that form along with potentially disclosing the documentation you are going to use for that general solicitation. Therefore, it really does not help the accidental general solicitation or statement in the press. In addition, there are so many other things you need to do to verify that the investors who purchase or invest in the fund under the general solicitation scheme are, in fact, accredited that, quite frankly, so far, in my opinion it is more trouble than it is worth for fund sponsors who are seasoned Reg D issuers and accustomed to conducting the regular, traditional private placement offering. So far, that has been less useful, but it has only been about eight weeks since it came into being, so we will see over time.

They have made the traditional private placement Reg D offering now more burdensome as well because of the representations that issuers now need to obtain from everybody: the GP, manager, officers and directors, placement agents, personnel directly involved in the fundraising, portfolio companies that are under control of the issuer and its affiliates, etc. Therefore, for just a plain old Reg D private placement offering in the United States you now have much more that you need in the way of certifications from all of those parties in order for the issuer to be able to sign Form D and conduct a valid placement. In fact, my hopes have been dashed and it is more cumbersome than it used to be.

I do not think at the moment we are really seeing much of an improvement. Over time, it could be that you will see more use of the general solicitation of 506(c) offering through, possibly, the private banking networks. There is more of a call to try to give access to private equity funds to a broader set of individual investors in the US, but I am not seeing a lot of it right now, to tell you the truth.

ANNA MARX: We are certainly not relying on it at Morgan Stanley; we are waiting to see what happens. Also, we have to look at the other exemptions that we are relying on, for example, under the CFTC.

GEOFF KITTREDGE: Yes. Anna probably knows more about

'The relaxation of the prohibition on general solicitation has so many hurdles and conditions associated with it that for private equity fund sponsors it is just not that useful.'

this than I do, but if you are a fund manager and you employ commodities as part of your investment strategy for hedging, etc, and it is broadly defined, it includes all sorts of derivatives, you probably rely on an exemption from having to register as a commodity pool operator that depends, in part, on conducting a valid private placement.

ANNA MARX: Exactly.

GEOFF KITTREDGE: The CFTC, which is not in step with the SEC on this, has not come out to confirm that if you were to engage in a 506(c) general solicitation offering it does not harm your ability to rely on the de minimis exemption from CPO registration. The SEC has come out and said it does not taint your ability to rely on the usual Investment Company Act exemptions, it does not taint your ability to rely on Reg S, which is the non US offering component, but CFTC has not confirmed that, so it is somewhat useless.

ANNA MARX: We are in limbo at the moment.

GEOFF KITTREDGE: Yes, so the general solicitation regime is just not that useful right now. In the meantime, I assume everybody around the table is running around trying to get bad actor representations from your firms, portfolio companies, placement agents, 20% investors in your funds. Maybe you do not have that many of them, although sometimes you do not always know who is going to be a 20% investor in the fund when you are doing the fundraising.

JULIE BRADSHAW: That is right. It promised much and our investor relations guys were very excited about it for a long time and now, as you say, they are not excited at all because it has just increased the burden of what is required, a burden that they do not understand. They think it very odd we have to get 'bad actor' representations from people who have absolutely nothing to do with our fundraising business.

GEOFF KITTREDGE: Yes, and there is a long list of bad acts, but it is basically conviction, court order, cease and desist order from anything involving the purchase or sale of securities, involving broker dealer, investment advisor, compliance, etc. There is a long list of representations which many of the portfolio companies probably do not understand.

JULIE BRADSHAW: Correct. It is not that there is any concern that they are involved; it is just time and explanation, because it is completely irrelevant to the businesses.

GEOFF KITTREDGE: If there have been violations prior to 23 September, those just need to be disclosed. If there have been violations that took place after 23 September this year, there is more analysis that needs to be done for the regular, traditional private placement safe harbour. Is everyone around the table having to send out these packages of certificates if you are doing a fundraising or if your portfolio company is raising capital as well?

ANNA MARX: We certainly have across our funds. Of course the worry we have, because there is such a broad fund platform in Morgan Stanley, is if something happens in one part of the firm it could contaminate or prevent another fund or another part of the platform from relying on private placement. Therefore, we have a quite rigorous programme that is being run out of the US, but it is pretty comprehensive from what I can tell. We have all had to certify, for example, internally, as well as portfolio companies, as you mentioned.

PETER GIBBS: This is an issue we have been considering. I would say that investors are quite familiar with it. We have an internal reporting and risk management framework which we can utilise for information gathering.

GEOFF KITTREDGE: My understanding is that one may need it from portfolio companies from other funds that are under common control. It is all doable and

Anna Marx - Morgan Stanley

Reg D offerings are closing and Form Ds are being filed. It is just that to some extent it has caught everybody by surprise, because the JOBS Act was supposed to make Reg D offerings easier and now they have just layered on a little more administration associated with it without many of the benefits that were promised from the JOBS Act. However, it is expected that you do a semi annual or quarterly update or re certification process, particularly for your own personnel.

ALEXANDER BOYES: Maybe we should turn to the European regulatory issues and focus on AIFMD a little bit more. At the start of the discussion a number of you highlighted the issue of marketing and how to best approach that. We have both EEA and non EEA managers here, so it might be worth talking a little bit about how one goes about marketing in the EEA post AIFMD from both those perspectives.

SALLY GIBSON: I would guess everyone is sick of talking about AIFMD, so it is probably just whatever the issues are that people have been experiencing. It sounds like marketing is the primary issue and I am guessing everyone has been trying, as far as possible, to rely on grandfathering regimes, which is not necessarily easy. I imagine everyone was in a mad scramble before 22 July trying to understand what it was they had to do in the various EEA jurisdictions. As seems to be typical with every AIFMD question, the answer is not uniform across the EEA member states, which is the real problem at the moment with some of the fundamental points around AIFMD, particularly around marketing. That is, how do you ensure that you are satisfying the conditions in each of the EEA member states? You need to make sure that you ask certain questions of EEA local counsel in order to understand what it really means to engage with investors in that member state.

Even if you can rely on grandfathering, the period of time for which grandfathering is going to be relevant is rapidly declining and I think people are now starting to think about, even in those member states where we can rely on

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grandfathering, what are we going to do once we get to 22 July next year? That date is going to come around very quickly, particularly because, for a number of the EEA member states you now need to receive some sort of marketing approval or licence or satisfy much more onerous conditions than previously needed to be satisfied. Everyone probably knows about the situation in Germany, because it was well publicised before 22 July that it was going to be much more difficult to market in Germany post-AIFMD implementation.

I do not know about other people's experiences, but the difficult marketing condition that now exist in some EEA member states were not known before 22 July. Denmark, for example, and the condition that the Danish regulator now requires the fund manager to get a statement from the fund's local regulator – so a Cayman regulator; in Delaware I assume it is the SEC that they are expecting a statement from – addressed to the Danish regulator and in respect of the particular fund that is being marketed, which says that similar Danish funds can be marketed in the same way in the fund's home member state as the way the fund can be marketed in Denmark. Therefore, you need the Cayman regulator to issue a statement to the Danish regulator that says a similar Danish fund could be marketed in the Caymans in the same way that the Cayman fund can be marketed in Denmark. How these conditions can be achieved from a practical perspective no one really knows yet and the idea that every single fund sponsor of a Cayman fund is going to be pitching up to the offices of the Cayman regulator asking them to give a specific statement to the Danish regulator each time they have a fund that needs to be marketed seems unreal and unwieldy. I guess the ultimate hope is that some sort of general statement by the Cayman regulator is going to be sufficient, which will cover all Cayman funds going forward. However, some of these issues have not been ironed out yet and people are going to have to face these issues pretty soon.
I do not know if anyone has started to try to get any marketing approvals or permissions in jurisdictions where they cannot rely on grandfathering. I do not know if anyone has started the process in Germany, for example.

GEOFFREY BAILHACHE: The process in Denmark has been onerous, but seems to be possible. That seems to be a recurring theme; that all of these processes are slow and cumbersome but you can still get there. Therefore, part of our job is to make sure that the marketing teams are all aware of the impact on timing and how this affects their general fundraising.

ANNA MARX: That is right. It is a timing issue for them, because they do not want there to be a hiatus in their fundraising, so at the moment we are grappling with what is marketing in each jurisdiction. As Sally said, you have to look at the rules in each jurisdiction, so can we pre market just so that at least we can gauge the interest for a particular fund, or can we say that it is genuinely, based on the facts, reverse solicitation, existing investors in predecessor funds, that sort of thing. We are trying to see if we can get ourselves comfortable with that, but it is a jurisdiction by jurisdiction, fund by fund basis. Even within an organisation like Morgan Stanley we do not yet have a process for dealing with that and that is what we are finding very difficult. You have the fund investor relation teams, you have the Morgan Stanley sales people and what I am worried about is that there is an inadvertent breach because a sales person has forgotten the rule in Germany or wherever and we trip ourselves into a registration requirement. At the moment, therefore, we are working to ensure our controls are sufficiently robust to make sure that we do not have these inadvertent breaches. I guess time will tell whether they are.

SALLY GIBSON: That is the problem. A number of jurisdictions believe AIFMD marketing is any sort of communication or activity that mentions a specific fund. Picking up the phone and calling someone and discussing the fact that you are thinking of launching a fund soon, in some EEA jurisdictions apparently is AIFMD marketing. It means that you could be in a situation where you inadvertently step over the line. Also, in some EEA jurisdictions, AIFMD marketing triggers ongoing disclosure obligations, even if you do not actually end up with an investor in the fund from that jurisdiction.

JULIE BRADSHAW: I think I am probably the only one here who has the passport. We grappled with the fact that we did not want to have the sort of issues you were discussing, so we did apply for the passport and therefore we do not have to go through the analysis that has been necessary on a jurisdiction by jurisdiction basis. However, what has surprised

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us is that notwithstanding having the passport we have been getting letters from other regulators in Europe asking us to pay them a fee. Some of them want a one off fee, a fairly nominal amount; some of them are asking us to make a filing, as they want to calculate the fee by reference to the assets managed which is not appropriate at the moment because we do not have an AIF under management – we are just marketing. Some seem to be suggesting that a fee is payable, 'for so long as you are marketing it', so I am considering whether we should cancel any of the passport rights we have. Another regulator seems to indicate you have to keep paying once the fund is raised and marketing ceased even if you don't have any investors in their jurisdiction.

All of that does not feel right, so we are making some representations to the FCA and I think the EVCA and others are also talking to them and ESMA. I do not think it is a terribly expensive thing and I think most of it will be a nominal fee, but it seems a bit of a nonsense given that the whole process was supposed to give you a single point of contact and a single point of reporting with the FCA as the home regulator. However, it is still easier to have the passport than dealing with the jurisdiction-by-jurisdiction analysis, and I do not need to worry about the phone calls in the same way as to whether it amounts to marketing or not, because I have that comfort there.

JIM STONER: Do those fees fall on the fund or on the manager, because they are fund by fund fees?

JULIE BRADSHAW: The charge falls on the manager by reference to the funds that are being marketed.

JIM STONER: Ultimately, therefore, can you push that cost back to the investors?

GEOFF KITTREDGE: It depends on your definition of organisational expense.

JULIE BRADSHAW: Yes, but even so multiple fees is not the outcome that we were expecting. We were expecting something different, and that part of the benefit of complying with all the AIFMD requirements was you got access without dealing with other regulators. It is not quite as simple as that. It never is, is it?

SALLY GIBSON: One of the interesting things about the marketing passport and the concept that what constitutes AIFMD marketing is not consistent across the EEA jurisdictions arises where you have a jurisdiction that adopts the position that marketing is any communication that references a

specific fund. In that case, there is a question mark for a European fund manager who needs to get the marketing passport but who does not yet have it because they do not have all the fund documents drafted, they are not so far advanced in their marketing process, whether they can go into that jurisdiction and do any pre marketing. Can they pick up the phone and call someone or can they send out a teaser in circumstances where, in their own jurisdiction, it is not yet possible for them to get the marketing passport because they do not have a draft LPA or a draft PPM to submit to the regulator? I have been having discussions with local counsel about this on the basis that if that is really the position, then non European fund managers are in a better position in some of these jurisdictions than a European fund manager who needs to go to the hassle, at a very early stage in pre marketing, of producing all the fund documents in order to get the marketing passport, because otherwise they have no capacity to pre market in these jurisdictions. The concept of what constitutes marketing is one that ends up having a lot of knock on consequences, principally in respect of ongoing AIFMD disclosure obligations. Also, it makes it more important to put compliance systems in place that somehow track who has picked up the phone to call someone or who has sent an email in circumstances where, in the past, that was just par for the course as part of the pre marketing of the fund.

There are also some AIFMD issues around communicating with existing investors in your funds. If you end up sending annual reports to existing investors which provide too much information about the successor fund that you are thinking of raising, that may constitute AIFMD marketing in some of these EEA jurisdictions because the concept of marketing is so broadly defined. There are some real issues around how you deal with existing investors and whether you end up shutting down a reverse solicitation argument with existing investors if you have provided them with too much information about a successor fund.

I guess reverse solicitation is probably the issue at the moment that I get the most questions about. I do not know whether anyone has received generic requests from investors saying, 'I love a particular GP and I would be happy to receive information about any fund that you ever raise in the future'.

SALLY GIBSON: Again, the problem is that for some jurisdictions such a generic request is not sufficient to show reverse solicitation. I am sure people have been dealing with France at the moment and the fact that there is no private placement regime and it has to be reverse solicitation or nothing. In France, in order for reverse solicitation to be shown, the prospective investor needs to have mentioned the specific fund that they want information about. A generic letter, even mentioning the fund manager's name, is not necessarily sufficient in France to show reverse solicitation, so again it is a jurisdiction by jurisdiction analysis. What would satisfy the UK regulator around reverse solicitation

'The concept of what constitutes marketing is one that ends up having a lot of knock on consequences, principally in respect of ongoing AIFMD disclosure obligations.'

is not going to satisfy the French regulator, the German regulator or the Austrian regulator, for example. This makes it very difficult to deal with marketing teams who say, 'I have received this letter, so presumably I can just go and do what I like in those jurisdictions'.

TIM HAMES: From a regulatory and political management viewpoint, marketing always has been the biggest mess throughout this process. It was through level one and level two and will be all the way. There are very simple and clear political reasons for that. It was kept deliberately ambiguous throughout this phase. A number of member states have very little enthusiasm for the passport, but felt obliged to stick with it as part of the package, with every intention of trying to kill it off or turn it into a visa rather than a passport later. A number of national regulators come out of national cultures which basically regard marketing as an exercise in which foreigners arrive in your country and extract capital from you and therefore are not something to be greeted with enormous enthusiasm. Therefore, it is going to remain the most awkward point all the way through.

Having said that, ESMA is privately surprised by how cautious and conservative all you people have been. They expected more testing of elasticity, more challenge, more people willing to risk being a test case.

[CROSSTALK]

TIM HAMES: They have never been in a room full of lawyers, obviously, but I can tell you seriously that people thought that there would be a diversity of approaches. That some people would say, 'Oh, bugger this. It says marketing. It does not seem like it.' Some people would be much more Anglo Saxon, if you like, about it than they have been, especially in jurisdictions where the culture was not going to be so hostile. Obviously, I am not going to ask you to draw lots as to who is the one brave enough to go and advise a firm to take the more capital 'M' rather than small 'm' view of marketing. However, I would say in practice they are genuinely surprised that there has not been somebody who has gone out there, because ESMA is not wandering around with a pair of handcuffs looking to slap them on someone over this issue. ESMA is well aware that this is insane, that this is producing a coat of many colours instead of a single blanket. They are well aware of that. More broadly, if I can bring crude politics to this elevated discussion, both in the UK and the ESMA sense. I am very much a glass half full person both for FCA and ESMA. Our experience of the FCA is that it is aware of the danger that Ireland and Luxembourg will outflank the UK in terms of attractiveness. We are not aware that insofar as there are means by which the Treasury can informally influence the FCA, it is occurring on a very regular basis. However, they are basically sympathetic to the view that it is a very difficult directive to make work and that they should, in a sense, give a break where a break can be given.

There are problems that they are under staffed. One of the reasons we have this 22 January thing in is pure practicality. They cannot get the stuff out the door if they do not have the forms in six months in advance. It is not gold plating. I have heard people say, 'This is terrible gold plating'. No, it is pure practicality and on areas such as remuneration, where there was a bit of wiggle room, they have taken a bit of wiggle room.

There is still a cultural problem with the British in not really getting the concept of a directive. It is a very French concept, which is a law but there is room within the law, you can wander around the house a bit. That is not something that comes comfortably to British officialdom, for whom there are either laws or there are not laws. It is binary; it is nought or one. You cannot have 0.8. In fact, directives are about 0.8 rather than regulation. There is quite a bit of nuance there if you choose to exploit it. Not meaning the education process about the industry, but for the cultural education. Trying to persuade people to be a little bit more like some of our continental partners in the way that they view these things is tough, but on the whole I think it is happening. The journey towards plastic plating rather than gold plating will be quite a long one, but nevertheless the journey has at least started politically.

On the ESMA front, to be honest, I am a great fan of Verena Ross. All my discussions with ESMA show a willingness at the very top to want to be seen as technically literate. They do not want people to gather in rooms like this saying, 'God almighty these people are idiots. They do not understand what a fund is. They do not understand what a deal is.' There is a professional pride there and if you look at most of the history of what we have seen over the last three years, ESMA has listened during exercises of consulting and put forward not ideal but more reasonable positions. The European Commission has then invariably tried to knock them back, because the Commission is well aware who the Commissioner is and where he comes from politically and a view of Anglo Saxon capitalism that is not entirely first in the queue of fan clubs. Even if Monsieur Barnier started with a more general disposition, he is looking over his shoulder at a European Parliament which is now co equal in terms of power and that, during the tenure of this parliament, has been

persistently on the most hostile end of the spectrum. He does not want to get grief from them just because she has listened to us and made technically relevant adjustments.

That is the politics of what you have been facing: a relatively weak regulator in terms of the political architecture, because of a Commission, unusually, and never before Gordon Brown screwed this up in 2009 has there been a Commissioner in that slot who has not been of an Anglo spheric character. Charlie McCreevy was Irish rather than British, but he fitted perfectly comfortably into British culture on these things. If you think about it, with the greatest of respect and I love France, I do want to stress this very, very firmly, but the idea that there is a French Commissioner for Financial Services makes as much logic in the EU as a British Commissioner for the Common Agricultural Policy. It is just nuts.

However, to my mind, the likely politics, given that we have European elections next May followed by a change of Commissioner in January, is that whilst it is unlikely, alas, the British will recapture that particular Commission slot, we might have done if Cameron had not pledged the EU referendum afterwards, which is just regarded as blackmail by European partners and blackmail of the maddest sort: a man standing on top of a building saying, 'If you do not do what I say I will jump'. Nevertheless, some sort of compromise, be it Dutch, Luxembourg, Swedish perhaps, that does not start off from such an instinctive position of saying, 'These people need to be regulated', that is my first instinct. Therefore, I think we will have a friendlier Commissioner.

What we may really benefit from though is – and I mean this in the nicest possible way – the European Parliament elections next May are likely to produce a rather anarchic outcome, in that anti system parties are going to do well everywhere. Anti system parties of the right and left, an anti system party something like the Five Star movement in Italy, which are impossible to define ideologically but they are anti system. Therefore, in the UK, UKIP will do very well. In France, the National Front is going to do very well. In Germany, Allianz für Deutschland, which I stress is very respectable compared to the parties I have just referred to, but nevertheless is, by German standards, outrageously euro sceptic, is going to do very well, as will the far left Die Linke. In Italy, absolutely everyone who is not part of the establishment will do well, the establishment parties will do badly. The Communists are going to do very well. In Spain they are going to do very well and Poland.

Therefore, what you are going to have is a European Parliament where at a minimum 25% and a maximum 37.5% of people essentially do not want to be there. They are in there in order to make a statement about the institution or about the economic system, but they are not in there because they want to be rapporteurs or serve on committees or do detailed work on regulation. Hence there will be a small number of people in the middle who are interested in that sort of thing, divided between the mainstream left, the mainstream right, the alliance of liberals in the middle. The British Tories are still howling in the wind over there with some Polish neo Fascists – I hope this is not being written down. It is going to be extraordinarily difficult to produce legislation of any sort in any space in those circumstances, because you

'If you look at most of the history of what we have seen over the last three years, ESMA has listened during exercises of consulting and put forward not ideal but more reasonable positions.'

have to get 50% of the two thirds who want to play on board. The other third, as I say, are only there in order to wave their fingers either at the European federalist ideal or at capitalism or at something or other. God knows what the Five Start movement will be waving its finger at, but it will be in there waving its finger. To use an American analogy, it is gridlock à la Washington but within one institution. That means the Parliament will be a much, much weaker actor in terms of whoever the next Commissioner is in the next parliament, because it will be divided, unclear on its mandate, incoherent, in effect. Much like, for those who are fans of post War European history, the French Fourth Republic, when nothing could get done ever, because between them the Gaullists and the Communists stopped everything happening. Therefore, the next Commissioner is going to have much more freedom of manoeuvre and if it is a sensible person that, in turn, means that ESMA will have more freedom of manoeuvre and, if they have freedom of manoeuvre, their instinct will be to be technically robust rather than just head cases.

End of sermon. Sorry.

ALEXANDER BOYES: Does anyone want to follow that? In terms of AIFMD II, what would you say?

TIM HAMES: The long grass thickens.

ALEXANDER BOYES: Sally, do you want to touch on the issue that was raised at the start with regard to co invest in AIFMD? I have the impression, certainly in terms of the interpretation in the UK, it is fairly narrow, but obviously it is dependent on the separate jurisdictions.

SALLY GIBSON: I guess people are facing this with co invest at the moment particularly. Obviously if you set up a co investment fund and you are getting fees and carry out of it, then it looks like an AIF and if you only have a single investor then you potentially get out of treating it as an AIF. However, the bigger issues arise where you set up a co investment vehicle with more than one co-investor and you are not taking any fees and you think it does not really look like a fund, do I need to treat it as an AIF? Perhaps more difficult is where you have co investors investing directly into the holdco. Therefore, if you have co investors investing directly in a Lux holdco, does Lux holdco become an AIF as a consequence of co-investment? These are difficult issues and if it is Luxembourg, then Luxembourg counsel will generally try to get you to the point of being fairly comfortable that it is not an AIF, but the avenues in getting there are not necessarily that clear. The only arguments you have available are that the Lux holdco is a holding company and it is excluded from the concept of AIF, or it is a joint venture,

but the joint venture argument is not necessarily easy to show because of the rights that the co investors have, which typically are limited in terms of governance. Then it becomes a question of how you get comfortable that Lux holdco does not constitute an AIF in those circumstances.

There are other issues to consider when marketing co investment opportunities. If you are setting up a co investment vehicle, how do you go about dealing with co-investors in EEA jurisdictions where, even if you are grandfathered for your main fund, you may not necessarily be grandfathered for the co-investment vehicle. In those circumstances you are obviously identifying specific co-investors and then it becomes an issue of going to local counsel and finding out the answers to certain questions. If I market to that co-investor outside of the jurisdiction can I get out of AIFMD law? Can I show reverse solicitation if, for example, I have entered into a side letter with that investor where I have agreed to show them co investment opportunities? Is there some way of getting around strict rules on marketing, because you can manoeuvre a little bit more where you are only going to one or two European investors rather than trying to rely on these sorts of arguments when you are marketing your main fund.

Do you want to talk about asset stripping?

DAVID INNES: Julie touched on this at the beginning. We are starting to get requests from deal teams to advise on what it means in practice and provide checklists of things they should worry about on deals. The issue with it, as with many things around AIFMD, is, as one client put it to me, 'This looks a mess, can you clarify?' The BVCA are looking at it. There is a mixture of views in the legal community around certain issues as to what asset stripping means in practice. I have to say it is a nice neutral term to give to a bit of legislation and the problem is that they have effectively just cut and pasted the EU directive into UK legislation and as a result there are a lot of grey areas.

The only really good news about it is it does not catch debt, it has only imposed a level of restriction that is the same as UK plcs have, so it is not saying that you cannot make distributions at all. It is just saying

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you have to satisfy these additional tests. There is a whole load of grey areas, though, around things like if you get a change of control at the top does that cover the whole of the pre existing group? It would seem to be an odd result that a group within which you used to be able to pay dividends without having the asset stripping regime applying, suddenly every company within that has to think about it. I do not think it was intended to catch all the pre existing companies within the group, but the drafting is such that technically it does. There is a whole load of issues like that. Again, the protection lasts two years; what happens if you sell that portfolio company within the two years? Do you have to put something in the SPA that says the purchaser cannot breach this, because then you have used your best efforts to make sure there are not distributions?

Practice is going to develop. I do not know if people are receiving requests now from deal teams to say, 'What can we do? What do we have to think about? Do we have to make sure we have extracted cash or that the seller has extracted cash before we buy it, because we may not be able to do so?' Deal teams never like paying cash for cash anyway, but do we have to make sure that if there is a long, locked box period that the cash has been distributed out before we get it, because it is going to be difficult for us? I think the answer to that is, if it can be done, it makes sense not to be buying lots of cash, because you have to be able to move it and you do not want to get it trapped somewhere down in a portfolio company.

CHRISTINE CHEN: It is more in the context of refinance also, because there is so much more debt available and so you buy something and there is no cash in it, but six months later, because you have merged it with something else or added something, the banks are ready to give you a higher level of debt and then it is getting that cash out.

DAVID INNES: You have to look at that reasonably carefully. A lot of the things that are happening now are not necessarily caught, but restarting the clock, having problems getting cash out, yes, it needs carefully looking at.

JULIE BRADSHAW: It limits some restructuring options, does it not, in terms of, as you say, wanting to make sure you can get the cash out at a later date. You have to plan well in advance and perhaps not have the flexibility you might have liked to change it later on.

DAVID INNES: I am not sure if all of the accountants are yet addressing these issues in their structuring reports. Some, but not all, of them are thinking about this issue, but with any reorganisation now you have to think about it and get someone to take a view. There may or may not be things that can be done easily to avoid an issue, but it makes sense to do the easy things now just to avoid problems going forward.

JULIE BRADSHAW: It comes back to what Tim was saying in terms of being a directive and are we comfortable taking the French approach to how to interpret and implement directives or do we want to be very British or American even and make sure that we know what is right? The challenge is how to address it in the next 12 to 24 months. It clearly will become easier as practice develops and you have the comfort of doing what everyone is doing, even if they attack it at a later date. The reaction to it is going to be different if you are one of 20 who have approached it in a certain way.

DAVID INNES: I am aware that we are running up against the time limit, but I do not know if there are other issues that it would be useful to discuss quickly.

JULIE BRADSHAW: Again picking up on what Tim said, one thing that was causing concern for the deal teams and other people was remuneration, because that was potentially a large change and, as you say, Tim, the way that that has been dealt with has shown some

pragmatism, particularly by the FCA. The FCA has taken a sensible approach to it and been as helpful as it can within the scope of the directive.

TIM HAMES: There is a secondary concern about the danger at a later point, about stuff porting in that rather lazy cut and paste way from banking regulation over to our side. However, as that is very unlikely to happen this side of the European Parliament elections and if the scenario I have just painted comes to pass, then I suspect we will not be having quite the conveyor belt of new regulation coming through. Also, there is the passage of time from the financial crisis, any sort of evidence of European economic recovery, all that creates a slightly different atmosphere around political debates. Similarly in the UK, if we really have turned a corner in the economy, Margaret Hodge is going to be a less influential voice in our public debate next year than she was last year on the whole corporate tax stuff. People just feel differently about these things if there is money in their pocket and they see an economy that, on the whole, looks as if it is showing signs of life. If they do not get us before May 2014, and they are running out of time, they are probably not going to get us before the end of the decade. ■