# Contents

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreword</td>
<td>1</td>
</tr>
<tr>
<td>The Promotion of Professional Standards</td>
<td>2</td>
</tr>
<tr>
<td><strong>Section 1</strong></td>
<td></td>
</tr>
<tr>
<td>Code of Conduct</td>
<td>4</td>
</tr>
<tr>
<td><strong>Section 2</strong></td>
<td></td>
</tr>
<tr>
<td>Commentary on the Code of Conduct</td>
<td>6</td>
</tr>
<tr>
<td><strong>Section 3</strong></td>
<td></td>
</tr>
<tr>
<td>Guidance on the Application of the Code of Conduct: Questions and Answers</td>
<td>8</td>
</tr>
<tr>
<td>Outline</td>
<td>9</td>
</tr>
<tr>
<td>Contents</td>
<td>10</td>
</tr>
<tr>
<td>3.1 Fund formation</td>
<td>11</td>
</tr>
<tr>
<td>3.2 Fundraising</td>
<td>12</td>
</tr>
<tr>
<td>3.3 Investing</td>
<td>16</td>
</tr>
<tr>
<td>3.4 Management of an investment</td>
<td>21</td>
</tr>
<tr>
<td>3.5 Disposal of an investment</td>
<td>26</td>
</tr>
<tr>
<td>3.6 Distribution</td>
<td>28</td>
</tr>
<tr>
<td>3.7 LP relations</td>
<td>28</td>
</tr>
<tr>
<td>3.8 Secondaries</td>
<td>31</td>
</tr>
<tr>
<td>3.9 Winding up of a Fund</td>
<td>31</td>
</tr>
<tr>
<td>3.10 Management of multiple Funds</td>
<td>32</td>
</tr>
<tr>
<td>3.11 GP’s internal organisation</td>
<td>32</td>
</tr>
<tr>
<td>3.12 Responsible investment factors</td>
<td>36</td>
</tr>
<tr>
<td>Glossary</td>
<td>38</td>
</tr>
<tr>
<td>IPEV Valuation Guidelines</td>
<td>40</td>
</tr>
<tr>
<td>IPEV Reporting Guidelines</td>
<td>62</td>
</tr>
</tbody>
</table>
EVCA is the pan-European industry association for investors and managers in the Private Equity and Venture Capital Industry. Its membership represents the full range of Private Equity activity, from early-stage Venture Capital firms to the largest Private Equity firms, investors such as pension funds, insurance companies, fund-of-funds and family offices, as well as welcoming associate members from related professions.
Introduction to the Handbook

The Promotion of Professional Standards

EVCA promotes the highest ethical and professional standards within the Private Equity and Venture Capital Industry. 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 relationships between all those engaged in the Industry, with a particular focus on the relationship between GPs and their LPs and GPs and their Portfolio Companies. The GP/LP terminology used in this Handbook is explained under the heading ‘The long-term partnership between GPs and LPs’.

The observance of the standards set out in this Handbook enables EVCA to better represent the interests of its members.

Our high ethical standards
Ethical behaviour is fundamental to the success of the Industry. First, GPs and LPs within the Industry are entitled to expect their peers and Portfolio Company co-investors to operate in an environment of trust and are expected to behave in a similar manner towards Portfolio Companies, service providers and other stakeholders. Secondly, in order to ensure sustainable and equitable conditions for the Industry across Europe, it is in members’ best interests to promote confidence in the Industry for the public at large. EVCA membership creates a responsibility to act in a manner that is both ethical and beneficial to the interests of the Industry and its stakeholders.

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 and Venture Capital is foremost a co-investment structure of a particular fund. The nature of the long-term partnership formed through negotiations 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 and during the life of a Fund the GP and LPs actively engage with each other to ensure the highest professional 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 (please see diagram on next page)
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. GPs play an active role through their board representations in the strategy and direction of the Portfolio Company in order to create lasting value for all stakeholders. Good corporate governance is key to creating lasting value. GPs demand rigorous accountability, transparency (through monitoring and reporting), adoption of best practices and alignment of interest from 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.

This Handbook aims to help EVCA members exercise business judgment and act with integrity. Private Equity and Venture Capital 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.

Editing notes
The Industry’s original Code of Conduct, published in 1983, has been further developed throughout the years, recently also 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 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 as ethical principles.
This Handbook integrates several existing EVCA professional standards documents, namely EVCA Code of Conduct (October 2008, reprint July 2011), EVCA Governing Principles (May 2003, updated 2010) and EVCA Corporate Governance Guidelines (June 2005, updated 2010). These are replaced in their entirety by this Handbook.

The Handbook is a dynamic document. EVCA’s 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 erika.blanckaert@evca.eu. The Handbook will be formally reviewed annually. EVCA will issue updates to the Handbook to reflect Industry developments. Updating is also particularly anticipated upon publication and implementation of detailed pan-European legislation relating to the regulation of alternative investment fund managers (AIFM Directive) during 2013.

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. 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.

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 may be variation to this model.
Section 1
Code of Conduct
Objectives of the Code
The objectives of the Code are:
• to state the principles of ethical behaviour that members of EVCA abide by;
• to assert on behalf of the membership the collective view that high standards of commercial honour and just and equitable principles of trade and investment shall be observed; and
• to provide the basis for consideration of, and dealing with lapses in, professional conduct within EVCA membership.

Compliance with the Code is mandatory for all EVCA members and their affiliates and is dealt with through the Professional Standards Committee on behalf of the Board of Directors of EVCA. In the event of a proven serious case of misconduct by a member, the sanction is expulsion of that member from EVCA.

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

The Code of Conduct is mandatory for all EVCA members.
Section 2
Commentary on the Code of Conduct
The following section includes some commentary which can be helpful in the application and interpretation of the Code. There is further explanation on how the Code itself can be seen in practice in ‘Guidance on the Application of the Code of Conduct: Questions and Answers’.

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 personal conviction that one’s actions would stand up to public scrutiny. An alternative test is to judge one’s actions by reference to whether one 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 will expect 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.

Within the industry, commitments are made subject to 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 and what is still subject to further investigation is very important.

Promises are made in the light of circumstances which are known at the time that the promise is made. The ethical individual or business only makes promises which he/she/it reasonably believes 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 arise inevitably within business and 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. A GP should seek to manage conflicts of interest fairly and, where relevant, always consult with the LP Advisory Committee as part of this process. 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. To help in this process, LPs should ensure they declare their own conflicts of interest in any situation, for example if the LP is an investor in two Funds managed by the GP and one Fund is selling an investment to the other Fund. Conflicts of interest should be diligently identified and disclosed to all parties concerned.

2.4 Act in fairness

Fairness means playing by the rules, based on facts and circumstances.

Rules for conducting business in our Industry may vary between countries, regions, societies, legal systems and transactions. It is important that members understand the different rules that apply to their particular business or situation. A GP should pay due regard to the interests of LPs in the Fund taken as a group and should, where relevant, consult with the LP Advisory Committee or all LPs. An LP should pay due regard to the interests of the Fund as a whole and how their individual behaviour may implicate 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 an LP vote under the Fund’s constitutional documents.

A GP should pay due regard to the information needs of LPs in the Fund, and communicate adequate information to them in a way which is 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 commercially sensitive information from other market participants. The GP will treat Portfolio Company or LP information as confidential and will not make use of that information in a way that is detrimental to the Portfolio Company or LP. LPs should also comply with the contractual 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 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 in this regard.

2.6 Do no harm to the Industry

Success in commercial enterprise requires the generation and analysis of options and the rigorous 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.
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 by way of questions and answers both for the establishment and management of a Fund as well as to provide guidance on how the Code may apply during the life cycle of a Fund. In doing so, it takes account of common market practice and corporate governance in the Industry wherever possible. As mentioned in the Introduction, this Handbook is a dynamic document and will be reviewed annually. EVCA expects that the Handbook as a whole, and these examples of sound practice in particular, will be modified over time to reflect developments in the sectors and countries in which the Funds invest. Updating is also anticipated upon publication and implementation of detailed pan-European legislation relating to the regulation of alternative investment fund managers.

The illustrations are not intended to be exhaustive or prescriptive. While the questions are intended to provide a useful resource for GPs, LPs and other Industry participants, it should not be assumed that “one size fits all”. Some of the scenarios may be inappropriate as a result of the size, nature, local environment and complexity of some GPs’ operations. The different investment objectives of some Funds may also mean that the examples are not appropriate to all Funds.

Local legal and regulatory requirements, and the extent to which there are fiduciary relationships and obligations, differ in the various European jurisdictions. The principle is that these legal requirements, including, but not limited to, financial services legislation, company law, fiscal legislation, competition legislation, consumer and data protection legislation and anti-money laundering measures are observed in all relevant jurisdictions. This document does not describe those requirements or provide a complete or mandatory statement of the duties of those involved in the establishment and management of Funds. It is not a substitute for professional advice, which should still be obtained where appropriate. The Industry participants should also be familiar with and mindful of applicable national and supranational corporate governance guidance.

While endeavouring to reflect anticipated pan-European legislation and regulation, this document does not reflect the impact of differing legal structures used for Private Equity and Venture Capital vehicles. In particular, it is assumed that Funds are being marketed to sophisticated LPs and hence this document does not reflect the large range of legal protections surrounding investments that are marketed to retail investors.
The Q&A covered in section 3, is set out under a number of headings, which are highlighted in the grid below. The Q&A itself follows this grid.

<table>
<thead>
<tr>
<th>Section</th>
<th>Title</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>Fund formation</td>
</tr>
<tr>
<td>3.1.1</td>
<td>Early stage planning</td>
</tr>
<tr>
<td>3.1.2</td>
<td>LPs and marketing</td>
</tr>
<tr>
<td>3.1.3</td>
<td>Structuring</td>
</tr>
<tr>
<td>3.2</td>
<td>Fundraising</td>
</tr>
<tr>
<td>3.2.1</td>
<td>The Fundraising process</td>
</tr>
<tr>
<td>3.2.2</td>
<td>The Fundraising Team</td>
</tr>
<tr>
<td>3.2.3</td>
<td>Target LPs</td>
</tr>
<tr>
<td>3.2.4</td>
<td>Origin of capital</td>
</tr>
<tr>
<td>3.2.5</td>
<td>LPs</td>
</tr>
<tr>
<td>3.2.6</td>
<td>Structure of the offer: terms of investment</td>
</tr>
<tr>
<td>3.2.7</td>
<td>Structure of the documents</td>
</tr>
<tr>
<td>3.2.8</td>
<td>Terms in the Fund documents</td>
</tr>
<tr>
<td>3.2.9</td>
<td>Presentations to LPs</td>
</tr>
<tr>
<td>3.2.10</td>
<td>Responsible investing</td>
</tr>
<tr>
<td>3.2.11</td>
<td>Track records</td>
</tr>
<tr>
<td>3.2.12</td>
<td>Forecasts</td>
</tr>
<tr>
<td>3.2.13</td>
<td>Time period for Fundraising</td>
</tr>
<tr>
<td>3.3</td>
<td>Investing</td>
</tr>
<tr>
<td>3.3.1</td>
<td>Due diligence</td>
</tr>
<tr>
<td>3.3.2</td>
<td>Investment decision</td>
</tr>
<tr>
<td>3.3.3</td>
<td>Structuring investments</td>
</tr>
<tr>
<td>3.3.4</td>
<td>Responsibilities to other shareholders in the same or other classes of shares and to bondholders</td>
</tr>
<tr>
<td>3.3.5</td>
<td>Investment Agreement</td>
</tr>
<tr>
<td>3.3.6</td>
<td>GP’s consent to Portfolio Company actions and board appointments</td>
</tr>
<tr>
<td>3.3.7</td>
<td>The Portfolio Company’s corporate strategy</td>
</tr>
<tr>
<td>3.3.8</td>
<td>Co-operation with co-investors and syndicate partners</td>
</tr>
<tr>
<td>3.3.9</td>
<td>Co-investment and parallel investment by the GP and its executives</td>
</tr>
<tr>
<td>3.3.10</td>
<td>Co-investment and parallel investments by LPs and other third parties</td>
</tr>
<tr>
<td>3.3.11</td>
<td>Divestment planning</td>
</tr>
<tr>
<td>3.4</td>
<td>Management of an investment</td>
</tr>
<tr>
<td>3.4.1</td>
<td>Investment monitoring</td>
</tr>
<tr>
<td>3.4.2</td>
<td>Board participation</td>
</tr>
<tr>
<td>3.4.3</td>
<td>Exercise of GP consents</td>
</tr>
<tr>
<td>3.4.4</td>
<td>Exercise of influence on responsible investment factors</td>
</tr>
<tr>
<td>3.4.5</td>
<td>Responsibilities in relation to other stakeholders</td>
</tr>
<tr>
<td>3.4.6</td>
<td>Follow-on investments</td>
</tr>
<tr>
<td>3.4.7</td>
<td>Under-performing investments</td>
</tr>
<tr>
<td>3.5</td>
<td>Disposal of an investment</td>
</tr>
<tr>
<td>3.5.1</td>
<td>Implementation of divestment planning</td>
</tr>
<tr>
<td>3.5.2</td>
<td>Responsibility for divestment decision making</td>
</tr>
<tr>
<td>3.5.3</td>
<td>Warranties and indemnities</td>
</tr>
<tr>
<td>3.5.4</td>
<td>Cash vs. shares/earn-outs on realisation</td>
</tr>
<tr>
<td>3.5.5</td>
<td>Sale of a Portfolio Company between Funds managed by the same GP</td>
</tr>
<tr>
<td>3.5.6</td>
<td>Managing quoted investments</td>
</tr>
<tr>
<td>3.6</td>
<td>Distribution</td>
</tr>
<tr>
<td>3.6.1</td>
<td>Distribution provisions</td>
</tr>
<tr>
<td>3.6.2</td>
<td>Timing of Distributions</td>
</tr>
<tr>
<td>3.7</td>
<td>LP relations</td>
</tr>
<tr>
<td>3.7.1</td>
<td>Reporting obligations to LPs</td>
</tr>
<tr>
<td>3.7.2</td>
<td>Transparency to LPs</td>
</tr>
<tr>
<td>3.7.3</td>
<td>LP relations generally</td>
</tr>
<tr>
<td>3.7.4</td>
<td>LP conflicts of interest</td>
</tr>
<tr>
<td>3.7.5</td>
<td>LP Advisory Committee</td>
</tr>
<tr>
<td>3.7.6</td>
<td>Keyman Provisions</td>
</tr>
<tr>
<td>3.8</td>
<td>Secondaries</td>
</tr>
<tr>
<td>3.8.1</td>
<td>Liquidation</td>
</tr>
<tr>
<td>3.8.2</td>
<td>Fund documents</td>
</tr>
<tr>
<td>3.9</td>
<td>Winding up of a Fund</td>
</tr>
<tr>
<td>3.9.1</td>
<td>Liquidation</td>
</tr>
<tr>
<td>3.9.2</td>
<td>Fund documents</td>
</tr>
<tr>
<td>3.10</td>
<td>Management of multiple Funds</td>
</tr>
<tr>
<td>3.10.1</td>
<td>Conflicts of interest</td>
</tr>
<tr>
<td>3.10.2</td>
<td>Establishment of new Funds</td>
</tr>
<tr>
<td>3.11</td>
<td>GP’s internal organisation</td>
</tr>
<tr>
<td>3.11.1</td>
<td>Management are responsible for establishing the control environment</td>
</tr>
<tr>
<td>3.11.2</td>
<td>Management are responsible for establishing procedures for risk assessment</td>
</tr>
<tr>
<td>3.11.3</td>
<td>Management are responsible for control activities</td>
</tr>
<tr>
<td>3.11.4</td>
<td>Human resources</td>
</tr>
<tr>
<td>3.11.5</td>
<td>Incentivisation</td>
</tr>
<tr>
<td>3.11.6</td>
<td>Financial resources</td>
</tr>
<tr>
<td>3.11.7</td>
<td>Segregation of Fund assets</td>
</tr>
<tr>
<td>3.11.8</td>
<td>Procedures and organisation</td>
</tr>
<tr>
<td>3.11.9</td>
<td>Internal reviews and control</td>
</tr>
<tr>
<td>3.11.10</td>
<td>Management are responsible for the organisation’s information and information systems and for communications within and outside the organisation</td>
</tr>
<tr>
<td>3.11.11</td>
<td>External assistance</td>
</tr>
<tr>
<td>3.11.12</td>
<td>Considerations relating to monitoring of governance - GP governance</td>
</tr>
<tr>
<td>3.12</td>
<td>Responsible investment factors</td>
</tr>
<tr>
<td>3.12.1</td>
<td>Approach to responsible investment</td>
</tr>
<tr>
<td>3.12.2</td>
<td>Environmental factors</td>
</tr>
<tr>
<td>3.12.3</td>
<td>Social factors</td>
</tr>
<tr>
<td>3.12.4</td>
<td>Governance factors</td>
</tr>
</tbody>
</table>
The Fundraising Team's early stage planning should address the following issues:

- what the Fund's investment policy, investment objectives and investment strategy will be and, if applicable, deal flow allocation to prior Funds;
- what size of Fund the Fundraising Team will need to establish to implement the investment strategy;
- what will be the length of the Investment Period and the term of the Fund;
- from what type of LPs the Fundraising Team intends to try and raise Commitments for the Fund and in which jurisdictions those potential LPs are based (as this can impact on the structure(s) to be used);
- what human resources the Fundraising Team will need to put in place in order to implement the Fund's objectives, in particular who the relevant investment and industry professionals will be and ensuring such individuals are likely to remain committed to the Fund for its duration;
- what the appropriate Management Fee is for the Fund;
- what the appropriate Carried Interest structure will be, in particular focusing on timing of payment and GP Clawback mechanisms (e.g. Clawback and escrow arrangements);
- how responsible investment considerations will be incorporated into the organisation and investment and portfolio monitoring processes;
- consideration of the existing Fund's constitutional documents, if applicable, to ensure that the Fundraising Team is aware of any restrictions contained in those documents as to timings in relation to raising new Funds, scope, etc.

### Recommendation

Along with the advent of pan-European regulation, the marketing of Funds within the EU may depend on the jurisdiction of the Fund vehicle, as well as the location of the GP/manager. An EU-wide “marketing passport” will be available from July 2013 to those EU-based GPs/managers who comply with the relevant requirements set out in the AIFM Directive. Until 2018 the national private placement regimes will continue to be in force within the EU for the marketing of Funds on a national basis, but with certain new essential conditions attached from July 2013.

### 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 LPs (such as institutional and professional investors) and in some jurisdictions, these restrictions may apply to early informal discussions with potential LPs. Planning identifies relevant jurisdictions giving the Fundraising Team the opportunity to obtain appropriate advice.

### Recommendation

The Fundraising Team should clearly identify the regulatory landscape, particular LPs and types of LPs that they wish to attract to the Fund in any relevant jurisdiction. Before commencing Fundraising, the Fundraising Team should establish what restrictions apply to the marketing of Funds in each jurisdiction where they wish to market the Fund.

Consideration should also be given to the content of the due diligence information to be provided to prospective LPs and the medium through which it will be delivered. For example, will the information be available electronically through a virtual data room hosted on a secure area of the GP's website, or on a secure data hub site. Thought should also be given as to how meetings with prospective LPs will be held. For example, will they all be one-on-one meetings or should an initial launch meeting be arranged to which all prospective LPs are invited to enable them to meet a cross-section of members of the GP's team.
### 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 be determined at a later stage, an initial outline structure is necessary both from a regulatory and commercial perspective to allow the Fundraising Team to market the Fund. Certain categories of target LP may have an impact on the structure of the Fund (such as US-based ERISA LPs). 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 an initial outline structure for the Fund, including suitable vehicle(s) for the Fund and custody arrangements. Wherever possible, the GP should take account of likely requirements of targeted LPs when considering these structures (including their tax requirements and regulatory requirements of different vehicles in different jurisdictions). During the Fund structuring stage, the GP should also consider what arrangements it will make for the custody of investments held by the Fund.

### 3.2 Fundraising

**Question**
The Fundraising stage (which is also often referred to as the marketing stage) is the stage at which the basis of 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 and the fiduciary duties of due skill, care and diligence.

#### 3.2.1. The Fundraising process

**Question**
Who takes part in the Fundraising process?

**Explanation**
A Private Equity Fundraising is a complex and time-intensive process with many parties involved. It needs to be planned and prepared well in advance as part of the marketing preparations. Thought should be given to how much of the process can be managed in-house by the GP and what roles can be played by advisors.

**Recommendation**
Tasks and responsibilities during the Fundraising stage should be clearly identified and apportioned among the key personnel appropriately.

It should also be made clear to potential LPs which responsibilities will be undertaken by the GP once it is established and what (if any) the Fundraising Team’s role will be once this is in place.

#### 3.2.2. The Fundraising Team

**Question**
How should responsibility during the Fundraising period and prior to the establishment of the Fund structure be apportioned?

**Explanation**
During the Fundraising period, the legal entity that will manage the Fund is sometimes not yet established and the structure of the Fund will not usually be finalised. However, the key personnel of the GP will be involved in establishing the initiative and will undertake Fundraising. This Fundraising Team will usually have certain responsibilities during Fundraising (e.g., responsibilities for complying with applicable marketing laws, responsibilities for the information provided on the Fund to potential LPs and responsibilities relating to the verification of the origin of capital invested with a view to preventing money laundering).

**Recommendation**
Tasks and responsibilities during the Fundraising stage should be clearly identified and apportioned among the key personnel appropriately.

#### 3.2.3. Target LPs

**Question**
Which potential LPs should the Fundraising Team target?

**Explanation**
In many jurisdictions there are restrictions on the types of LPs to whom it is permissible to promote Funds. Investments in Private Equity and Venture Capital Funds are usually regarded as high-risk investments and Funds are usually primarily aimed at institutional LPs or professional investors who are considered to be fully aware of the potential risk of making an investment in a Fund.

Often restrictions only permit marketing of Funds to potential LPs for whom they are suitable. The tests for determining suitability vary from jurisdiction to jurisdiction. In some areas, the potential LPs’ net worth or the minimum size of investment may be one ground for permitting marketing.
Recommendation
The GP should comply with any local legal restrictions on marketing Funds. Failure to comply with these requirements may mean that any agreement to invest may be unenforceable. In some jurisdictions breach of these restrictions is also a criminal offence and, in addition to being liable for damages, the GP may be subject to fines and imprisonment.

If Fundraising is, as is normally the case, restricted to targeting potential LPs who can reasonably be considered to be experienced enough to properly evaluate the risk of the investment, they should be obliged to confirm in their application documents that they are suitably experienced and that they understand and accept the risks of the investment.

The Fundraising Team should maintain a record of all persons to whom it markets the Fund and a record of all information provided to them. The Fundraising Team will normally start by targeting existing LPs if they have already raised a Fund, as new investors will typically take comfort from re-investment by existing investors.

As mentioned in the Outline to this Q&A, it is assumed that the Funds are being marketed to institutional LPs or professional investors. If for any reason less-experienced LPs are accepted, due consideration should be given to any additional information, warnings and ongoing protections they may require.

3.2.4. Origin of capital
Question
Should the Fundraising Team be responsible for controlling the origin of the Capital Commitments offered for investment in a Fund 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 legislation can vary from jurisdiction to jurisdiction. However, there are general requirements and a common ground with respect to anti-money laundering legislation stipulated in the guidelines issued by the European Community and these include checks not only on the investing entity but also for establishing who the “ultimate beneficiary” is, to prevent investors from laundering money through Funds.

Recommendation
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 should in all cases comply with the relevant local rules in any jurisdiction where the Fund is marketed. In addition, during Fundraising, steps should be taken to ensure that investments are not made to effect money laundering. These steps should include verifying the origin of Capital Commitments offered for investment and the identity of potential LPs. Investment should not be accepted where the source of the investment causes concern (e.g. where the investment originates in a FATF black-listed country) or the LPs (or its beneficial owners’) identity cannot be verified.

Subscription documents should include suitable warranties from LPs in the Fund regarding the origin of money invested, although such warranties should not be considered to be a substitute for making appropriate enquiries. The Fund documents may include provisions that allow the GP to require LPs to withdraw from the Fund, if the GP reasonably believes that the investment has been made in order to undertake money laundering.

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

3.2.5. LPs
Question
What factors regarding LPs should the Fundraising Team consider?

Explanation
The quality and reliability of LPs affect all those investing in a Fund, as Drawdowns can be made throughout the life of the Fund. If one LP defaults, even when suitable sanctions are applied, other LPs are likely to be disadvantaged especially if the Fund cannot honour its investment commitment. Managing a default situation requires GP time, in addition this may reflect negatively on the GP and its reputation.

Moreover, 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 Fundraising, the Fund may find it more difficult to make investments or be forced to find additional financing at short notice. In order to comply with ongoing requirements under the US Dodd-Frank Act relating to the identity of investors in a Fund, GPs should ensure that the Fund documents require LPs to provide any necessary identification information that the GP is obliged to provide to US authorities during the life of the Fund. Failure or refusal to comply with this requirement should provide the GP with the right to expel that LP from the Fund.

Another consideration is the long-term nature of the relationship with a prospective LP and if they are likely to invest over multiple Fund cycles.

Recommendation
It is difficult to foresee the default of an individual LP however the Fundraising Team can reduce the overall risk and impact of default by obtaining a sufficient level of diversification by type and geography of LPs and to the extent possible build a balanced LP base avoiding concentration risk.

Any withdrawal of an LP should be subject to strictly defined exceptional situations.

Fund documents should give the GP the right to expel an LP who is causing serious legal, regulatory or taxation problems for the Fund.

3.2.6. Structure of the offer: terms of investment
Question
Should different LPs be offered different terms?

Explanation
The terms of investments in a Fund will normally be subject to and the result of negotiation. LPs may be keen to get certain preferential rights or economic advantages (such as positions on the LP Advisory Committee, preferential Co-investment rights, reduced Management Fees or a participation in Carried Interest). Trade and strategic investors will have different priorities in investing to those of financial investors.
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 it and the LPs.

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

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 impact on LP alignment of 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 mean that an LP loses its limited liability. They may also expose themselves to claims from other LPs.

In determining initial terms and subsequent negotiations with potential LPs, a GP should consider the alignment of interest of the group with all LPs.

Where a Fund is structured as multiple parallel partnerships or entities, the Fundraising Team should prevent one such entity or group with all LPs.

3.2.7. Structure of the documents

Question
What documents should the Fundraising Team produce with respect to the Fund and what matters should it address?

Explanation
Due to the ongoing negotiations until final closing of a Fund, documents tend to be continually revised to reflect all discussions with LPs. However, certain core elements describe the offer and its essential characteristics.

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. The Fundraising Team will normally also assemble a comprehensive data pack or virtual data room and documents about the Fund and its investment strategy, collectively comprising the due diligence materials.

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 constitutional documents.

Continuous amendment of documents can, if not addressed appropriately, mean that not all potential LPs receive the same information about the Fund before they make an investment.

Recommendation
A draft private placement memorandum or similar Fund documents should typically be made available to LPs prior to first closing. Constitutional documents establishing the Fund should also be produced.

Appropriate records should be kept to ensure that all LPs receive the same information. The use of due diligence rooms (physical or virtual) can be an effective way to provide information to prospective LPs. Between the first and the 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 received the same information.

3.2.8. 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. It is recommended that the Fund documents should address, at a minimum, the following matters:

Team
• a description of the management structure and the management team, identification of the key executives of this team and the regulation of a Keyman event (such as departure of a key executive);
• a description of the team’s skills and experience;
• details of team continuity, dynamics, decision-making processes and team succession;

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

The Fund documents should contain full and true information presented 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 documents, employing third-party advisors where appropriate e.g. auditing of a Fund’s track record.

The Fundraising Team should ensure that it can justify expressions of belief and statements made in the Fund's marketing materials using reliable documents and research, updating where necessary until the Fund has closed.

As a general rule, any changes to the Fund’s constitutional documents would require the approval of LPs. However, there will typically be 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 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.
track record

- the track record of prior investments made by the GP;

Investment strategy

- the investment scope of the Fund (e.g. target economies, target regions, etc.);
- 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 policy of the Fund and the procedures for ensuring compliance with such policy;

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 LP Advisory Committee;
- the reporting obligations that the GP will have to LPs;

Financial

- the cost and fee structure (including expenses borne by the Fund);
- how any Transaction fees and directors’ fees received by the GP will be treated;
- the GP Commitment and Carried Interest arrangements;
- the mechanics for Drawdown of Commitments and default mechanics in the event of LPs’ defaults on Drawdowns (which should normally impose significant sanctions on default to reduce the risk of such default);
- the valuation policy that will apply;
- if applicable, the pricing of interests, units, shares, etc. in the Fund;
- how Distributions to LPs will be made;

Co-investments and follow-on investments

- Co-investment rights and powers;
- the policy on co-investment with other Funds managed by the GP or any of its associates;
- the provisions that the GP will make for follow-on investments;

Term, Exits and new Funds

- the term of the Fund, the process for extending the Fund and termination and liquidation procedures for the Fund;
- Exit strategies;
- 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 Funds, and also any particular risk factors that may adversely affect the Fund's ability to carry out the investment policy or to meet any projection or forecast made.

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 them prior to closing and to allow time for negotiation with LPs. 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 matters to be addressed.

The Fundraising Team should ensure that information provided to potential LPs in sufficient time for them to consider them prior to closing and to allow time for negotiation with LPs. Appropriate subscription documents and confirmation of participation should also be circulated.

Any subsequent material changes to such information should be communicated to potential LPs.

3.2.9. Presentations to LPs

Question

What responsibilities arise with respect to marketing presentations?

Explaination

Presentations and information provided by the Fundraising Team that influence LPs' decisions are often subject to the law of all 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.

Recommendation

As mentioned in the section on “LPs and marketing” above, 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 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.

3.2.10. Responsible investing

Question

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

Explaination

The topic of responsible investing is becoming increasingly important to LPs who require consideration to be given to environmental, social and governance factors in the GP's investment processes.

Recommendation

GPs should clearly define and document their responsible investment policy and 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 any applicable professional bodies they are affiliated with.
3.2.11. Track records

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

**Explanation**
Potential LPs are generally interested in the track record of the GP. 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 selective presentation of material.

**Recommendation**
Information with respect to the track record set out in the private placement memorandum or in other documents should not be made on the basis of selective data that is unrepresentative, misleading or incomplete. The basis of all such statements should, in any event, be fully disclosed in the Fund documents. In particular, the period to which any track record information relates 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.

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.

3.2.12. 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 selective presentation of material.

**Recommendation**
Forecasts are legally not required 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/Fundraising Team when marketing the respective product.

If the GP/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.

3.2.13. Time period for Fundraising

**Question**
Is there any specific period during which Fundraising must be completed?

**Explanation**
It is important the Fundraising Team does not allow Fundraising to continue indefinitely, as this can prevent the GP from implementing the Fund's investment strategy, while resources continue to be committed to marketing.

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.

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.

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.

**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 12-18 months of the first close, unless 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.

3.3 Investing

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.

3.3.1. Due diligence

**Question**
What due diligence should be done when evaluating an investment and to what level of detail?

**Explanation**
The due diligence process undertaken by the GP 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, financial, tax, legal, regulatory, technology and environmental aspects. 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 potential Exit opportunities from the investment for the Fund.
**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 address all appropriate issues (which may include the financial position of the target company, the experience and ability of its management team, the market 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, possible environmental liabilities and other responsible investment factors in the broader context, litigation risks and insurance coverage).

The due diligence process should also include testing the assumptions upon which business plans are based, verifying the identity, experience and capability of GPs and co-investors, 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 specifically includes checks being made on the sellers to ensure that the investment does not facilitate money laundering, and to ensure that the investment complies with anti-corruption or anti-bribery regulations.

**3.3.2. 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 quantities of 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. LPs look to 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.

**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. As part of this process, consideration will also have been given as to whether the proposed investment fits the investment criteria and complies with the investment restrictions in the Fund documents. 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.

Investment decisions should be made by suitably senior and experienced personnel of the GP; normally these individuals will form an Investment Committee. Typically, the experienced individuals responsible for evaluating and proposing an investment will not be involved in making the final investment decision. If there are any significant changes to an investment proposal, further review, evaluation and additional approvals may be required.

**3.3.3. 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 in a Portfolio Company.

The Fund 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 beyond those envisaged and any such restrictions 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.

When structuring any investment the GP should take steps to minimise any adverse tax or other consequences. For example, the GP should take into consideration ERISA requirements where there are US based ERISA LPs, of any investment for the Fund and its LPs, which may require certain information and observer/board rights to be obtained in respect of the Portfolio Company.
3.3.4. Responsibilities to other shareholders in the same or other classes of shares and to bondholders

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.

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 securities 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 if expectations are unclear or based on erroneous assumptions, or if actual Portfolio Company performance is not as projected at the outset.

Recommendation

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, to the extent possible, be conducted fairly and in such a way that the outcome does not impact the value of the Portfolio Company.

3.3.5. 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 will be influenced by many factors, for example tax mitigation, local legal and regulatory requirements and structural considerations, such as whether a minority or majority interest is to be acquired.

The documents will need to take account of the commercial terms that the GP has agreed with the Portfolio Company. It is common practice for the roles of the GP and the management team of the Portfolio Company in relation to the running of the Portfolio Company, to be set out in the Investment Agreement at the time of the investment.

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. Note, (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 to a third-party purchaser on the same terms; and
- the consideration of responsible investment factors.

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

Recommendation

The team should consider these matters when negotiating an investment and ensure that the legal documents reflect the commercial terms negotiated by the GP. The team should consider using local legal advice on the appropriate manner for recording what has been agreed.

3.3.6. 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?

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 effect a number of decisions, and in so doing influences the Portfolio Company by virtue of this majority shareholding. The GP may also seek to specify certain rights in the Portfolio Company’s constitutional documents and agree contractual rights in the Investment Agreement if it enters into with the shareholders of the Portfolio Company, such as obtaining (i) investor consents; and (ii) board appointments.
(i) Investor consents
In some jurisdictions, it is common in the Investment Agreement between the Fund and the Portfolio Company for certain actions of the Portfolio Company to be subject to the prior consent of the GP on behalf of the Fund in its capacity as shareholder. These are commonly called “investor consents”.

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

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

(ii) Board appointments
The GP will typically also consider making:

- appointments to the board or other decision-making bodies of the Portfolio Company (see further the section on “Board participation” below); and
- appointments of persons to internal committees of the Portfolio Company (e.g., advisory committees or the remuneration and audit committee, 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 company 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 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 corporate, financial and accounting, business and other key matters. The list of matters will vary depending on the relevant jurisdiction and the size of investment, but the following should be considered:

- significant developments in the business (e.g., capital expenditure, new issues of capital, disposals of a significant amount of assets including real estate, changes to the Portfolio Company’s constitution);
- 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; and
- winding up or dissolving the Portfolio Company.

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 above 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.

3.3.7. 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 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 initial 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 on 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.

The degree of activism of the GP will vary according to the nature and structure of investments made 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.
3.3.8. 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 not accept any obligations in favour of other investors, unless it would be in the Fund’s interests to have some agreement or understanding with those investors.

3.3.9. 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’s constitutional documents permits the GP, its associates or its executives to co-invest or make parallel investments alongside the Fund, there is potential for the Fund’s interests to be prejudiced.

Recommendation
Subject to what is provided in the Fund’s constitutional 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 constitutional 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 terms. If this recommendation is not followed, it is particularly important that the operation of the Co-investment arrangements should be disclosed to LPs.

3.3.10. 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. Allowing such direct investment can be detrimental to the Fund’s interests; if the investment proves to be successful and the Fund’s investment allocation was reduced to allow direct investment by the Fund’s LPs and third parties, the return to the Fund’s LPs will be reduced. Such syndication may, however, allow smaller Funds to invest in larger target companies than might otherwise be the case, while still complying with any diversification restrictions in the constitutional 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). Details of Co-investment arrangements should be disclosed to the Fund’s LPs. When a conflict of interest arises, it should be resolved in accordance with the GP’s conflict of interest resolution procedures.

3.3.11. 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 investors 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 or conditions are not favourable for an IPO, but it is desirable to agree an Exit strategy in advance.

Recommendation
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.
3.4 Management of an investment

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.

The following sections on investment monitoring and exercise of LP 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. The Code principles of (i) Act with integrity; (ii) Disclose conflicts of interest; and (iii) Maintain confidentiality are particularly relevant in this context.

3.4.1 Investment monitoring

Question
How should the GP monitor an investment made by the Fund?

Explanation
The Investment Agreement should ensure that the GP regularly receives sufficient information from a Portfolio Company allowing the GP to monitor and appraise both the financial and non-financial performance of the investment and sufficient resource should be allocated by the GP to review, monitor and analyse such information.

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 to monitoring the investments of the Fund and apportions these resources and responsibilities appropriately. Typically, greater resources will be allocated by the GP to those Portfolio Companies which have more recently been acquired in order to set in place the platform for value creation as well as to those that are underperforming.

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 confidence that it may owe to the Portfolio Company. However, the GP should seek to negotiate appropriate rights to disclose information to the Funds' LPs so that they may, in turn, monitor their investments in the Fund.

The GP should prepare regular written analyses of investments which should be reviewed by the senior executives of the GP. The written analyses should 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. It should 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, and recommend any remedial action that the GP should consider taking in order to ensure the Portfolio Company continues to hit the targets set.

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Recommendation
The GP should agree non-legislative information requirements with the Portfolio Company's management 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. Typically, key performance indicators (KPIs) are developed that allow company management and the GP to carefully monitor company performance.

The GP should treat corporate information which it obtains confidentially and with due consideration to commercial sensitivity and the needs of the Portfolio Company's other stakeholders and should ensure that its own LPs are bound by similar confidentiality obligations with respect to such information in the Fund's constitutional documents.

3.4.2 Board participation

Question
How should the GP act in relation to the board of the Portfolio Company?

Explanation
The GP will frequently appoint one or more experienced members of its own staff or representatives to the board of the Portfolio Company. Typically, designees of the GP will have in-depth experience of the sector and will have been involved in the original due diligence and review of the investment.

There are many variations on the overall composition of boards, but in relation to non-executive members of the 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 as they have specific and appropriate industry knowledge and insight.
Recommendation
The GP should ensure that the board is structured and appointments 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
Whose interests do the GP-appointed director 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 him. Fiduciary duties generally are summarised as a duty of loyalty to the company, a duty to avoid and disclose conflicts, duties of confidentiality, 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. Where conflicts arise, the GP may need to excuse the director from meetings and may need to reach investment related decisions in full disclosure of the director’s conflict of interests. The GP should ensure that its appointee(s) clearly disclose any conflicts of interest with respect to their role as members of the board promptly when they arise.

Question
What does being a board member entail?

Explanation
The overriding principle of fiduciary duty to the company and all its shareholders apply to the whole board. A director is expected to devote such time and diligence as is reasonably necessary to further the business of the company. 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 such as 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.

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. All these skills, plus the ability to evaluate risk and other skills, are likely to be needed by every company over time and are unlikely to be offered by one sole director. Therefore, the ability to work collaboratively and openly with senior management and other directors is also of great importance.

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.

Question
What is the best size for a board?

Explanation
Thinking has evolved on optimum board size. Factors to bear in mind in considering board composition include the skills required to run the business, the interests of the shareholders and their desire for active participation in decision-making, the governance and logistics and costs 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
What liabilities come with board membership?

Explanation
Some directors may be unwilling to accept office because of the potential liabilities attaching to the position. The office of director is a position of responsibility and trust and no one should be forced into accepting the position. Directors may incur personal liabilities in particular for failure to maintain company books and records; for transactions at an undervalue and 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 as well as Directors and Officers liability insurance (often called “D&O” insurance).

Recommendation
Directors should be able to obtain legal or other specialist advice for complex board decisions and should have the assurance of legal and insurance protections when properly conducting their duties.
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 balanced and informed decision-making. A policy need not be codified to be effective.

**Recommendation**

In reviewing board composition, the board should be aware of the benefit of diversity in its selection. It may be helpful to have a written diversity policy to further the selection process.

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What is the board's role in relation to the management of risk of the Portfolio Company?

**Explanation**

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**

Each member of the board is responsible for risk identification and management and should take an active role in ensuring that the management of the Portfolio Company establish effective policies and procedures that adequately address the identification and control of risk. Members of the board should actively and regularly seek assurance that risk management procedures are in place and are operating effectively.

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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. First and foremost is the development of long-term value creation through sources of current and future revenue. Of importance here are the efficient and effective delivery of appealing products and services, the development of competitive future products and services, attracting and retaining talent and management capacity, the effective use of available resources (including financial resources) and obtaining future financial resources to help grow the business effectively and efficiently.

**Recommendation**

A key component of the Industry’s investment and ownership model is to ensure that the interests of the members of the Portfolio Company board are aligned. All members of the board should seek to understand, support and further develop the business strategy of the Portfolio Company and should challenge that strategy in the context of their individual understanding of market, product, service and financial developments as appropriate. 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.

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What is the board's role in relation to the identification and assessment 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.

**Recommendation**

All members of the board should participate in risk and opportunity identification and assessment across all business areas, including the review of financial and non-financial factors.

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What about best practice governance guidance?

**Explanation**

There are a number of think tanks and organisations offering best practice guidance on the office of director and on the governance of boards. There are also variations between jurisdictions.

**Recommendation**

A GP in a position to nominate directors to boards of Portfolio Companies should be aware of best practice guidance and factor this into its own board nominations and expectations of its directors.

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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 availability to perform their duties fully.

**Recommendation**

A director should only accept the number of board seats that they can reasonably expect to discharge properly, 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 time to review of board information.

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

**Explanation**

Remuneration and reward mechanisms for investments in Portfolio Companies will include incentives which are determined by the GP (typically for senior level executives) as well as those determined by the board of the Portfolio Company. Sometimes these activities will be led by a remuneration committee.

The structure and remuneration of Portfolio Company executives and senior management should provide an incentive for excellent long-term performance and reward for sustainable results. 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.
However, frequently in Private Equity and Venture Capital investing, 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.

**Recommendation**

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.

### 3.4.3. Exercise of GP consents

The level of GP (investor) consents that are deemed appropriate, will be agreed when negotiating the Investment Agreement. This is considered in the section “GP’s consent to Portfolio Company actions and board appointments” above. It is the exercise of those consents, when managing an investment, that we turn to now.

**Question**

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

**Explanation**

Normally, an investment will be structured in such a way that certain proposals of the Portfolio Company will require consent from investors, including 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 the 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.

### 3.4.4. Exercise of influence on responsible investment factors

**Question**

How should a GP exercise its influence with regard to responsible investment factors relating to a Portfolio Company?

**Explanation**

A GP may be in a position of considerable influence as regards the development, implementation and monitoring of responsible investment policies within Portfolio Companies.

The GP, ideally through the information produced and provided by the Portfolio Company, should be in a position to identify, monitor and where necessary, support the mitigation of relevant risks and recognition and pursuit of opportunities in responsible investment matters within the Portfolio Company. 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.

The GP should ensure appropriate board level awareness of responsible investment matters relevant to the country and sector of the Portfolio Company, including familiarity with appropriate external guidance issued by national, supranational and private bodies.

**Recommendation**

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.

### 3.4.5. 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 and Venture Capital 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 and Venture Capital investments will have other stakeholders including, but not restricted to, employees, customers, suppliers, regulators, trade unions and the wider community.

**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 other stakeholders.
3.4.6. Follow-on investments

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

Explanation
It may be necessary or desirable to make further investments into a Portfolio Company (e.g. to fund future 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 further investments into a Portfolio Company by allowing the GP to retain an appropriate amount of capital 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 and should be supported by adequate written evidence that demonstrates a clear benefit to the Fund in making the further 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 GPs conflict of interest resolution procedures.

3.4.7. Under-performing 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;
- introducing changes in the Portfolio Company’s management team, perhaps introducing a senior level “trouble-shooter”; and
- agreeing to reschedule payments (e.g. loan or fixed payment commitments) 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 on a Portfolio Company’s directors (including “shadow” directors) if they permit that 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 under-performing investments, the GP should ensure that sufficient resources remain committed to the monitoring and management of more successful investments. 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.
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, 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 not simply a matter of the GP exercising its judgment to decide when value has been maximised or the extent of a loss minimised. There may be considerations other than “paper” profits or loss that are relevant when considering disposal (e.g. the future prospects of the Portfolio Company, and the GP’s reputation within the broader community). The GP may also have set out a divestment strategy to LPs in the Fund and co-investors and other syndicate members, which could impact upon when an investment can be realised.

**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.

3.5.2 Responsibility for divestment decision-making

**Question**
Who should make the decision to realise an investment?

**Explanation**
Any decision to realise an investment involves a comparison of the present certain value of an investment, its potential future value and the opportunities to realise that value in the future. It is important that the decision to dispose of an investment is subject to the same checks and procedures that an investment decision is subject to.

**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.

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 often be a key issue for the GP when disposing of an investment. During negotiations, the GP must consider the risks 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 should also take into account the remaining life of the Fund and the fact that in the future it may be difficult to draw down cash to meet liabilities in the event of a claim.

**Recommendation**
GPs should normally only give warranties and indemnities 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 so long as they remain outstanding. The GP may also take out insurance that affects the Fund’s ability to give warranties and indemnities and may help to meet the expectations of a potential purchaser.

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.

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. There are also risks of falls in the market.

Cash returned is also an important measure of performance; LPs may also have concerns about receiving Distributions in specie and there may be restrictions upon a holder’s ability to sell quoted securities, also known as “lock-up periods”.

3.5.5. 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 not simply a matter of the GP exercising its judgment to decide when value has been maximised or the extent of a loss minimised. There may be considerations other than “paper” profits or loss that are relevant when considering disposal (e.g. the future prospects of the Portfolio Company, and the GP’s reputation within the broader community). The GP may also have set out a divestment strategy to LPs in the Fund and co-investors and other syndicate members, which could impact upon when an investment can be realised.

**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.
Recommendation

GPs should carefully assess any non-cash offer consideration in an Exit balancing the immediate value of any 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

Although it might be the right time for one Fund to Exit (for example, because of the life cycle of a Fund), there may still be future value which can be created in the investment through a secondary buyout (where a Fund sells its majority stake in a Portfolio Company to a Fund managed by a different GP).

In these circumstances, there may well be conflict of interest issues: for example, price and whether warranties are to be given and the conditions attaching to them.

Recommendation

The sale of investments between Funds operated by the same GP is not recommended and could lead to legal consequences or be forbidden in some jurisdictions.

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 (LP Advisory Committees) for the Funds and that the LPs in both Funds are fully aware of the transaction.

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 be clearly separated and appropriate information barriers should be erected.

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 of its dealings on the market in the Portfolio Companies 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.

The GP should recognise and observe any applicable Codes of Conduct concerning responsible investment management which are relevant to the listed securities markets in which the GP operates.

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.

Where the GP retains a relationship with a Portfolio Company whose investments 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.
3.6 Distribution

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's constitutional documents at all times.

3.6.1 Distribution provisions

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 and how it may impact uncalled Commitments to the Fund are all important issues. Addressing these will 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 liability to the Fund.

Recommendation

The Fund's constitutional documents should include adequate provisions on Distributions. These provisions should address at least the following issues:

- how any Distributions in specie will be valued (generally this should be on a conservative basis and where freely tradable, reflect 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's constitutional documents;
- the extent to which Distributions will take account of taxation liabilities;
- the extent to which the GP may be permitted to re-invest 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's constitutional documents;
- LP Clawback provisions; and
- when Distributions will be made.

3.6.2 Timing of Distributions

When should Distributions be made?

Explanation

Distributions are expected to be made as soon as possible after an investment has been realised and proceeds have been received by the Fund. 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's constitutional documents.

Before making a Distribution, the GP should consider the Fund's 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 with LPs are at the essence of partnership. Ongoing relations with LPs are a vital issue for the GP to address to ensure 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

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 nor ensure that the full range of financial and extra-financial responsibilities are being considered.

Recommendation

The IPEV Reporting Guidelines and IPEV Valuation Guidelines should be followed.

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

1 First developed by EVCA, the Reporting Guidelines have now been transferred to the International Private Equity and Venture Capital Valuation Board (IPEV Valuation Board), of which EVCA is a founding member, for further development in an international context. The intention is that the EVCA Reporting Guidelines will eventually be replaced by the IPEV Reporting Guidelines. They will shortly be published for consultation before becoming an integral part of the EVCA Handbook.
### 3.7.2. Transparency to LPs

**Question**

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

**Explanation**

LP relations is an area where, unless it takes sufficient care, the GP can prejudice the interests of some or all LPs in a Fund. At the same time, in a number of circumstances a GP may be subject to confidentiality obligations to Portfolio Companies or third parties or may be subject to restrictions relating to insider dealing or market abuse.

The GP may also have to consider the need to disclose significant issues to LPs outside of established reporting obligations.

**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.

The GP should follow the agreed procedures for disclosure of conflicts of interest 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, responsible investment policy or commercial obligations. Subject to contractual and legal obligations, where practicable the GP should comply with those requests.

Although it is not obliged to provide all information requested by one LP to other LPs for whom it may not be relevant, the GP should ensure that there is parity of treatment of LPs and that all LPs are provided with key, relevant information regarding the Fund promptly (and normally at the same time).

### 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’s constitutional documents on reporting and, if relevant, meetings. The use of due diligence rooms can be an effective way to provide information to prospective LPs.

It is strongly recommended that an annual LP meeting is held. It 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, 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 of investments and divestments as and when they occur.

Quarterly 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 hub 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 LPs of 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 be conflicted. 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 LPs 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 LPs of 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.

Whenever any conflicts arise, it would be expected that the GP will consult with the LP Advisory Committee of the relevant Fund(s). Sometimes, however, the LP Advisory Committees of different Funds managed by the same GP meet together as one committee, or there may only be one committee for all Funds managed by a GP.

**Recommendation**

When LPs are consulted by the GP on a situation likely to involve a conflict of interest between any of the LPs, they should be immediately disclosed to the GP and the other LPs of the relevant Fund(s). In this way the situation can be discussed in an open manner. 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 our Industry facilitates an interactive relationship between the GP and the LPs is through the use of an LPAC. A well-functioning LPAC should help ensure good governance of the Fund by addressing conflicts of interests 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.

For legal reasons it is important that LPs do not become involved in the management of a Fund. In particular, LPs should not be involved in making investment or divestment decisions. This should be the sole responsibility of the GP. Nor are LPs able to represent or act on behalf of the GP in such matters which impact the governance of the Fund. The LPAC ought to be consulted on all conflicts of interest relating to the Fund.

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.

The role of the LPAC should be to advise and not to make decisions. It 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 relating to the Fund.

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 broad and 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 the discussion can be made.

**Recommendation**

The LPAC should be run on a good governance basis, with the agenda and supporting papers circulated in good time ahead of the meeting, members declaring any conflicts at the start of the meeting and formal minutes taken and circulated in a timely fashion. The minutes of any LPAC meeting should also be 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 be allowed to be held 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.

The role of the LPAC should be described in the Fund’s constitutional 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 in good time ahead of the meeting, members declaring any conflicts at the start of the meeting and formal minutes taken and circulated in a timely fashion. The minutes of any LPAC meeting should also be available to all LPs.

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**Question**
What issues should be addressed regarding Keyman Provisions in the Fund’s constitutional documents?

**Explanation**

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

**Recommendation**

The Fund’s constitutional 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.

Keymen 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 Keyman 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 Keyman ceases to devote the necessary time to a Fund (the triggering of the Keyman Provisions) should be clearly set out in the Fund’s constitutional documents.

Usually the triggering of Keyman Provisions causes the investment period to be temporarily suspended. The procedures for what happens next should enable the situation to be resolved promptly. The GP will normally tell all LPs immediately when the Keyman 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 Keyman to be replaced and so avoid the Keyman Provisions being triggered, or to resolve the situation if the Keyman Provisions have been triggered.

It is normal to require a majority vote of all LPs to agree to any Keyman replacements, or to lift the suspension of an investment period. It is important for the good governance of the Fund that LPs participate when a vote is required.
3.8 Secondaries

Question
What are Secondaries?

Explanation
The expression "Secondaries" may be used in different contexts in the industry. The first context 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. Fund interests in general are illiquid investments which are not traded on a recognised investment exchange. A privately negotiated contract of secondary sale is formed between transferor and transferee, usually subject to GP consent on behalf of the Fund. The GP and remaining LPs will be concerned in particular to ensure confidentiality provisions are observed in any such transfer and that all obligations are properly transferred so that the Fund may continue to function with the new investor in place.

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. This constitutes an investment realisation by the Fund. Depending on the circumstances, it may be that no alteration is required to the investment documents, or alternatively, new investment documents will be negotiated and put in place.

Recommendation
On the transfer of any asset, professional advice will be required to make sure no existing rights are contravened and that all obligations are properly transferred. Investors, be they GPs in Portfolio Companies or LPs in Funds, should be particularly careful not to breach confidentiality constraints and pre-emption rights in negotiating such transfers.

3.9 Winding up of a Fund

The liquidation of a Fund must be undertaken with care by the GP to ensure that neither the Fund, the LPs, nor the GP are exposed to unacceptable potential liabilities following liquidation.

3.9.1. Liquidation

Question
What issues should the GP address on liquidation?

Explanation
The liquidation of a Fund will, generally, mean that the assets will be distributed to LPs. This means that if claims are subsequently brought against the Fund, there are unlikely to be assets available to meet those claims.

Recommendation
On liquidation, the GP should make a thorough assessment of the risk of claims against the Fund and should ensure suitable sums are held in escrow/are 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.

3.9.2. Fund documents

Question
What provisions should the Fund’s constitutional documents include on liquidation?

Explanation
The GP’s powers and responsibilities on liquidation will usually be set out in the Fund’s constitutional documents. It is important that these provisions are clear and exhaustive to reduce the likelihood of disputes on liquidation.
### 3.10 Management of multiple Funds

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

#### 3.10.1 Conflicts of interest

**Question**

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

**Explanation**

Conflicts of interest can arise relatively easily where a GP manages multiple Funds. For example, one Fund managed by a GP may acquire an investment being disposed of by another, or opportunities for follow-on investment 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 (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 all conflicts of interest with the LPAC before making any decision about the best course of action to take. The GP should establish procedures to identify, disclose and resolve conflicts of interest. These should be set out in the Fund’s constitutional documents.

### 3.10.2 Establishment of new Funds

**Question**

When can 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 dilute the return to LPs in the existing Fund and compromise the GP’s ability to implement the existing Fund’s investment policy. It can also give rise to conflicts of interest if an investment in a Portfolio Company is split between different Funds.

**Recommendation**

A GP should seek to avoid making new investments in a Portfolio Company from more than one Fund which it manages. In general, a new Fund should not be established until the existing Fund is substantially invested/committed. Specific limits on when a new Fund may be marketed or closed are often set out in the Fund’s constitutional documents.

### 3.11 GP’s internal organisation

For the purposes of this section 3.11, management are those members of the board who have executive roles within the GP’s organisation and those other employees of the organisation 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 specific and detailed implementation of the strategy.

The GP has responsibility to ensure that it has adequate resources to source, analyse, negotiate and advise on potential transactions as well as to invest in, manage and divest Portfolio Companies. This includes, in particular, human resources (of the right calibre and with the requisite skills and experience) and financial resources.

#### 3.11.1 Management are responsible for establishing the control environment

**Question**

How should management go about establishing the control environment?

**Explanation**

Management are responsible for ensuring that throughout the GP organisation employees recognise and respond to the need for integrity and ethical behaviour in relation to the achievement of the GP’s and its investment portfolio’s goals. A high standard of corporate governance sets the framework to meet these goals 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.
3.11.2. Management are responsible for establishing procedures for risk assessment

**Question**
What procedures should be established for appropriate risk assessment on an ongoing basis?

**Explanation**
Risk assessment includes determining an appropriate risk appetite, identifying specific risks, assessing the effectiveness of controls over specific risks and comparing residual risk to the overall appetite for risk that has been agreed. Effective procedures for risk assessment cover strategic and operational matters and operate on a regular and rolling basis.

Any procedures or processes introduced to an organisation should normally be subjected to an analysis comparing cost and benefits. The introduction of risk assessment procedures should acknowledge that much of what happens in business process is the proactive assessment and mitigation of risk and that therefore the introduction of risk assessment procedures is partly a matter of making explicit what is already in place. This is particularly true in the case of Private Equity and Venture Capital firms that typically will have well developed risk assessment and mitigation approaches and processes.

**Recommendation**
Risk assessment should cover at least:
- strategic risk;
- risk within the core business processes; and
- risk within the resource management processes.

Where appropriate, specialist help and advice should be sought when dealing with specific risk areas, for example market/public relations risk, treasury risk, labour relations risk, regulatory risk or information technology risk. The assessment of risk should be a regular ongoing process and not a “once a year” exercise.

3.11.3. Management are responsible for control activities

**Question**
How can management fulfil their obligations in respect of control activities?

**Explanation**
Control activities are those elements 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 are 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.

**Recommendation**
Management should ideally conduct a review of control activities on a regular basis covering both the design and operation of those activities.

3.11.4. 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 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.

3.11.5. 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 returns to LPs.

**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. The GP should ensure that Carried Interest and similar arrangements are structured in a balanced manner to motivate 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.

3.11.6. Financial resources

**Question**
What financial resources should the GP maintain?

**Explanation**
It is important that the GP monitors its own financial resources to ensure that they remain sufficient to allow the GP to trade and to implement the investment policies of the Funds under management.
While the efficient operation of the GP will be ensured by adhering to general principles of good governance and general business management, there are certain matters that are specific to the industry that the GP should address.

### 3.11.7. Segregation of Fund assets

**Question**

Should the GP make particular arrangements regarding 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. To ensure that this is the case, Fund assets must be segregated from the GP’s own assets.

**Recommendation**

The GP should make appropriate arrangements to ensure that Fund assets (including cash) are segregated from its own assets.

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.

### 3.11.8. Procedures and organisation

**Question**

What other procedures and organisational measures should the GP implement?

**Explanation**

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

**Recommendation**

The GP should implement internal financial reporting procedures to ensure that it effectively monitors its financial position on an ongoing basis. If the GP becomes aware that its financial resources have been seriously eroded, it should liaise with the LPs in its Funds to agree suitable measures to remedy the situation.

- The GP should make provision for internal review procedures which allow the board of the GP to gain a reasonable 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.

### 3.11.9. 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 reasonable level of comfort that the terms of the agreement with any LP or customer and any applicable legal requirements are being followed.

### 3.11.10. Management are 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; and
- provided 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 technology 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.

Question
How should management approach communication of information?

Explanation
Management need to communicate both internally within the GP and externally with LPs and advisors.

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; and
- delivered in a timely manner.

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

Explanation
GPs should have an external website in order to provide basic information regarding themselves and their investments in a timely fashion.

The GP’s website should include information on:

- the legal structures (form) of its Funds;
- an overview of the GP ownership structure;
- the Keymen or key employees;
- size and investment strategy of the different Funds;
- Fund investors by category and geography;
- primary contact person for each Portfolio Company;
- investments made with the following information about each Portfolio Company:
  - date of investment
  - date of divestment
  - type of industry and turnover
  - link to the Portfolio Company’s website
- applicable guidelines for portfolio valuation and reporting to investors;
- policies regarding handling of potential conflicts of interest;
- policies regarding responsible investment;
- press releases issued by the GP and the name of the individual who is the press contact.

3.11.11. 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 and technological) may be requested.

3.11.12. 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
- policies and procedures
- 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).
3.12 Responsible investment factors

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 responsible investment factors such as environmental, social and governance (ESG) factors throughout the period of its investment.

3.12.1 Approach to responsible investment

How should a GP approach responsible investment factors?

A GP should be mindful of the risks posed and opportunities presented to its Portfolio Companies by responsible investment 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 as regards reporting on responsible investment factors in the investment and ownership processes and in some cases exclusions from investing in certain sectors.

Recommendation

GP s 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 addressed. Evaluation of responsible investment matters should not be limited to legal compliance, but could also include potential future regulation and marketplace factors such as existing or emerging voluntary standards; consumer expectations and client requirements; and broader issues that could have reputational impact.

Explanation

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3.12.2. Environmental factors

**Question**
What environmental factors would be applicable to the conduct of the Fund’s Portfolio Companies?

**Explanation**
Generally, GPs should support a prudential approach to environmental challenges within their Portfolio Companies. These challenges could concern a range of factors including resource use, waste production and disposal, emissions to air, land and water; energy use, cost of carbon and climate change; biodiversity and habitat conservation.

**Recommendation**
Due diligence into prospective investments should include an evaluation of the likely environmental impact of the conduct of such business. The boards of Portfolio Companies should be required to send unsolicited reports on responsible investment factors to all LPs.

3.12.3. Social factors

**Question**
What social factors would be applicable to the conduct of the Fund’s Portfolio Companies?

**Explanation**
Human rights 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 may also consider introducing a corporate social responsibility programme and publishing corporate social responsibility reports. A GP should ensure that such items are put on the agenda for board discussion where appropriate.

**Recommendation**
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. If not already in place, the GP should typically ensure that each Portfolio Company has appropriate governance structures to safeguard against fraud, bribery and corruption and to ensure internal financial control, quality assurance, risk and conflict management and transparent reporting and communication. Ensuring these 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.

3.12.4. Governance factors

**Question**
What governance processes 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 and the GP itself. Further relationships with third parties such as business partners, suppliers and regulators should be strengthened.

**Recommendation**
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 good practice and guidance in the respective countries and industries in which its Portfolio Companies are based. This can be done in a number of ways, for example through a suitable law firm or advisor 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. Also, by recruiting and installing experienced executives to 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. Finally, it is important that the GP also demonstrates to its wider stakeholder community sound environmental, social and governance (ESG) practices and standards that are both appropriate and proportionate to its own business.
Carried Interest
A share of the gains realised from a Fund’s underlying investments. 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 20 per cent of the Fund’s net gains and is payable to the GP only once LPs have been repaid an amount equal to their drawn down Commitments plus a “preferred return”. Depending on the jurisdiction, the GP may be required to make a significant investment alongside the LPs in the Fund to obtain the right to receive Carried Interest. 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 a combination of the use of escrow arrangements (where a certain portion of the Carried Interest is put into an escrow account to secure clawback obligations) and periodic or annual true-up mechanisms.

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” 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 at the end of the life of the Fund, when all proceeds have been distributed. 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 the Fund.

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 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 EVCA members and their affiliates.

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 club together to acquire a majority stake in a Portfolio Company.

Commitment(s) or 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, 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 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”.

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Exit(s)
Realisations of investments made by a Fund. This will normally take the form of a sale or flotation (IPO) of the Portfolio Company.

Fund(s)
A Private Equity or Venture Capital Fund. 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.

Fundraising and Fundraising Team
The process by which money is raised to create a Fund. Funds are typically raised directly by the professionals (Fundraising Team) who are actively involved in the sourcing, analysis, negotiation and subsequent monitoring of potential transactions on behalf of the Fund. 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.

GP
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
Private Equity and Venture Capital Industry.
“Investment Agreement”  
This is the agreement typically entered into by the Fund(s), the GP, the Portfolio Company(ies) and the management team of the Portfolio Company, which sets out the investment to be made by the Fund(s) in the Portfolio Company and the terms agreed between the Portfolio Company shareholders.

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”  
In a Fund, this is the rate at which the internal rate of return earned by investors/LPs is calculated to a stated date.

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

IRRs can be stated on a net basis (meaning net of fees, expenses and Carried Interest) or a gross basis (meaning inclusive of fees and before the deduction of Carried Interest).

“Keyman(men)” and “Keyman Provisions”  
The key senior 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 Keymen. Provisions are made regarding what happens should any of these individuals cease to devote sufficient time to the Fund, so called Keyman Provisions.

“LP”  
An investor in a Fund. More specifically it means the limited partner in a Limited Partnership. LPs in a Fund include, as examples, institutional investors, 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 and Venture Capital Funds. It is used especially when catering for broad categories of international investors and looking to make cross-border investments. The partnership is usually a fixed-term investment vehicle, and consists of a general partner (the GP) 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 conflicts of interest and generally to act 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. The Industry’s basic partnership model of investments between LPs and GPs rests on the 80/20 split of profits. 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, funded out of LP Commitments, is generally equal to a certain percentage of the committed capital of the Fund during the Investment Period and then as a percentage of the cost of investments still held by the Fund.

“Most Favoured Nation”  
A Most Favoured Nation (or “MFN”) clause is a common protection sought by LPs found in the constitutional documents or the side letter. In an MFN provision, the GP assures the LP that it will benefit from side letter provisions granted to other LPs. The MFN provision usually carves out side letter provisions that relate to tax or regulatory considerations of individual LPs.

“Placement Agent”  
A person or entity acting as an agent for the Fundraising Team in raising investment funds.

“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 industries. The term is widely used and encompasses Venture Capital (typically a minority stake invested in an early-stage or pre-profitable business), through to enterprise capital (a minority or majority stake invested in Portfolio Companies at critical points of their development). When majority stakes are acquired through enterprise capital investments, these are commonly referred to as “buyout” transactions.

“Secondary Investments” or “Secondaries”  
These terms are typically used to refer to the transfer of an LP’s contractual commitment and interest in an existing Fund to another LP (“secondary fund 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 corporate finance or M&A fee charged by the GP to the holding company making the acquisition of a Portfolio Company.

Broken Deal Fees (also referred to as “abortion costs”) are costs incurred by the GP in pursuing a deal that falls through (e.g. accountants, lawyers, due diligence costs etc).

Such fees can be offset against the Management Fee.

“Venture Capital”  
Funding typically provided in equity form to companies in early stages of their life cycles, i.e. seed, early-stage, development, or expansion. Historically the term was used to refer generally to all Private Equity investments which is why many Private Equity associations refer only to Venture Capital in their name.
IPEV Valuation Guidelines

This document includes the latest International Private Equity and Venture Capital (IPEV) Valuation Guidelines (edition August 2010), which are also available on the IPEV website at www.privateequityvaluation.com.

For all the latest updates to the Guidelines and/or to ask questions to the IPEV Board, please visit the IPEV website. The site also includes a complete listing of endorsing associations and IPEV supporters.
These guidelines have been developed by the IPEV Board with the valuable input and endorsement of the following associations:

- AFIC - Association Française des Investisseurs en Capital*
- AIFI - Italian Private Equity and Venture Capital Association
- AMEXCAP - Mexican Private Equity Association
- AMIC - Moroccan Private Equity and Venture Capital Association
- APCCI - Portuguese Private Equity and Venture Capital Association
- APREA - Arab Private Equity Association
- ASCRI - Spanish Private Equity and Venture Capital Association
- ATEC - Tunisian Venture Capital Association
- AVEC - African Venture Capital Association
- AVCAL - Australian Private Equity and Venture Capital Association
- AVCO - Austrian Private Equity and Venture Capital Organization
- BVA - Belgian Venture Association
- BVCA - British Venture Capital Association*
- BVMK - German Private Equity and Venture Capital Association e.V.
- CVCA - Canada's Venture Capital and Private Equity Association
- CVCA - China Venture Capital Association
- CVCA - Czech Venture Capital and Private Equity Association
- DAVCA - Danish Venture Capital Association
- EMPEA - Emerging Markets Private Equity Association
- EVCA - European Private Equity and Venture Capital Association*
- FVCA - Finnish Venture Capital Association
- GAVCA - Gulf Venture Capital Association
- HAVCA - Hong Kong Venture Capital Association
- HVCA - Hungarian Venture Capital and Private Equity Association
- ILPA - Institutional Limited Partners Association
- IVCA - Irish Venture Capital Association
- LAEVCA - Latin American Venture Capital Association
- LPEQ - LPEQ Listed Private Equity
- LVCA - Latvian Venture Capital Association
- NVCA - Norwegian Venture Capital & Private Equity Association
- NVP - Nederlands Vereniging van Participatemaatschappijen (Dutch Private Equity and Venture Capital Association)
- NZVCA - New Zealand Private Equity & Venture Capital Association
- PFEA - Polish Private Equity Association
- Réseau Capital - Québec Venture Capital and Private Equity Association
- RVCA - Russian Private Equity and Venture Capital Association
- SAIVCA - Southern African Venture Capital and Private Equity Association
- SECA - Swiss Private Equity and Corporate Finance Association
- SLOVCA - Slovak Venture Capital Association
- SVCA - Singapore Venture Capital and Private Equity Association
- SVCA - Swedish Private Equity and Venture Capital Association

*AFIC, BVCA and EVCA founded the IPEV Board in 2005.

ENDORSEMENT AS OF 31 JANUARY 2011

INTERNATIONAL PRIVATE EQUITY AND VENTURE CAPITAL VALUATION GUIDELINES
Disclaimer
The information contained within this paper has been produced with reference to the contributions of a number of sources. The IPEV Board has taken suitable steps to ensure the reliability of the information presented. However, the IPEV Board nor other named contributors, individuals or associations can accept responsibility for any decision made or action taken, based upon this paper or the information provided herein.
For further information please visit: www.privateequityvaluation.com

Contents

PREFACE 6
INTRODUCTION 7
DEFINITIONS 8

SECTION I: DETERMINING FAIR VALUE 10
1. The Concept of Fair Value 11
2. Principles of Valuation 11
3. Valuation Methodologies 14
3.1. General 14
3.2. Selecting the Appropriate Methodology 14
3.3. Price of Recent Investment 15
3.4. Multiples 17
3.5. Net Assets 20
3.6. Discounted Cash Flows or Earnings (of Underlying Business) 21
3.7. Discounted Cash Flows (from the Investment) 21
3.8. Industry Valuation Benchmarks 22
3.9. Available Market Prices 23
4. Valuing Fund Interests 24
4.1. General 24
4.2. Adjustments to Net Asset Value 24
4.3. Secondary Transactions 25

SECTION II: APPLICATION GUIDANCE 26
Introduction 27
1. Specific Considerations 27
1.1. Insider Funding Rounds 27
1.2. Distressed Market 27
1.3. Deducting Higher Ranking Instruments 28
1.4. Bridge Financing 28
1.5. Mezzanine Loans 28
1.6. Rolled up Loan Interest 29
1.7. Indicative Offers 29
1.8. Impacts from Structuring 29

ENDORsing ASSOCIATIONS 31
These Guidelines set out recommendations, intended to represent current best practice, on the valuation of private equity and venture capital investments. The term “private equity” is used in these Guidelines in a broad sense to include investments in early stage ventures, management buyouts, management buy-ins and similar transactions and growth or development capital.

The recommendations are intended to be applicable across the whole range of Private Equity Funds (seed and start-up venture capital, buyouts, growth/development capital, etc) and financial instruments commonly held by such Private Equity Funds. They also provide a basis for valuing investments by other entities, including Funds-of-funds, in such Private Equity Funds.

The recommendations themselves are surrounded by a border and set out in bold type, whereas explanations, illustrations, background material, context and supporting commentary, which are provided to assist in the interpretation of the recommendations, are set out in normal type.

Where there is conflict between a recommendation contained in these Guidelines and the requirements of any applicable laws or regulations or accounting standard or generally accepted accounting principle, the latter requirements should take precedence.

No member of the International Private Equity and Venture Capital Valuation Guidelines (‘IPEV Guidelines’) Board (‘IPEV Board’), any committee or working party thereof can accept any responsibility or liability whatsoever (whether in respect of negligence or otherwise) to any party as a result of anything contained in or omitted from the Guidelines nor for the consequences of reliance or otherwise on the provisions of these Guidelines.

These Guidelines should be regarded as superseding previous Guidelines issued by the IPEV Board with effect for reporting periods post 1 July 2009.

Private equity managers may be required to carry out periodic valuations of investments as part of the reporting process to investors in the Funds they manage. The objective of these Guidelines is to set out best practice where private equity investments are reported at ‘Fair Value’, with a view to promoting best practice and hence helping investors in Private Equity Funds make better economic decisions.

The increasing importance placed by international accounting authorities on Fair Value reinforces the need for the consistent use of valuation standards worldwide and these Guidelines provide a framework for consistently determining valuations for the type of investments held by Private Equity Funds.

Private Equity Funds are typically governed by a combination of legal or regulatory provisions or by contractual terms. It is not the intention of these Guidelines to prescribe or recommend the basis on which Investments are included in the accounts of Funds. The IPEV Board confirms fair value as the best measure of valuing private equity portfolio companies and investments in private equity funds. The board’s support for fair value is underpinned by the transparency it affords investors in funds, which use fair value as an indication of the interim performance of a portfolio. In addition, institutional investors require fair value to make asset allocation decisions, and to produce financial statements for regulatory purposes.

The requirements and implications of financial reporting standards and in particular International Financial Reporting Standards and US GAAP have been considered in the preparation of these Guidelines. This has been done, in order to provide a framework for Private Equity Funds for arriving at a Fair Value for Investments which is consistent with accounting principles.

It is not a requirement of accounting principles that these Guidelines are followed. However compliance with these accounting principles can be achieved by following the Guidelines.

These Guidelines are intended to represent current best practice and therefore will be revisited and, if necessary, revised to reflect changes in international regulation or accounting standards.

These Guidelines are concerned with valuation from a conceptual standpoint and do not seek to address best practice as it relates to investor reporting, internal processes, controls and procedures, governance aspects, Committee oversight, the experience and capabilities required of the Valuer or the audit or review of valuations.

A distinction is made in these Guidelines between the basis of valuation (Fair Value), which defines what the carrying amount purports to represent, a valuation methodology (such as the earnings multiple technique), which details the method or technique for deriving a valuation, and inputs used in the valuation methodology (such as EBITDA).
The following definitions shall apply in these Guidelines:

**Active Market**

A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm’s length basis.

A market is considered active when transactions are taking place regularly at an arm’s length basis with sufficient volume and frequency to determine a price on an ongoing basis. The necessary level of trading required to meet these criteria is a matter of judgement.

**Attributable Enterprise Value**

The Attributable Enterprise Value is the Enterprise Value attributable to the financial instruments held by the Fund and other financial instruments in the entity that rank alongside or beneath the highest ranking instrument of the Fund.

**Distressed or Forced Transaction**

A forced liquidation or distress sale (i.e., a forced transaction) is not an orderly transaction and is not determinative of Fair Value. An entity applies judgement in determining whether a particular transaction is distressed or forced.

**Enterprise Value**

The Enterprise Value is the value of the financial instruments representing ownership interests in an entity plus the net financial debt of the entity.

**Fair Value**

The Fair Value is the price at which an orderly transaction would take place between Market Participants at the Reporting Date (measurement date).

**Fund or Private Equity Fund**

The Fund or Private Equity Fund is the generic term used in these Guidelines to refer to any designated pool of investment capital targeted at all stages of private equity investment from start-up to large buyout, including those held by corporate entities, limited partnerships and other investment vehicles.

**Fund-of-Funds**

Fund-of-Funds is the generic term used in these Guidelines to refer to any designated pool of investment capital targeted at investment in underlying Private Equity Funds.

**Investee Company**

The term Investee Company refers to a single business or group of businesses in which a Fund is directly invested.

**Investment**

An Investment refers to all of the financial instruments in an Investee Company held by the Fund.

**Liquidity**

Liquidity is defined as the relative ease and promptness with which an instrument may be sold when desired.

**Market Participants**

Market Participants are potential or actual willing buyers or willing sellers when neither is under any compulsion to buy or sell, both parties having reasonable knowledge of relevant facts and who have the ability to perform sufficient due diligence in order to be able to make orderly investment decisions related to the enterprise.

**Net Asset Value (‘NAV’)**

NAV of a Fund is the amount estimated as being attributable to the investors in that Fund on the basis of the Fair Value of the underlying Investee Companies and other assets and liabilities.

**Orderly Transaction**

An orderly transaction is a transaction that assumes exposure to the market for a period prior to the Reporting Date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities.

**Quoted Instrument**

A Quoted Instrument is any financial instrument for which quoted prices reflecting normal market transactions are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency.

**Realisation**

Realisation is the sale, redemption or repayment of an Investment, in whole or in part; or the insolvency of an Investee Company, where no significant return to the Fund is envisaged.

**Reporting Date**

The date for which the valuation is being prepared, which equates to the measurement date.

**Secondary Transaction**

A Secondary Transaction refers to a transaction which takes place when a holder of an interest in unquoted or illiquid Funds trades their interest to another party.

**Unquoted Instrument**

An Unquoted Instrument is any financial instrument other than a Quoted Instrument.

**Underlying Business**

The Underlying Business is the operating entities in which the Fund has invested, either directly or through a number of dedicated holding companies.

**Valuer**

The Valuer is the person with direct responsibility for valuing one or more of the Investments of the Fund or Fund-of-Funds.
Section I: Determining Fair Value

1. The Concept of Fair Value

The Fair Value is the price at which an orderly transaction would take place between Market Participants at the Reporting Date. For Quoted Instruments, available market prices will be the primary basis for the determination of Fair Value. For Unquoted Investments, the estimation of Fair Value requires the Valuer to assume the Underlying Business is realised at the Reporting Date, appropriately allocated to the various interests, regardless of whether the Underlying Business is prepared for sale or whether its shareholders intend to sell in the near future.

The objective is to estimate the hypothetical exchange price at which Market Participants would agree to transact at the Reporting Date. Fair Value is not the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distressed sale. However, the hypothetical exchange price must take into account current market conditions for buying and selling assets.

Although transfers of shares in private businesses are often subject to restrictions, rights of pre-emption and other barriers, it should still be possible to estimate what amount a willing buyer would pay to take ownership of the Investment.

2. Principles of Valuation

The Fair Value of each Investment should be assessed at each Reporting Date.

In the absence of an active market for a financial instrument, the Valuer must estimate Fair Value utilizing one or more of the valuation methodologies.

In estimating Fair Value for an Investment, the Valuer should apply a methodology that is appropriate in light of the nature, facts and circumstances of the Investment and its materiality in the context of the total Investment portfolio and should use reasonable data and market inputs, assumptions and estimates.
2. Principles of Valuation

In private equity, value is generally crystallised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes, the value of the business as a whole at the Reporting Date (Enterprise Value) will often provide a key insight into the value of investment stakes in that business.

The Fair Value is estimated by the Valuer, from the Enterprise Value, as follows:

(i) Determine the Enterprise Value of the Investee Company using the valuation methodologies;
(ii) Adjust the Enterprise Value for surplus assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;
(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund’s Investment to derive the Attributable Enterprise Value;
(iv) Apportion the Attributable Enterprise Value between the company’s relevant financial instruments according to their ranking;
(v) Allocate the amounts derived according to the Fund’s holding in each financial instrument, representing their Fair Value.

It is important to recognise the subjective nature of private equity investment valuation. It is inherently based on forward-looking estimates and judgements about the Underlying Business itself, its market and the environment in which it operates, the state of the mergers and acquisitions market, stock market conditions and other factors that exist at the Reporting Date.

Due to the complex interaction of these factors and often the lack of directly comparable market transactions, care should be applied when using publicly available information regarding other entities in deriving a valuation. In order to determine the Fair Value of an Investment, the Valuer will have to exercise judgement and make necessary estimates to adjust the market data to reflect the potential impact of other factors such as geography, credit risk, foreign currency, rights attributable, equity prices and volatility.

As such, it must be recognised that, whilst valuations do provide useful interim indications of the progress of a particular Investment or portfolio of Investments, ultimately it is not until Realisation that true performance is firmly determined. A Valuer should be aware of reasons why realisation proceeds are different from their estimates of Fair Value.

Fair Value should reflect reasonable estimates and assumptions for all significant factors that parties to an arm’s length transaction would be expected to consider, including those which impact upon the expected cash flows from the Investment and upon the degree of risk associated with those cash flows. In assessing the reasonableness of assumptions and estimates, the Valuer should:

- note that the objective is to replicate those that the parties in an arm’s-length transaction would make at the Reporting Date;
- take account of events taking place subsequent to the Reporting Date where they provide additional evidence of conditions that existed at the Reporting Date;
- take account of current market conditions at the reporting date; and
- take account of materiality considerations.

Because of the uncertainties inherent in estimating Fair Value for private equity Investments, care should be applied in exercising judgement and making the necessary estimates. However, the Valuer should be wary of applying excessive caution.

Private Equity Funds often undertake an Investment with a view to build, develop and/or to effect substantial changes in the Underlying Business, whether it is to its strategy, operations, management, or financial condition. Sometimes these situations involve rescue refinancing or a turnaround of the business in question. Whilst it might be difficult in these situations to determine Fair Value, it should in most cases be possible to estimate the amount a Market Participant would pay for the Investment in question.

There may be situations where:

- the range of reasonable Fair Value estimates is significant;
- the probabilities of the various estimates within the range cannot be reasonably assessed;
- the probability and financial impact of achieving a key milestone cannot be reasonably predicted; and
- there has been no recent investment into the business.

While these situations prove difficult, the Valuer must still come to a conclusion as to their best estimate of the hypothetical exchange price between willing Market Participants.

Estimating the increase or decrease in Fair Value in such cases may involve reference to broad indicators of value change (such as relevant stock market indices). After considering these broad indicators, in some situations, the Valuer might reasonably conclude that the Fair Value at the previous Reporting Date remains the best estimate of Fair Value.

Where a change in Fair Value is perceived to have occurred, the Valuer should amend the carrying value of the Investment to reflect the estimated impact.

Apportion the Attributable Enterprise Value appropriately

The apportionment should reflect the respective amounts accruing to each financial instrument holder in the event of a sale or flotation at the Reporting Date. As discussed further in section 1.3.8, where there are ratchets or share options or other mechanisms (such as ‘liquidation preferences’, in the case of Investments in early-stage businesses) in place which are likely to be triggered in the event of a sale of the company at the given Enterprise Value at that date, these should be reflected in the apportionment.

The estimation of Fair Value should be undertaken on the assumption that options and warrants are exercised, where the Fair Value is in excess of the exercise price and accordingly it is a reasonable assumption that these will be exercised. The aggregate exercise price of these may result in surplus cash arising in the Underlying Business if the aggregate exercise price is significant.

Differential allocation of proceeds may have an impact on the value of an Investment. If liquidation preferences exist, these need to be reviewed to assess whether they are expected to give rise to a benefit to the Fund, or a benefit to a third party to the detriment of the Fund.

Where significant positions in options and warrants are held by the Fund, these may need to be valued separately from the underlying Investments using an appropriate option-based pricing model.
3. Valuation Methodologies

3.1. General
A number of valuation methodologies that may be considered for use in estimating the Fair Value of Unquoted Instruments are described in sections 3.3. to 3.8. below. These methodologies should be amended as necessary to incorporate case-specific factors affecting Fair Value. Methodologies for valuing Quoted Instruments are described in section 3.9. below.

For example, if the Underlying Business is holding surplus cash or other assets, the value of the business should reflect that fact.

Because, in the private equity arena, value is generally crystallised through a sale or flotation of the entire Underlying Business, rather than through a transfer of individual shareholder stakes, the value of the business as a whole at the Reporting Date will often provide a key insight into the value of investment stakes in that business. For this reason, a number of the methodologies described below involve estimating the Enterprise Value as an initial step.

There will be some situations where the Fair Value will derive mainly from the expected cash flows and risk of the relevant financial instruments rather than from the Underlying Business. The valuation methodology used in these circumstances should therefore reflect this fact.

In determining the Fair Value of an Investment, the Valuer should use judgement. This includes a detailed consideration of those specific terms of the investment which may impact its Fair Value. In this regard, the Valuer should consider the substance of the Investment, which may take preference over the strict legal form.

Movements in rates of exchange may impact the value of the Fund’s Investments and these should be taken into account.

Where the reporting currency of the Fund is different from the currency in which the Investment is denominated, translation into the reporting currency for reporting purposes should be done using the bid spot exchange rate prevailing at the Reporting Date.

3.2. Selecting the Appropriate Methodology

The Valuer should exercise their judgement to select the valuation methodology that is the most appropriate for a particular Investment.

The key criterion in selecting a methodology is that it should be appropriate in light of the nature, facts and circumstances of the Investment and its materiality in the context of the total portfolio of Investments. The Valuer may consider utilising further methodologies to check the Fair Value derived, if appropriate.

When selecting the appropriate methodology each Investment should be considered individually. Where an immaterial group of Investments in a portfolio are similar in terms of risk profile and industry, it is acceptable to apply the same methodology across all Investments in that immaterial group. The methodology applied should be consistent with that used for material Investments with a similar risk profile in that industry.

An appropriate methodology will incorporate available information about all factors that are likely materially to affect the Fair Value of the Investment.

The Valuer will select the valuation methodology that is the most appropriate and consequently make valuation adjustments on the basis of their informed and experienced judgement. This will include consideration of factors such as:

- the relative applicability of the methodologies used given the nature of the industry and current market conditions;
- the quality and reliability of the data used in each methodology;
- the comparability of enterprise or transaction data;
- the stage of development of the enterprise;
- the ability of the enterprise to generate maintainable profits or positive cashflow; and
- any additional considerations unique to the enterprise.

In assessing whether a methodology is appropriate, the Valuer should be biased towards those methodologies that draw heavily on market-based measures of risk and return. Fair Value estimates based entirely on observable market data should be of greater reliability than those based on assumptions. In some cases observable market data may require adjustment by the Valuer to properly reflect the facts and circumstances of the entity being valued. This adjustment should not be automatically regarded as reducing the reliability of the Fair Value estimate.

Methodologies utilising discounted cashflows and industry benchmarks should only be used in isolation of the market-based measures and then only with extreme caution. These methodologies may be useful as a cross-check of values estimated using the market-based methodologies.

Where the Valuer considers that several methodologies are appropriate to value a specific Investment, the Valuer may consider the outcome of these different valuation methodologies so that the results of one particular method may be used as a cross-check of values or to corroborate or otherwise be used in conjunction with one or more other methodologies in order to determine the Fair Value of the Investment.

3.3. Price of Recent Investment

Where the Investment being valued was itself made recently, its cost may provide a good indication of Fair Value. Where there has been any recent Investment in the Investee Company, the price of that Investment will provide a basis of the valuation.

The validity of a valuation obtained in this way is inevitably eroded over time, since the price at which an Investment was made reflects the effects of conditions that existed on the date that the transaction took place. In a dynamic environment, changes in market conditions, the passage of time itself and other factors will act to diminish the value of recent transactions. The price of a recent Investment may therefore be reduced by the Valuer to reflect the impact of these factors.

Methodologies should be applied consistently from period to period, except where a change would result in better estimates of Fair Value.

The basis for any changes in valuation methodologies should be clearly understood. It is expected that there would not be frequent changes in valuation methodologies over the course of the life of an investment.

The table below identifies a number of the most widely used methodologies:

<table>
<thead>
<tr>
<th>METHODOLOGY</th>
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<tbody>
<tr>
<td>Price of Recent Investment</td>
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<tr>
<td>Multiples</td>
<td></td>
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<tr>
<td>Dividends</td>
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<tr>
<td>Discounted cash flows or earnings</td>
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<td>Discounted cash flows (from the</td>
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<td>Investment)</td>
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<td>Industry valuation benchmarks</td>
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For example, methodological benchmarks should be consistent with comparable market benchmarks so that the results of one particular method may be used as a cross-check of values or to corroborate or otherwise be used in conjunction with one or more other methodologies in order to determine the Fair Value of the Investment.
3. Valuation Methodologies

In particular, the following factors may indicate that the price was not wholly representative of the Fair Value at the time:

- different rights attach to the new and existing Investments;
- disproportionate dilution arising from a new investor; or
- a new investor motivated by strategic considerations;
- the transaction may be considered to be a forced sale or ‘rescue package’; or
- the absolute amount of the new investment is relatively insignificant.

This methodology is likely to be appropriate for all private equity investments, but only for a limited period after the date of the relevant transaction. Because of the frequency with which funding rounds are often undertaken for seed and start-up situations, or in respect of businesses engaged in technological or scientific innovation and discovery, the methodology will often be appropriate for valuing Investments in such circumstances.

The length of period for which it would remain appropriate to use this methodology will depend on the specific circumstances of the investment and is subject to the judgement of the Valuer.

In stable market conditions with little change in the entity or external environment, the length of period for which this methodology is likely to be appropriate will be longer than during a period of a rapidly changing environment.

The Price of Recent Investment methodology is commonly used in a seed, start-up or an early-stage situation, where there are no current and no short-term future earnings or positive cash flows. For these enterprises, typically, it is difficult to gauge the probability and financial impact of the success or failure of development or research activities and to make reliable cash flow forecasts.

Consequently, the most appropriate approach to determine Fair Value is a methodology that is based on market data, that being the Price of a Recent Investment.

If the Valuer concludes that the Price of Recent Investment, unchanged, is no longer relevant, and there are no comparable companies or transactions from which to infer value, it may be appropriate to apply an enhanced assessment based on an industry analysis, sector analysis and/or milestone analysis.

In such circumstances, industry-specific benchmarks/milestones, which are customarily and routinely used in the specific industries of the Investee Company, can be used in estimating Fair Value where appropriate. In applying the milestone approach, the Valuer attempts to ascertain whether there has been a change in the milestone and/or benchmark which would indicate that the Fair Value of the investment has changed.

For an investment in early or development stages, commonly a set of agreed milestones would be established at the time of making the investment decision. These will vary across types of investment, specific companies and industries, but are likely to include;

**Financial measures:**
- revenue growth;
- profitability expectations;
- cash burn rate;
- covenant compliance.

**Technical measures:**
- phases of development;
- testing cycles;
- patent approvals.

**Marketing and sales measures:**
- customer surveys;
- testing phases;
- market introduction;
- market share.

In addition, the key market drivers of the Investee Company, as well as the overall economic environment are relevant to the assessment.

In applying the milestone analysis approach, the Valuer attempts to assess whether there is an indication of change in Fair Value based on a consideration of the milestones. This assessment might include considering whether:

- there has been any significant change in the results of the Investee Company compared to budget plan or milestone;
- there have been any changes in expectation that technical milestones will be achieved;
- there has been any significant change in the market for the Investee Company or its products or potential products;
- there has been any significant change in the global economy or the economic environment in which the Investee Company operates;
- there has been any significant change in the observable performance of comparable companies, or in the valuations implied by the overall market;
- any internal matters such as fraud, commercial disputes, litigation, changes in management or strategy.

If the Valuer concludes that there is an indication that the Fair Value has changed, they must estimate the amount of any adjustment from the last Price of Recent Investment. By its very nature such adjustment will be subjective. This estimation is likely to be based on objective data from the company, and the experience of the investment professionals and other investors.

However, the necessity and magnitude of the adjustments are relatively subjective and require a large amount of judgment on the part of the Valuer. Where deterioration in value has occurred, the Valuer should reduce the carrying value of the Investment reported at the previous Reporting Date to reflect the estimated decrease.

If there is evidence of value creation, such as those listed above, the Valuer may consider increasing the carrying value of the Investment. Caution must be applied so that positive developments are only valued when they contribute to an increase in value of the Underlying Business when viewed by a Market Participant. When considering these more subtle indicators of value enhancement, in the absence of additional financing rounds or profit generation, the Valuer should consider what value a purchaser would place on these indicators, taking into account the potential outcome and the costs and risks to achieving that outcome.

In the absence of significant revenues, profits or positive cash flows, other methodologies such as the earnings multiple are generally inappropriate. The DCF methodologies may be utilised, however the disadvantages inherent in these, arising from the high levels of subjective judgment, may render the methodology inappropriate.

3.4. Multiples

This methodology involves the application of an earnings multiple to the earnings of the business being valued in order to derive a value for the business.

This methodology is likely to be appropriate for an investment in an established business with an identifiable stream of continuing earnings that are considered to be maintainable.

This section sets out guidance for preparing valuations of businesses on the basis of positive earnings. For businesses that are still in the development stage and prior to positive earnings being generated, multiples of revenue may be used as a basis of valuation.
3. Valuation Methodologies

A revenue multiple is commonly the product of an assumption as to the ‘normalised’ level of earnings that can be generated from that revenue. The methodology and considerations set out here for earnings multiples equally apply if a multiple of revenue is utilised.

This methodology may be applicable to companies with negative earnings, if the losses are considered to be temporary and one can identify a level of ‘normalised’ maintainable earnings.

This may involve the use of adjusted historic earnings, using a forecast level of earnings or applying a ‘sustainable’ profit margin to current or forecast revenues.

The most appropriate earnings to use in this methodology would be those likely to be used by a prospective purchaser of the business.

Guidance on the interpretation of the terms in bold is given below.

**Appropriate multiple**

A number of earnings multiples are used, including price/earnings (P/E), Enterprise Value/earnings before interest and tax (EV/EBIT) and depreciation and amortisation (EV/EBITD&A). The particular multiple used should be appropriate for the business being valued. (I.B. The multiples of revenues and their use are presented in 3.B. Industry Valuation Benchmarks).

In general, because of the role of financial structuring in private equity, multiples should be used to derive an Enterprise Value for the Underlying Business. Where EBITD&A multiples are available, these are commonly used. When unavailable, P/E multiples may be used since these are more commonly reported. For a P/E multiple to be comparable, the two entities should have similar financing structures and levels of borrowing.

Therefore, where a P/E multiple is used, it should generally be applied to an EBIT figure which is adjusted for finance costs relating to operations, working capital and tax. These adjustments are designed to eliminate the effect on the earnings of the acquisition financing on the Enterprise Value since this is subsequently adjusted.

By definition, earnings multiples have as their numerator a value and as their denominator an earnings figure. The denominator can be the earnings figure for any specified period of time and multiples are often defined as ‘historical’, ‘current’ or ‘forecast’ to indicate the earnings used. It is important that the multiple used correlates to the period and concept of earnings of the company being valued.

**Reasonable multiple**

The Valuer would usually derive a multiple by reference to current market-based multiples, reflected in the market valuations of quoted companies or the price at which companies have changed ownership. This market-based approach presumes that the comparator companies are correctly valued by the market.

Whilst there is an argument that the market capitalisation of a quoted company reflects not the value of the company but merely the price at which ‘small parcels’ of shares are exchanged, the presumption in these Guidelines is that market based multiples are indicative of the value of the company as a whole.

Where market-based multiples are used, the aim is to identify companies that are similar, in terms of risk, attributes and earnings prospects, to the company being valued. This is more likely to be the case where the companies are similar in terms of business activities, markets served, size, geography and applicable tax rate.

In using P/E multiples, the Valuer should note that the P/E ratios of comparator companies will be affected by the level of financial gearing and applicable tax rate of those companies.

In using EBITD&A multiples, the Valuer should note that such multiples, by definition, remove the impact on value of depreciation of fixed assets and amortisation of goodwill and other intangibles. If such multiples are used without sufficient care, the Valuer may fail to recognise that business decisions to spend heavily on fixed assets or to grow by acquisition rather than organically do have real costs associated with them which should be reflected in the value attributed to the business in question.

It is important that the earnings multiple of each comparator is adjusted for points of difference between the comparator and the company being valued. These points of difference should be considered and assessed by reference to the two key variables of risk and earnings growth prospects which underpin the earnings multiple. In assessing the risk profile of the company being valued, the Valuer should recognise that risk arises from a range of aspects, including the nature of the company’s operations, the markets in which it operates and its competitive position in those markets, the quality of its management and employees and, importantly in the case of private equity, its capital structure and the ability of the Fund holding the investment to effect change in the company.

When considering adjustments to reported multiples, the Valuer should also consider the impact of the differences between the liquidity of the shares being valued and those on a quoted exchange. There is a risk associated with a lack of liquidity or marketability. The Valuer should consider the extent to which a prospective acquirer of these shares would take into account the additional risks associated with holding an unquoted share.

In an unquoted company the risk arising from the lack of marketability is clearly greater for a shareholder who is unable to control or influence a realisation process than for a shareholder who owns sufficient shares to drive a realisation at will. It may reasonably be expected that a prospective purchaser would assess that there is a higher risk associated with holding a minority position than for a control position.

The multiple at the date of acquisition should be calibrated against the market comparable multiples. Differences, if any, should be understood and similar differences may be expected or need to be understood at subsequent valuation dates.

For example, the reasons why the comparator multiples may need to be adjusted may include the following:

• the size and diversity of the entities and, therefore, the ability to withstand adverse economic conditions;
• the rate of growth of the earnings;
• the reliance on a small number of key employees;
• the diversity of the product ranges;
• the diversity and quality of the customer base;
• the level of borrowing;
• for any other reason the quality of earnings may differ; and
• the risks arising from the lack of marketability of the shares.

Recent transactions involving the sale of similar companies are sometimes used as a frame of reference in seeking to derive a reasonable multiple. It is sometimes argued, since such transactions involve the transfer of whole companies whereas quoted multiples relate to the price for ‘small parcels’ of shares, that they provide a more relevant source of multiples.

In using the Earnings Multiple methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) Apply a multiple that is appropriate and reasonable (given the risk profile and earnings growth prospects of the underlying company) to the maintainable earnings of the company;

(ii) Adjust the Enterprise Value for surplus assets or excess liabilities and other contingencies and relevant factors to derive an Adjusted Enterprise Value for the Investee Company;

(iii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund’s Investment to derive the Attributable Enterprise Value;

(iv) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments.
3. Valuation Methodologies

However, their appropriateness in this respect is often undermined by the following:

- the lack of forward looking financial data and other information to allow points of difference to be identified and adjusted for;
- the generally lower reliability and transparency of reported earnings figures of private companies; and
- the lack of reliable pricing information for the transaction itself.

It is a matter of judgement for the Valuer as to whether, in deriving a reasonable multiple, they refer to a single comparator company or a number of companies or the earnings multiple of a quoted stock market sector or sub-sector. It may be acceptable, in particular circumstances, for the Valuer to conclude that the use of quoted sector or sub-sector multiples or an average of multiples from a ‘basket’ of comparator companies may be appropriate.

Maintainable earnings

In applying a multiple to maintainable earnings, it is important that the Valuer is satisfied that the earnings figure can be relied upon. Whilst this might tend to favour the use of audited historical figures rather than unaudited or forecast figures, it should be recognised that value is by definition a forward-looking concept, and quoted markets more often think of value in terms of ‘current’ and ‘forecast’ multiples, rather than ‘historical’ ones. In addition, there is the argument that the valuation should, in a dynamic environment, reflect the most recent available information. There is therefore a trade-off between the reliability and relevance of the earnings figures available to the Valuer. On balance, whilst it remains a matter of judgement for the Valuer, he should be predisposed towards using historical (though not necessarily audited) earnings figures or, if he believes them to be reliable, forecast earnings figures for the current year.

Whichever period’s earnings are used, the Valuer should satisfy himself that they represent a reasonable estimate of maintainable earnings, which implies the need to adjust for exceptional or non-recurring items, the impact of discontinued activities and acquisitions and forecast material changes in earnings.

3.5. Net Assets

This methodology involves deriving the value of a business by reference to the value of its net assets.

This methodology is likely to be appropriate for a business whose value derives mainly from the underlying Fair Value of its assets rather than its earnings, such as property holding companies and investment businesses (such as Funds-of-funds as more fully discussed in 4. Valuing Fund Interests).

This methodology may also be appropriate for a business that is not making an adequate return on assets and for which a greater value can be realised by liquidating the business and selling its assets. In the context of private equity, it may therefore be appropriate, in certain circumstances, for valuing Investments in loss-making companies and companies making only marginal levels of profits.

In using the Net Assets methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive an Enterprise Value for the company using appropriate measures to value its assets and liabilities (including, if appropriate, contingent assets and liabilities);

(ii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund’s Investment to derive the Attributable Enterprise Value; and

(iii) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments.

3.6. Discounted Cash Flows or Earnings (of Underlying Business)

This methodology involves deriving the value of a business by calculating the present value of expected future cash flows (or the present value of expected future earnings, as a surrogate for expected future cash flows). The cash flows and ‘terminal value’ are those of the Underlying Business, not those from the Investment itself.

The Discounted Cash Flows (DCF) technique is flexible in the sense that it can be applied to any stream of cash flows (or earnings). In the context of private equity valuation, this flexibility enables the methodology to be applied in situations that other methodologies may be incapable of addressing. While this methodology may be applied to businesses going through a period of great change, such as a rescue refinancing, turnaround, strategic repositioning, loss making or in its start-up phase, there is a significant risk in using this methodology.

The disadvantages of the DCF methodology centre around its requirement for detailed cash flow forecasts and the need to estimate the ‘terminal value’ and an appropriate risk-adjusted discount rate. All of these inputs require substantial subjective judgements to be made, and the derived present value amount is often sensitive to small changes in these inputs.

Due to the high level of subjectivity in selecting inputs for this technique, DCF based valuations are useful as a cross-check of values estimated under market-based methodologies and should only be used in isolation of other methodologies under extreme caution.

In assessing the appropriateness of this methodology, the Valuer should consider whether its disadvantages and sensitivities are such, in the particular circumstances, as to render the resulting Fair Value insufficiently reliable.

In using the Discounted Cash Flows or Earnings (of Underlying Business) methodology to estimate the Fair Value of an Investment, the Valuer should:

(i) Derive the Enterprise Value of the company, using reasonable assumptions and estimations of expected future cash flows (or expected future earnings) and the terminal value, and discounting to the present by applying the appropriate risk-adjusted rate that quantifies the risk inherent in the company;

(ii) Deduct from this amount any financial instruments ranking ahead of the highest ranking instrument of the Fund in a liquidation scenario (e.g. the amount that would be paid) and taking into account the effect of any instrument that may dilute the Fund’s Investment to derive the Attributable Enterprise Value;

(iii) Apportion the Attributable Enterprise Value appropriately between the relevant financial instruments.

3.7. Discounted Cash Flows (from the Investment)

This methodology applies the DCF concept and technique to the expected cash flows from the Investment itself.

Where Realisation of an investment or a flotation of the Underlying Business is imminent and the pricing of the relevant transaction has been substantially agreed, the Discounted Cash Flows (from the Investment) methodology (or, as a surrogate, the use of a simple discount to the expected Realisation proceeds or flotation value) is likely to be the most appropriate methodology.
3. **Valuation Methodologies**

This methodology, because of its flexibility, is capable of being applied to all private equity Investment situations. It is particularly suitable for valuing non-equity Investments in instruments such as debt or mezzanine debt, since the value of such instruments derives mainly from instrument-specific cash flows and risks rather than from the value of the Underlying Business as a whole.

Because of its inherent reliance on substantial subjective judgements, the Valuer should be extremely cautious of using this methodology as the main basis of estimating Fair Value for Investments which include an equity element.

The methodology will often be useful as a sense-check of values produced using other methodologies.

Risk and the rates of return necessary to compensate for different risk levels are central commercial variables in the making of all private equity Investments. Accordingly there exists a frame of reference against which to make discount rate assumptions.

However the need to make detailed cash flow forecasts over the Investment life may reduce the reliability and crucially for equity Investments, there remains a need to estimate the "terminal value".

Where the Investment comprises equity or a combination of equity and other financial instruments, the terminal value would usually be derived from the anticipated value of the Underlying Business at Realisation. This will usually necessitate making assumptions about future business performance and developments and stock market and other valuation ratios at the assumed Realisation date. In the case of equity Investments, small changes in these assumptions can materially impact the valuation. In the case of non-equity Instruments, the terminal value will usually be a pre-defined amount, which greatly enhances the reliability of the valuation.

In circumstances where a Realisation is not foreseeable, the terminal value may be based upon assumptions of the perpetuity cash flows accruing to the holder of the Investment. These circumstances (which are expected to be rare in private equity) may arise where the Fund has little ability to influence the timing of a Realisation and/or those shareholders that can influence the timing do not seek a Realisation.

In using the Discounted Cash Flows (from the Investment) methodology to estimate the Fair Value of an Investment, the Valuer should derive the present value of the Investment, using reasonable assumptions and estimations of expected future cash flows and the terminal value and date, and the appropriate risk-adjusted rate that quantifies the risk inherent to the Investment.

3.8. **Industry Valuation Benchmarks**

A number of industries have industry-specific valuation benchmarks, such as ‘price per bed’ (for nursing-home operators) and ‘price per subscriber’ (for cable television companies). Other industries, including certain financial services and information technology sectors and some services sectors where long-term contracts are a key feature, use multiples of revenues as a valuation benchmark.

These industry norms are often based on the assumption that investors are willing to pay for turnover or market share, and that the normal profitability of businesses in the industry does not vary much.

The use of such industry benchmarks is only likely to be reliable and therefore appropriate as the main basis of estimating Fair Value in limited situations, and is more likely to be useful as a sense-check of values produced using other methodologies.

3.9. **Available Market Prices**

Private Equity Funds may be holding Quoted Instruments, for which there is an available market price.

In determining the level of discount to apply, the Valuer should consider the extent of compensation a holder would require when comparing the Investment in question with an identical but unrestricted holding.

A Valuer may consider using an option pricing model to value the impact of this restriction on realisation, however in practice for restrictions which only cover a limited number of reporting periods, this is simplified to a simple mathematical discount to the quoted price.

For certain Quoted Instruments there is only one market price quoted, representing, for example, the value at which the most recent trade in the Instrument was transacted.

For other Quoted Instruments there are two market prices at any one time: the lower ‘bid’ price quoted by a market maker, which he will pay an investor for a holding (i.e. the investor’s disposal price), and the higher ‘ask’ price, which an investor can expect to pay to acquire a holding. However, as an alternative to the bid price (where not required by regulation), is the mid-market price (i.e. the average of the bid and ask prices), where this is considered the most representative point estimate in the bid/ask spread.

Discounts should not be applied to prices quoted on an Active Market, unless there is some contractual, Governmental or other legally enforceable restriction that would impact the value realised at the Reporting Date.
4. Valuing Fund Interests

4.1. General

Fund-of-Funds and investors in Private Equity Funds must value their interest in an underlying Fund at regular intervals to support their financial reporting. Historically, the Net Asset Value (‘NAV’) based on the underlying Fair Value of the Investments, as reported by the Manager, has been used as the basis for estimating the Fair Value of an interest in an underlying Fund.

Fair Value for an underlying Fund interest is, at its most basic level, equivalent to the summation of the estimated value of underlying investments as if realised on the Reporting Date. The proceeds from such a realisation would flow through to the investor in an amount equal to NAV. This concept makes particular sense for closed-end Fund investors who realise cash returns on their investment when realisation events occur through the sale of the underlying portfolio companies.

As an investor in a Fund, reliance on a reported NAV provided by the investee Fund manager can only be used by the investor to the extent that they have evidence that the reported NAV is appropriately derived using proper Fair Value Principles as part of a robust process. Typically, evidence as to the Fair Value approach, procedures and consistency of application is gathered via initial due diligence, ongoing monitoring, and review of financial reporting and governance of the investee Fund by the investor entity.

Therefore, NAV when rigorously determined in accordance with the principles of Fair Value and these Guidelines provides the best estimate upon which to base the Fair Value of an interest in a Fund.

4.2. Adjustments to Net Asset Value

After the Valuer determines that the reported NAV is an appropriate starting point, it may be necessary to make adjustments based on the best available information at the Reporting Date. Although the Valuer may look to the Fund Manager for the mechanics of their Fair Value estimation procedures, the Valuer needs to have appropriate processes and related controls in place to enable the Valuer to assess and understand the valuations received.

Factors which might result in an adjustment to the reported NAV would include the following:

• significant time elapsing between the Reporting Date of the Fund NAV and the Valuer entity’s Reporting Date.
• the Fund making additional investments or achieving realizations;
• the Valuer becoming aware of subsequent changes in the Fair Value of underlying investee companies;
• market changes or other economic conditions changing to impact the value of the Fund’s portfolio;
• information from an orderly Secondary Transaction if sufficient and transparent;
• the appropriate recognition of potential performance fees or carried interest in the Fund NAV;
• any features of the Fund agreement that may affect distributions but which are not captured in the NAV;
• materially different valuations by GPs for common companies and identical securities; and
• any other facts and circumstances which might impact underlying Fund value.

NAV should be adjusted such that it is equivalent to the amount of cash that would be received by the holder of the interest in the Fund if all underlying Investee Companies were realised as at the Reporting Date.

4.3. Secondary Transactions

Limited Secondary Transactions exist for Private Equity Funds. External market transactions for a Fund are typically infrequent, opaque and information extremely limited. Secondary prices are negotiated, influenced by factors beyond Fair Value and based on assumptions and return expectations that are often unique to the counter parties. In addition, information relevant to specific transactions may not be deemed orderly and any pricing data available may no longer be current.

When a Valuer of an interest knows the relevant terms of a Secondary transaction in that particular Fund and the transaction is considered orderly, the Valuer should consider the transaction price as one component of the information used to determine the Fair Value.

In the event that the investor in the Private Equity Fund has decided to sell their interest in that fund, then data known from orderly Secondary Transaction prices is likely to be better evidence of Fair Value.

Any use of a Secondary Transaction price requires considerable judgement.
SECTION II: APPLICATION GUIDANCE

1. SPECIFIC CONSIDERATIONS

1.1. Insider Funding Rounds

The price at which a funding round takes place may be a clear indicator of Fair Value at that date. When using the Price of Recent Investment methodology, the Valuer should consider whether there are specific circumstances surrounding that round of Investment which may reduce the reliability of the price as an indicator of Fair Value.

Where there is a round of financing that involves only existing investors of the Underlying Business in the same proportion to their existing Investments (insider round), the commercial need for the transaction to be undertaken at Fair Value may be diminished. The Valuer needs to assess whether the transaction was appropriately negotiated and reflected the Enterprise Value at that date.

Nevertheless, a financing with existing investors that is priced at a valuation that is lower than the valuation reported at the previous Reporting Date (insider down round) may indicate a decrease in value and should therefore be taken into consideration.

Insider down rounds may take various forms, including a corporate reorganisation, i.e. a significant change in the common equity base of a company such as converting all outstanding shares into equity, combining outstanding preferred shares into a smaller number of shares (share consolidation) or even cancelling all outstanding shares before a capital increase.

1.2. Distressed Market

Markets from which transaction data may be extracted may be viewed by Valuers to be ‘distressed markets’. A distressed market does not mean that all transactions within that market may be deemed to be distressed and invalid for use as comparative purposes, however an individual transaction may be distressed.

In these situations significant judgement is needed when determining whether individual transactions are indicative of Fair Value.

When considering whether a transaction may be deemed to be distressed or forced (e.g. not orderly), the Valuer may include such matters as the following indicators in their consideration:

• a legal requirement to transact, for example a regulatory mandate;
• a necessity to dispose of an asset immediately and there is insufficient time to market the asset to be sold;
• the existence of a single potential buyer as a result of the legal or time restrictions imposed; and
• there was not adequate exposure to the market to allow for usual and customary marketing activities.
1. SPECIFIC CONSIDERATIONS

1.3. Deducting Higher Ranking Instruments

Many acquisition structures include third party debt which ranks higher than the interests of the Fund, which is deducted from the Enterprise Value to estimate the Attributable Enterprise Value.

For certain transactions, this debt is actively traded and may be acquired by the Investee Company or the Fund in the market at a price which is at a discount to the par value.

In calculating the Attributable Enterprise Value, the Valuer should deduct from the Enterprise Value the amount which is expected to be repaid in settlement of this debt at the Reporting Date. Typically this is the par value since the debt is repayable at the time of disposal of the Investee Company and the Enterprise Value has been estimated on the basis of disposal at the Reporting Date.

Where the debt is trading at a discount to par, this lower amount would not normally be deducted from the Enterprise Value until the Investee Company or the Fund has acquired that debt in the market at that value and intends to cancel the debt rather than seek repayment at par.

1.4. Bridge Financing

Funds, or related vehicles, may grant loans to an Underlying Business pending a new round of financing (Bridge financing). This may be provided in anticipation of an initial investment by the Fund, or ahead of a proposed follow on Investment.

In the case of an initial Investment, where the Fund holds no other investments in the Underlying Business, the Bridge loan should be valued in isolation. In these situations and if it is expected that the financing will occur in due course and that the Bridge loan is merely ensuring that funds are made available early, cost is likely to be the best indicator of Fair Value.

If it is anticipated that the company may have difficulty arranging the financing, and that its viability is in doubt, the Valuer should reassess Fair Value.

If the bridge finance is provided to an existing Investee Company in anticipation of a follow on Investment, the bridge finance should be included, together with the original investment, as a part of the overall package of investment being valued.

1.5. Mezzanine Loans

Mezzanine loans are one of the commonly used sources of debt finance for Investments. Typically these will rank below the senior debt, but above shareholder loans or equity, bear an interest rate appropriate to the level of risk being assumed by the loan provider and may have additional potentially value enhancing aspects, such as warrants.

Often these are provided by a party other than the equity provider and as such may be the only instrument held by the Fund in the Underlying Business. In these situations, the mezzanine loan should be valued on a standalone basis. The price at which the mezzanine loan was issued is a reliable indicator of Fair Value at that date.

The Valuer should consider whether any indications of deterioration in the value of the Underlying Business exist, which suggest that the loan will not be fully recovered. The Valuer should also consider whether any indications of changes in required yield exist, which suggest that the value of the loan has changed.

There are generally limited market opportunities for the holders of mezzanine loans to trade. There are agencies which regularly quote prices on these types of loans, however transactions cannot always be undertaken at the indicative prices offered. Prices reported of transactions should be considered by the Valuer as to whether these are a reasonable indication of Fair Value.

Since the cash flows associated with a mezzanine loan may be predicted with a reasonable amount of certainty, typically these are valued on the basis of a DCF calculation.

Warrants attached to mezzanine loans should be considered separately from the loan. The Valuer should select a methodology appropriate to valuing the Underlying Business and apply the percentage ownership that the exercised warrants will confer to that valuation.

In the event that the warrant position is significant, the Valuer may consider utilising one of the sophisticated option and warrant pricing models.

In the event that the mezzanine loan is one of a number of instruments held by the Fund in the Underlying Business, then the mezzanine loan and any attached warrants should be included as a part of the overall package of investment being valued.

1.6. Rolled up Loan Interest

Many financial instruments commonly used in private equity Investments accumulate interest which is only realised in cash on redemption of the instrument (e.g. deep discount debentures or Payment-in-Kind Notes).

In valuing these instruments, the Valuer should assess the expected amount to be recovered from these instruments. The consideration of recoverable amount will also include the existence of any reasonably anticipated enhancements such as interest rate step increases.

In a typical financing package, these are inseparable from the underlying equity investment and will be realised as part of a sale transaction.

The difference between the estimated recoverable amount (if in excess of the original cost) should be spread over the anticipated life of the note so as to give a constant rate of return on the instrument.

1.7. Indicative Offers

Indicative offers received from a third party for the Underlying Business may provide a good indication of Fair Value. This will apply to offers for a part or the whole Underlying Business as well as other situations such as price indications for debt or equity refinancing.

However, before using the offer as evidence of Fair Value, the Valuer should consider the motivation of the party in making the offer. Indicative offers may be made deliberately high for such reasons as, to open negotiations, gain access to the company or made subject to stringent conditions or future events.

Similarly they may be deliberately low if the offeror believes that the vendor may be in a forced sale position, or to take an opportunity to increase their equity stake at the expense of other less liquid stakeholders.

In addition, indicative offers may be made on the basis of insufficient detailed information to be properly valid.

These motivations should be considered by the Valuer, however it is unlikely that a firm conclusion can be drawn.

Accordingly, typically indicative offers will provide useful additional support for a valuation estimated by one of the valuation methodologies, but are insufficiently robust to be used in isolation.

1.8. Impacts from Structuring

Frequently the structuring of a private equity investment is complex with groups of stakeholders holding different rights which either enhance or diminish the value of their interests, depending on the success or otherwise of the Underlying Business.

Valuations must consider the impact of future changes in the structure of the investment which may materially impact the Fair Value. These potential impacts may take several different legal forms and may be initiated at the Fund’s option, automatically on certain events taking place, or at the option of another party.

Common clauses include, but are not limited to:

- stock options and warrants;
- anti-dilution clauses;
- ratchet clauses;
- convertible debt instruments;
- liquidation preferences;
- commitments to take up follow-on capital Investments.
These rights should be reviewed on a regular basis to assess whether these are likely to be exercised and the extent of any impact on value of the Fund’s Investment. At each Reporting Date, the Valuer should determine whether these rights are likely to be exercised.

In assessing whether rights are likely to be taken up by stakeholders, the Valuer may limit their consideration to a comparison of the value received by the exerciser against the cost of exercising. If the exerciser will receive an enhancement in value by exercising, the Valuer should assume that they will do so.

The estimation of Fair Value should be undertaken on the basis that all rights that are currently exercisable and are likely to be exercised (such as options), or those that occur automatically on certain events taking place (such as liquidation preferences on Realisation, or ratchets based on value), have taken place.

Consideration should also be given to whether the exercise price will result in surplus cash arising in the Investee Company.

Notwithstanding the above, when considering the impact of liquidation preferences, the Valuer should include in their assessment the likelihood of the Fund receiving their full contractual right under the preference. In practice full value for the preference may not be achieved, particularly when this would result in other investors who are integral to the sale process (such as a continuing management team) receiving a significantly reduced value for their investment.

AFIC
(Association Française des Investisseurs en Capital)

Established in 1984, AFIC has 280 active members covering all types of private equity activities in France. In addition, AFIC has 200 associate members from a wide range of related professions who support and advise investors and entrepreneurs in the structuring and management of their partnerships.

By virtue of its responsibilities in the areas of compliance, controlling and establishing generally accepted practices, AFIC is one of two associations recognized by the French Financial Market Authority (AMF). Management companies must be AFIC members in order to be certified by the AMF. AFIC is the only professional association focused on the private equity business.

AIFI
(Italian Private Equity and Venture Capital Association)

AIFI was founded in May 1986 in order to promote, develop and institutionally represent the private equity and venture capital activity in Italy. The Association is a non-profit organisation whose main activities are: to create a favourable legal environment for the private equity and venture capital investment activity, to analyse the Italian private equity market collecting statistical data, to organize business seminars and specialized courses addressed to institutional investors and to people interested in operating within the industry, to publish research papers regarding specific topics about the private equity market, to build up stable and solid relationships with other National Venture Capital Associations and key players in the international private equity market.

AMF

(Association Marocaine des Investisseurs en Capital)

AMIC is an independent non-profit association which was created in 2001 in order to:

• Develop the private equity and venture capital industry in Morocco;
• Promote best practices, transparency and responsibility amongst professionals;
• Create the most favourable legal and fiscal environment by lobbying policymakers;
• Represent and defend its members’ professional interests;
• Liaise with key industry players, entrepreneurs and media;
• Provide research and information on the industry;
• Educate and train practitioners;
• Foster networking between members and stakeholders.

Based in Casablanca, AMIC with its 10 members represents the vast majority of private equity and venture capital actors in Morocco.
INTERNATIONAL PRIVATE EQUITY AND VENTURE CAPITAL VALUATION GUIDELINES  

APEA (Arab Private Equity Association)  
APEA was established in 1989 and is based in Lisbon. APEA represents the Portuguese private equity and venture capital sector and promotes the asset class. APEA's role includes representing the interests of the industry to regulators and standard setters; developing professional standards; providing industry research; professional development and forums, facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics. APEA's activities cover the whole range of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins. APEA represents the vast majority of private equity and venture capital in Portugal. APEA has 16 full members and 5 associate members. Full members are active in making equity investments primarily in unquoted companies. The associate membership can include those firms who invest directly in private equity but for whom this is not their principal activity, advisory firms experienced in dealing with private equity and educational or research based institutions closely associated with the industry.

ASCRI (Spanish Private Equity and Venture Capital Association)  
ASCRI is a non-profit making association that was set up in 1986, to promote and develop the venture capital and private equity activity in Spain and represent, manage and defend its members’ professional interests. The Association stimulates the promotion and information analysis in the venture capital/private equity sector in Spain, and provides the contact between Official Organisations, Investors, professional advisers, business schools and other relevant institutions. At the end of May 2005, ASCRI had 84 full members and 28 associate members. The ASCRIs main activities are: Research activity, Organisation of different events such as Annual General Assembly, ASCRI Congress, Training Seminars and Conference/Workshops, Communication of investment opportunities between ASCRI members, and Institutional and lobbying activity.

ATIC (Tunisian Venture Capital Association)  
ATIC (Association Tunisienne des Investisseurs en Capital) is a professional association founded in April 2004, by more than 30 companies operating in the field of private equity and venture capital in Tunisia. Its main goal is to play the vis-a-vis with the Tunisian authorities to introduce the appropriate legal and fiscal measures to ease the development, and solve the problems of the private equity and venture capital industry in Tunisia. ATIC second objective is to offer its members the appropriate space for networking, information exchange and business development to upgrade the Tunisian industry by targeting higher value added technology projects, and stronger alliances with its North African and European Partners. ATIC’s third objective no less important is to inculcate the right private equity and venture capital culture to local professionals, to enhance the creation of a new generation of Funds managers and to reach strategic alliances with their European or US counterparts. ATIC aims to reach that by enforcing the best practices of the profession according to international standards, through its planned training programs.

AVCA (African Venture Capital Association)  
AVCA represents the private equity and venture capital industry in Africa. AVCA was established in 2002 and its head office is in Yaoundé, Cameroon. AVCA’s membership is drawn from across Africa and internationally. AVCA’s objectives are to represent the industry within Africa and internationally, stimulate the growth and expansion of the industry throughout Africa, stimulate professional relationships and co-operation, provide opportunities for professional development of industry practitioners, research, publish and circulate industry information and insights, provide policymakers with proposals to improve the corporate, fiscal and legal environment for the industry, maintain high ethical and professional standards and contribute to the management development of investors, investees and other stakeholders. AVCA activities include an annual industry conference, a quarterly newsletter, research, training and advocacy programs. For more information visit the AVCA website www.avcanet.com.

AVC (Australian Private Equity and Venture Capital)  
AVC represents the interests of Australia’s venture capital and private equity industry. AVC’s 50 investor members have A$10 billion under management. AVC’s roles include: promotion of the industry, education of practitioners, public policy development, staging networking events, application of valuation & disclosure guidelines, benchmarking IRVs, development of industry standard Limited Partnership agreement. AVC conducts about 40 networking events annually across Australia, and leverages its online presence at www.avcal.com.au for maximum efficiency.

AVCO (Austrian Private Equity and Venture Capital Organisation)  
AVCO is the National Association of Austria’s private equity and venture capital industry, which covers more than 90% of the Austrian private equity market with its members.

• It works as a Knowledgeable partner and independent information point for journalists, entrepreneurs, potential investors, private and public institutions as well as international bodies that are interested in Austria's private equity industry. Its development and structure as well as its activities and performance.

• It acts as the official representative of the industry actively engaged in improving the tax-related, legal and economic policy environments in close connection with respective policy makers.

• As a proactive networking institution it promotes co-operation inside the industry as well as interaction with complementary players from other fields in order to intensify information flows and create learning loops.

• In addition it takes the role of an interface to international organisations exchanging experience, information and knowledge with other Private Equity and Venture Capital Associations in Europe, with the European Commission and further relevant institutions in order to put international best practice at work for Austria.

Currently AVCO is engaged to initiate internationally favourite private equity fund structures for Austria and recently AVCO has published Investor Relations Guidelines – behavioural standards for its members vis-a-vis their fund investors – in order to raise transparency and faith in private equity as a professional asset class in Austria. In line with these efforts AVCO welcomes the International Private Equity and Venture Capital Guidelines and will be eager to support their introduction and accurate application by its members.
Endorsing Associations

BVA (Belgian Venture Association)
BVA was founded in 1986 as a professional association. Its mission is to:
1. Animate the Belgian private equity and venture capital industry by deploying a series of activities for its members and for other stakeholders in the prospect of the VC/PE sector in Belgium. The objectives of the main animation activities are: to foster active networking amongst members of the BVA and between members of the BVA and other third parties; to provide intensive information to its members on all topics relevant to the VC/PE industry; to improve the quality of the operation of the sector.
2. Promote the well being of the Belgian private equity and venture capital industry towards all relevant third parties. The objectives of the promotional activities are: to pro-actively represent the Belgian VC/PE industry to third parties as the industry’s recognized spokesperson, to conduct active lobbying for (i) improvements to or (ii) the removal of obstacles from the structural context in which the Belgian VC/PE industry operates, to contribute to the continuous development of business in our industry.

BVK (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – German Private Equity and Venture Capital Association e. V.)
BVK was founded in 1989. BVK represents most of the German private equity and venture capital firms as well as the German branches of foreign private equity and venture capital firms. As per March 31, 2005, BVK represented more than 180 private equity and venture capital firms. Apart from full membership BVK offers associate membership to companies and organizations working in this particular business sector, i.e. accountants, lawyers, consultants etc.
BVK serves as a link between government and business and represents its members’ views, needs and problems while supplying information and discussing any particular political and economic subject with the relevant governmental institutions.
Science and research are becoming more and more interested in private equity and venture capital issues. BVK supports universities, colleges and their students with their research activities and problem solving.
On the international level BVK exchanges information with other national organizations in the economic sector and other international private equity and venture capital associations.

CVCA (Canada’s Venture Capital & Private Equity Association)
The CVCA – Canada’s Venture Capital & Private Equity Association, was founded in 1974 and is the sole national representative of Canada’s venture capital and private equity industry. Its over 1800 members are firms and organizations which manage the majority of Canada’s pools of capital designated to be committed to venture capital and private equity investments. CVCA members collectively manage over $75 billion.
CVCA’s members actively collaborate to increase the flow of capital into the industry and expand the range of profitable investment opportunities.
This is accomplished by the CVCA undertaking a wide variety of initiatives, ranging from developing comprehensive performance and valuation statistics, education and networking activities to promoting the industry’s interests with governments and regulatory agencies.
For further information, please visit www.cvca.ca.

CVCA (Czech Venture Capital and Private Equity Association)
CVCA is an association representing companies active in the private equity and venture capital industry in the Czech Republic. CVCA has full members (private equity and venture capital fund managers) and associated members (companies providing advisory services to the private equity and venture capital industry). CVCA has 14 full members and 16 associated members as of May 2005.
CVCA’s priorities are: increasing the awareness about private equity/venture capital among entrepreneurs, state administration and general public, promoting interests of CVCA members in contact with the government and other state authorities, providing information on the private equity/venture capital industry in the Czech Republic, providing platform for discussion among members of CVCA.

DVCA (Danish Venture Capital Association)
DVCA is an association with the goal of strengthening its member’s business, network, and competences. DVCA includes a broad range of high tech investors in Denmark. Furthermore the organisation covers the whole investment chain from individual business angels over venture capital companies to private equity and institutional investors.
DVCA was founded in 2000 and was in 2004 merged with the formerly known Danish Business Angel Network. The association is situated in the Old Stock Exchange, Slotsholmsgade, Copenhagen. For more information please visit www.dvca.dk.
**Endorsing Associations**

**EMPEA** *(Emerging Markets Private Equity Association)*

EMPEA is a broad-based membership organization formed to serve private equity and venture capital firms operating in the emerging markets of Asia, Eastern Europe, Africa, Latin America and the Middle East. EMPEA believes private equity investing can generate strong returns for investors while also serving as a critical driver of economic growth and opportunity in these markets. Despite significant differences across emerging market regions, private equity firms face important common challenges and opportunities. EMPEA's programs include conferences, networking opportunities, research, a quarterly publication and advocacy.

EMPEA works closely with national and regional venture capital associations to achieve its mission.

**EVCA** *(European Private Equity and Venture Capital Association)*

EVCA is the voice of European private equity and venture capital. We promote and protect the interests of close to 1,300 members, thereby ensuring they can conduct their business effectively.

EVCA engages policymakers and promotes the industry among key stakeholders, including institutional investors, entrepreneurs and employee representatives. EVCA develops professional standards and research reports, as well as holding professional training and networking events.

EVCA covers the whole range of private equity, from early-stage venture capital to the largest buyouts.

For more information, please visit www.evca.eu.

**FVCA** *(The Finnish Venture Capital Association)*

The Finnish Venture Capital Association (FVCA) was established in 1990. The main objective of the FVCA is to enhance public confidence in venture capital and private equity, and also to increase awareness of venture capital and private equity as a part of established financial markets. The FVCA aims to improve the conditions for venture capital/private equity activity in Finland by overseeing the general interests and business-ethics of the industry together with governmental and other institutions as well as by assisting in improving professional practices, co-operating with other national associations, and generating statistics regarding the industry.

The FVCA also strives to develop the business environment by, among other things, contributing to the creation and development of appropriate legal, fiscal and operational environments for investors as well as entrepreneurs. Furthermore, the FVCA defines best practices and operational principles for the industry, while requiring members to comply with the FVCA Code of Conduct. The association also creates a unique network of contacts among its members and interest groups.

Furthermore, the FVCA defines best practices and operational principles for the industry, while requiring members to comply with the FVCA Code of Conduct. The association also creates a unique network of contacts within the Finnish private equity and venture capital industry by providing a forum for exchange of views and experiences among its members and interest groups.

The FVCA has 37 full members who represent the vast majority of the Finnish venture capital and private equity companies. Full membership has been approved for equity investors and risk financiers representing private and public investment capital, captive funds and corporate ventures. In addition, the FVCA has 66 associate members. Associate membership can be given to organizations and individuals with an interest in the venture capital and private equity industry.

Please see www.fvca.fi for more information.

**GVCA** *(Gulf Venture Capital Association)*

GVCA is a not-for-profit trade and industry association for venture capital (VC) and private equity (PE) based in the Kingdom of Bahrain to serve the whole region.

Its prime role is to promote a risk-taking investment culture, develop skills, facilitate networking, and provide relevant information and statistics on the venture capital and private equity industry.

**Mission:** GVCA’s mission is to serve the venture capital and private equity industry and foster its growth in the region.

**Goals:**
1. Promote and advocate venture capital and private equity as a vital industry, contributing to economic growth.
2. Facilitate communication and networking among stakeholders.
4. Develop and promote professional and ethical codes of conduct.
5. Foster professional development and learning environment.

The Association’s activities cover several aspects of the venture capital and private equity industry such as trends and strategies, legal and regulatory policies and regulations, investment models, management of fund raising and structures, technology evaluation and valuation, contracts and control rights, information/valuation, early-stage funding, buyout, IPO, and corporate venture capital, among others.

**Membership:** Members in GVCA include venture capital and private equity companies, financial institutions, corporations, and consultants, and business development organizations, among others. For more information please see: www.gulvca.org

**HKVCA** *(Hong Kong Venture Capital Association)*

Hong Kong Venture Capital Association was established on November 12, 1987 with the objectives of promoting and protecting the interests of the venture capital and private equity industry, networking and cooperation on regional and international front, and in raising the professional standards of the market.

Its 120 members are engaged in all levels of venture capital, expansion capital and buyout activities in China, Japan, Korea, Australia, Taiwan, Thailand, Singapore, and other markets in Asia.

It is committed to the promotion of the venture capital industry as a financial and business partner to businesses and the creation of an environment that creates sound partnerships. It is dedicated to developing a high standard of professionalism in the market to ensure investor confidence in the asset class.

The Association provides an effective channel of communication for members to share information on developments within the industry in Hong Kong and as well as on a regional and international level. It also works closely with the government and various trade bodies to further the interests of the industry.

**HVCA** *(Hungarian Venture Capital and Private Equity Association)*

HVCA represents virtually every major source of funds and expertise of private equity in Hungary. HVCA aims to promote the development of the industry, and to create and follow the highest possible professional and ethical standards.

HVCA was set up in 1991 and has developed considerably since then: the original five members have grown to 26 full members, 29 associate members and 9 individual members.

The Association provides a regular forum for the exchange of ideas among members, high-level discussions on the topical issues of the venture capital and private equity industry and the future trends. As the official representative of the industry it is in constant discussion with the financial and legislator institutions of the Hungarian State and with other professional organisations.
The IVCA is the representative body of the venture capital (Irish Venture Capital Association)
The IVCA membership comprises corporate and public pension plans, endowments and foundations, insurance companies and other institutional investors in private equity. The IVCA holds semi-annual meetings for members.

ILPA (Institutional Limited Partners Association)
The ILPA is a voluntary association funded by its members. The ILPA membership has grown to include more than 138 member organizations from 10 countries, who in total have assets under management in excess of two trillion U.S. dollars. Members of the ILPA manage more than US$300 billion of private equity capital.

The ILPA membership comprises corporate and public pension plans, endowments and foundations, insurance companies and other institutional investors in private equity. The ILPA holds semi-annual meetings for members.

LAVCA (Latin American Venture Capital Association)
The Latin American Venture Capital Association (LAVCA) is a not-for-profit membership organization dedicated to promoting the growth of the private equity and venture capital industry in Latin America and the Caribbean. LAVCA’s core membership consists of fund managers, institutional investors and corporate investors active in the region. Select service providers, development finance organizations, trade associations and educational institutions also participate as associate members of LAVCA.

LAVCA’s mission – to spur regional economic growth through the promotion of venture capital and private equity investment – is accomplished through programs of research, networking, education, the promotion of best investment practices, and the advocacy of sound public policy. For more information about LAVCA, its members, products and activities, please visit our website at www.lavca.org.

LPEQ (LPEQ Listed Private Equity)
LPEQ Listed Private Equity is a group of European listed private equity companies formed in 2006 to increase awareness and understanding of listed private equity among institutional and retail investors, their advisers, commentators and the public. LPEQ provides information on listed private equity specifically and on private equity in general, to constituents not necessarily covered by GPs. LPEQ seeks to identify and promote best practice in investor communications. LPEQ commissions and publishes investor and academic research on the listed private equity sector, contributes articles to relevant publications and fields speakers at conferences. LPEQ’s website is widely used as a source of non-promotional information by all constituents. www.lpeq.com

LVCANZ (New Zealand Venture Capital Association)
LVCANZ is the representative body of the venture capital industry in New Zealand. LVCANZ was established in 1985 to represent the views of its members and to promote the venture capital industry in New Zealand. LVCANZ membership is open to all individuals and organizations committed to fostering an economic and regulatory climate conducive to the growth and development of an enterprising economy.

LVCA (Latvian Venture Capital Association)
Latvian Venture Capital Association (LVCA) is a voluntary professional organization: the Latvian Venture Capital Association. The founders of the association are fund management companies that manage investment funds of different value and function profile.

LVCA has the following missions: to inform businessmen and society about venture capital financing possibilities, to promote the exchange of opinions and experience of the members of the association, to represent opinions and interests of the members in negotiations with public authorities, to organize and to ensure cooperation with international or other countries’ venture capital associations.

NVP (Nederlandse Vereniging van Participatieaandelenmaatschappijen)
The Dutch Private Equity & Venture Capital Association acts in the interests of private equity companies in the Netherlands. The aims of the NVP are: in cooperation with the government, work on an adequate regulatory framework for the private equity sector and its clients; inform entrepreneurs and businesses about the financing possibilities of private equity; inform investors about the characteristics of private equity as an asset class; raise awareness and improve the image of private equity to achieve aforementioned goals; contribute to further raising the level of professionalism of the private equity sector.

The NVP has about 59 members and 88 associated members. Members of the NVP represent 95% of the number of private equity investments and about 85% of the total invested capital in the Netherlands.

More information about the activities of the NVP and its members can be found on www.nvp.nl.

NZVCA (New Zealand Private Equity & Venture Capital Association)
The NZVCA is a not-for-profit industry body committed to developing the venture capital and private equity industry in New Zealand. Its core objectives include the promotion of the industry and the asset class on both a domestic and international basis and working to create a world-class venture capital and private equity environment. Members include venture capital and private equity investors, financial organisations, professional advisors, academic organisations and government or quasi-government agencies.
**ENDORSING ASSOCIATIONS**

**PPEA**
(Polish Private Equity Association)

PPEA gathers private equity/venture capital funds active in Poland. The mission of PPEA, established in January 2002, is to promote and develop the private equity and venture capital (PEVC) industry in Poland and to represent the interests of the Polish PEVC community in Poland and abroad. PPEA comprises 72 institutions: 38 Full Members, representing most of the private equity firms active in Poland and 34 Associate Members that are law and consulting companies working for PEVC industry. The Full Members manage more than EUR 13 bn and have currently in their portfolios more than 470 Polish and CEE companies.

**Réseau Capital**
(Quebec Venture Capital and Private Equity Association)

The Quebec Venture Capital and Private Equity Association has more than 500 members who represent public and private venture capital companies as well as firms of professionals serving the industry.

**Mission and Organizational Structure**

Réseau Capital is an association of key players in the private equity and venture capital industry. Its mission is to foster the growth of the industry and the professional development of its members through a range of services and activities, such as training, information, networking and promotion of their interests.

**Principal Objectives**

To further the development of a business environment favourable to the venture capital community, notably, through training activities; to establish an efficient network of relations and communications between the industry’s stakeholders; to promote venture capital as an efficient tool for the development of Quebec businesses; and to promote other organizations tied into the industry.

**RVCA**
(Russian Private Equity and Venture Capital Association)

RVCA was set up in 1997. The central office of RVCA is situated in St-Petersburg. By today RVCA united about 40 members more than half of them are private equity and venture capital funds. RVCA’s mission is to contribute to establishment and development of venture industry in Russia.

**SECA**
(Southern African Venture Capital and Private Equity Association)

SECA is a non-profit company based in South Africa that represents the interests of the participants of the private equity and venture capital industry in Southern Africa. All the key participants in the industry are members of the Association. Membership of SECA provides a high level of endorsement and denotes a high level of professionalism and integrity for the member firm. SECA plays a meaningful role in the Southern African private equity and venture capital industry by promoting the industry and its members, promoting self-regulation, setting professional standards, lobbying, disseminating information on the industry, arranging training for the staff of its members and researching the industry in South Africa. SECA represents over 70 private equity and venture capital fund managers, the industry has over R 100 billion (c.US$ 12.5 billion) in funds under management with approximately 400 professionals. (www.savca.co.za)

**SVCA**
(Singapore Venture Capital & Private Equity Association)

Established in 1992, the Singapore Venture Capital & Private Equity Association (SVCA) is a not-for-profit organization formed to foster the growth of venture capital (VC) and private equity (PE) in Singapore and around the region. From a humble start of 2, our membership now exceeds 100 and continues to grow with the industry’s development. Since its inception, SVCA has championed various efforts to promote the local VC/PE industry through talks, workshops, seminars, conferences and networking events. The thrusts of SVCA continues to be (1) fostering a greater understanding of the importance of venture capital and private equity to the Singapore economy in support of entrepreneurship and innovation; (2) representing the local VC/PE industry in and outside of Singapore; (3) nurturing an environment conducive for advancing VC/PE investment and profession; and (4) providing a platform to match fund-seeking businesses with our members and the investment community.

For more information about SVCA, please visit: www.svca.org.sg

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**SLOVCA**
(The Slovak Venture Capital Association)

SLOVCA was created in 1999 with primary purpose to increase the awareness of private equity and venture capital to the public, such as the entrepreneurs, Investment and banking institutions and the economic, political and regulatory bodies in Slovakia.

The mission of SLOVCA includes five key objectives: to provide information to those seeking capital for new and existing enterprises, to represent the interests of members before the government and other related institutions/ agencies, to provide a forum for networking for members to exchange views and practices, to provide education and training for members of SLOVCA and others, to encourage the highest standards of business practices.
Endorsing Associations

SVCA
(The Swedish Private Equity and Venture Capital Association)

The SVCA represents around 110 private equity firms as well as business angels and service providers. Sweden is one of the leading private equity markets with annual private equity investments over 1% of the national GDP.

The Association was established in 1985 and its objective is to work towards a well-functioning private equity industry in Sweden. This is done by supplying information and working for the professional development of the industry. We aim to inform about how the industry functions and what frameworks are needed to facilitate entrepreneurs and investors so that together they can help the development of the Swedish economy and industry that is necessary for the country’s future prosperity. We also inform about how investments in private equity funds have yielded a good profit over the long term for pension funds and other institutional investors.

We work for the professional development of players active in the industry through education, ethical guidelines, transparency and valuation principles, networking and seminars with the participation of international colleagues, amongst many other things.

See www.svca.se for more information.
IPEV Reporting Guidelines

First developed by EVCA, the Reporting Guidelines have now been transferred to the International Private Equity and Venture Capital Valuation Board (IPEV Valuation Board), of which EVCA is a founding member, for further development in an international context.

The intention is that the EVCA Reporting Guidelines will eventually be replaced by the IPEV Reporting Guidelines.

They will shortly be published for consultation before becoming an integral part of the EVCA Handbook. Those interested in participating can find all relevant information on the IPEV website (www.privateequityvaluation.com).